Country Partnership Strategy for Romania

EXECUTIVE SUMMARY

1. After eight years of rapid economic growth and impressive gains in poverty reduction, the shockwave of the global economic and financial crisis has exposed the growing imbalances and economic vulnerabilities in Romania's economy, rooted in weak economic management and a large, unfinished agenda of public sector and governance reforms.

2. The new Government faces the difficult task of reconciling short-term fiscal consolidation with the need to mitigate the social costs of the crisis and restore the sources of sustainable and equitable growth. The new Government has moved rapidly to take fiscal measures aimed at containing the impact of the crisis, to mobilize an international financial package spearheaded by the IMF, the EU and the World Bank, and to resume the structural reform agenda that had faltered since EU accession on January 1, 2007.

3. The World Bank Group will complement and support this program by i) helping the Government to implement structural reforms to help mitigate the crisis by reducing social and economic vulnerabilities and ii) putting in place the basis for sustainable economic growth in the medium-term. In the first few years of the Country Partnership Strategy (CPS), the Bank program will center on a programmatic series of Development Policy Loans (DPLs), the existing investment portfolio, and Advisory and Analytical Activities (AAA). A mid-term CPS progress report would articulate the Bank program for the outer years of the CPS period. This CPS is fully consistent with a forthcoming Regional Framework that will set out the Bank's value-added and key areas of activity across Central and South Central Europe and the Baltics region. Notwithstanding the current economic crisis, Romania's EU accession is resulting in increased market access and commercial banking activity, with a gradually declining role for the IFC. IFC therefore, envisages a phased reduction of its involvement within a period of 5 years, subject to market conditions, offering support to selective sectors and activities in which IFC can still provide value addition and in which the commercial sector and market cannot fulfill. In the short term, IFC's investment strategy is to play a crisis response role by helping to recapitalize the major banks which are considered vital to the financial system and offering trade finance to financial institutions in Romania.

I. COUNTRY CONTEXT

A. Political Environment

4. **Between 2001 and 2006 stakeholders in Romania united behind the objectives of joining NATO and the EU, but since 2007 reform momentum has slowed sharply.** After EU accession on January 1, 2007 political differences escalated and reform fatigue set-in. This affected the consistency and coherence of public policies, and complicated the adoption and implementation of longer-term policies and programs. Coalition politics is expected to prevail over the period covered by this Partnership Strategy but the global economic and financial crisis may provide the necessary impetus for renewed political accommodation that has, prior to EU accession, enabled minority or coalition governments to undertake important reforms.

5. **In late December 2008 a coalition Government took office following parliamentary elections a month before**. The current Government, which enjoys a 70 percent majority in the Parliament, is formed by a coalition between democrat-liberals and the social-democrats/conservatives alliance under a political pact - Partnership for Romania. Given its large majority in the Parliament and the support of the President, the coalition Government in principle controls the important legislative initiatives needed to manage the crisis and renew reform. The breadth and depth of these legislative and policy measures will be necessarily limited to the areas of overlap between the respective agendas of the coalition members. At the same time, these measures will necessarily have cross-party support and therefore may be more likely to be sustainable. However, the Presidential elections scheduled for Fall 2009 could strain the coalition as candidates from the two main coalition parties are likely to compete for the Presidency.

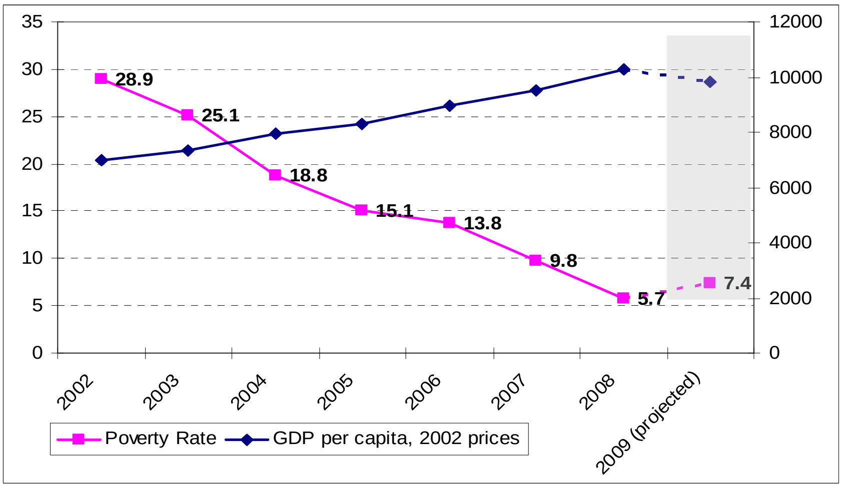
6. **The crisis provides stimulus for reform consensus**. The crisis has forced strong austerity measures and a re-evaluation of populist policies, including in public sector wages and pensions. Success in mitigating the impact of the crisis hinges on the commitment and capacity of political institutions to work together to enact bold reforms and to mobilize key stakeholders and the population behind them.

B. Recent Economic Developments

Growing macro imbalances and the build-up of vulnerability

7. **The Romanian economy experienced an economic boom during 2003-08, associated with the process of accession to the EU, leading to rapid gains in poverty reduction**. Growth averaged over 6.5 percent per year during that period, reaching over 7 percent in 2008. Absolute poverty declined from 35.9 percent in 2000 to 5.7 percent in 2008. A large part of the domestic absorption boom was driven by private investment: with EU accession prospects becoming more certain, capital flows, particularly foreign direct investment, were attracted by perceptions of lower investment risk that made Romania a favorable investment location. Sharp increases in asset prices and rising collateral values added a self-reinforcing momentum to the absorption boom.

ECONOMIC GROWTH & POVERTY, ROMANIA 2002-2009



Source: Romania - Rapid assessment of the economic crisis on poverty. Joint note by UNICEF and the World Bank, April 2009

8. **The strong economic growth was accompanied by widening current account imbalances**. Although exports to the EU countries grew at a robust pace, domestic demand grew at an even faster rate, and the current account deficit rose from just over 5.0 percent of GDP in 2003 to 12.4 percent of GDP in 2008.

9. **At the same time, in the past two to three years, the composition of the capital inflows moved increasingly towards private debt flows**—in large part the result of borrowing by banks, often by subsidiaries of foreign banks from their parent banks but also as a result of direct borrowing by corporates.

Figure 1.
Growing current account deficits were increasingly financed with private borrowing until 2008….

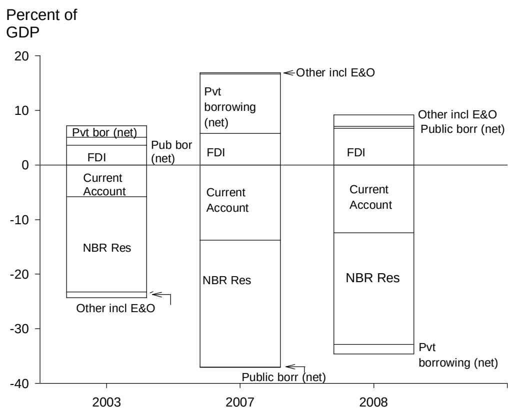
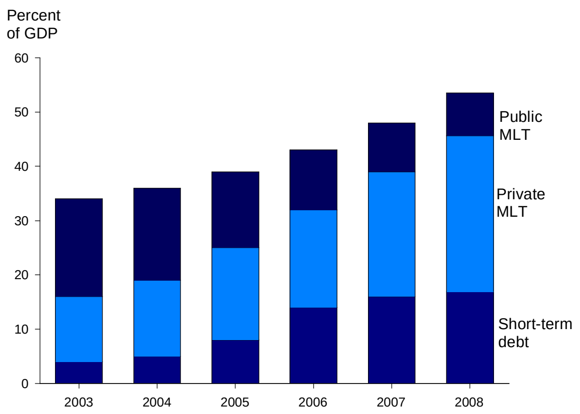


Figure 2.
.. and the structure of private debt shifted toward shorter maturity



10. **The domestic overheating and external imbalance were exacerbated by the fiscal policy stance**. Fiscal policy in Romania has been highly pro-cyclical in recent years with fiscal management lacking in medium term orientation. Following efforts of fiscal consolidation during 2003-05 that led to a narrowing of the fiscal deficit to 0.8 percent of GDP in 2005, the fiscal deficit widened again progressively to reach 4.9 percent in 2008 (while the structural fiscal deficit increased from 0.7 percent of GDP in 2005 to 6.5 percent of GDP in 2008) as a result of excessive public spending policies. Government spending doubled between 2005 and 2008 pushing the public sector share of economic activity from 31 percent of GDP to 37.8 percent of GDP. The public sector wage bill more than doubled over these three years due to high wage increases combined with a huge increase in government employment. In the final months of 2008, further expenditure hikes in the run up to the November 2008 parliamentary elections left a legacy of precarious financing of the deficit. This doubling of government spending was not matched by a corresponding increase in the amount and quality of public services.

Figure 3.
Fiscal policy was pro-cyclical and deficits grew..

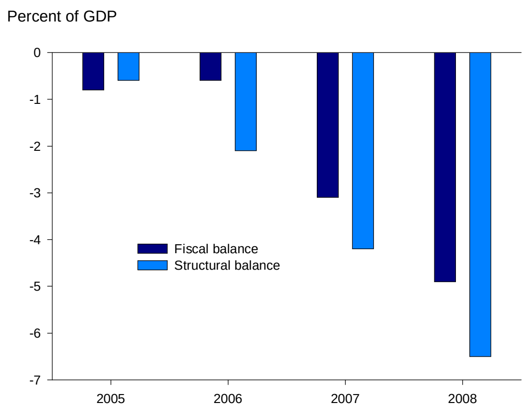
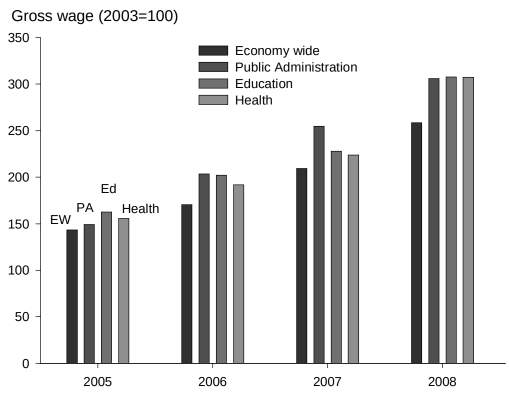


Figure 4.
..driven in large part by loose public pay policy



11. **The overheating and large capital inflows complicated monetary policy**. Monetary policy was relatively tight—with the National Bank of Romania (NBR) increasing reserve requirements and interest rates in an attempt to dampen inflationary pressures. In addition, a number of measures were undertaken to contain credit expansion, especially in foreign currency lending. Between 2004 and 2008, policy interest rates were raised, as were minimum reserve requirements (to 18 percent on local currency liabilities and 40 percent on foreign currency liabilities); measures were taken to limit household debt exposures, especially with regard to mortgage debt; prudential regulations were strengthened to limit lending to un-hedged borrowers of foreign exchange, and restrictions on household debt service ceilings were tightened. These measures contributed to the subsequent deceleration in household credit growth, but pressure from an expansionary fiscal policy and capital inflows caused the NBR to miss its inflation target in 2007 and 2008. At the same time, the interest rate differential between domestic and international rates and the restrictions on credit growth mentioned above, may have served to further encourage direct external borrowing and short term capital inflows. In particular, large firms began to borrow directly abroad as reflected in an increase in direct borrowing by firms from the equivalent of 4 percent (on a net basis) of GDP in 2005 to nearly 11 percent of GDP in 2007.

12. **Romania's financial system—which is dominated by commercial banks—played an integral part in the domestic overheating**. Between 2003 and 2007, total financial system assets more than doubled from about 36 percent to 74 percent of GDP (with the banking sector accounting for 83 percent of total assets). At the end of 2007, foreign-owned banks (mostly subsidiaries) accounted for 88 percent of total banking sector assets. Growth in real private sector credit rose from 23 percent per year in 2003 to over to 60 percent in 2007 before slowing slightly to 54 percent in 2008. Much of banks' lending was directed towards households, three quarters of which towards consumer credit. Between 2003 and 2007, claims on households rose from 12 to 28 percent of total banking sector assets (19.5 percent of GDP in mid-2008), while claims on companies declined from 37 to around 30 percent of banks' assets.

13. **The proportion of banks' lending funded from non-deposit sources—particularly foreign borrowing—rose progressively**. While deposits grew relatively steadily, lending significantly outpaced the growth in deposits with the loan to deposit ratio increasing by over 43 percent during 2003-2008 to reach 130 percent at end 2008. The large resort of banks to external financing of lending is reflected in the rise in net foreign liabilities of banks from the equivalent of -2 percent of GDP in 2003 to around 18 percent at end 2008.

14. **The indebtedness of households and corporates also grew rapidly, with much of the borrowing denominated in foreign currency**. Total borrowing by the corporate sector grew at an annualized rate of 44 percent between 2004 to mid-June 2008 entailing a near doubling of indebtedness to 28 percent of GDP. Although the proportion of foreign currency (FX) borrowing declined slightly over the period, it was still over 70 percent in 2008. While household disposable income grew at an average annual rate of 20 percent, household debt increased at a rate of 77 percent, with FX denominated borrowing rising even more rapidly; by mid-2008, the share of FX borrowing in total household borrowing had risen to 56 percent (from 45 percent in 2005).

15. **In sum, the Romanian economy had become vulnerable to liquidity and foreign exchange risks by the time the global financial crisis unfolded.**

C. Impact of crisis

16. **The economy has been hit hard by the global economic downturn.** Economic activity declined sharply in the last quarter of 2008 and has fallen further in early 2009. Real GDP growth shifted from an average of 9 percent (quarter on quarter annualized) during the first three quarters of 2008 to a 13 percent decline in the fourth quarter. The decline was driven primarily by a drop in domestic demand. Export growth also slowed. With imports dropping even more sharply, the correction in the current account deficit began towards the end of 2008. For the first quarter of 2009, early indicators (confidence, industrial production, retail sales and tax revenues) all point to a continued sharp drop in GDP, along with rising unemployment as well as poverty incidence.

17. **Asset and financial markets have been severely affected by the effects of the global crisis and economic downturn**. The stock market has lost 65 percent of its value since the peak in August 2008. The inter-bank market was disrupted in October 2008 by rumors of liquidity problems at a commercial bank, leading to a spiking of rates; these rates remained relatively high thereafter due to lingering concerns about counterparty risk, high risk aversion, and market segmentation due to an uneven distribution of assets (T-bills) eligible for discount with the NBR. Balance of payment pressures drove a 15 percent depreciation of the leu against the Euro from October 2008, putting pressures on household, corporate and bank balance sheets. To dampen currency volatility, the central bank intervened in the spot market, with some EUR4½ billion in reserves since end-October. Despite the depreciation, financial conditions tightened significantly on increased sovereign credit default swap premium and monetary policy tightening. Romania's international credit rating was cut in late 2008 by a larger margin than those of other countries in the region, reflecting market concerns about the sustainability of Romania's large current account deficit, uncertainties surrounding the outlook for fiscal and incomes policies, and the

financial health of banks with subsidiaries or branches in Romania. This has translated into significantly higher external borrowing costs for Romanian banks and corporates.

18. **As conditions in the financial markets have worsened, the financing of the fiscal deficit has been increasingly concentrated at very short maturities.** This has exposed the Government to roll-over risks in the current environment of de-leveraging.

19. **Romania's deteriorating macro-financial environment has created risks for financial stability.** Over the last few months, liquidity risk has become substantial in view of the difficulties in parent banks and the downgrading of Romania's sovereign rating to below investment grade by major international ratings agencies in late 2008 leading to a decline in the capital account flows. A sharp contraction or reversal of inflows could threaten macroeconomic and financial stability through a drying up of credit to the private sector, resulting in an even sharper slump in economic activity and larger increases in loan defaults. In addition, a reversal of capital inflows would put additional downward pressures on the exchange rate. While banks' direct exposures to foreign exchange risk reflected in their net open positions are low, as noted above, many households and businesses are exposed to un-hedged foreign exchange risks. Banks, therefore, have substantial indirect foreign exchange risk exposures, in the form of credit risk.

20. **The rapid deterioration in economic conditions and depreciation of the leu will place strains on bank capital positions.** The banking system entered the crisis well capitalized and with high liquidity buffers. Stress testing has already been performed by the National Bank of Romania. A strengthening of capital positions may be warranted and, in line with commitments made in Vienna and in Brussels, parents of most foreign owned banks have agreed to maintain lines of credit to their subsidiaries and borrowers in Romania and to increase their capital in order to comply with the minimum agreed level of solvency. In addition, banks will need to be proactive in enhancing loan quality by developing and implementing effective debt restructuring or workout procedures for household and corporate clients.

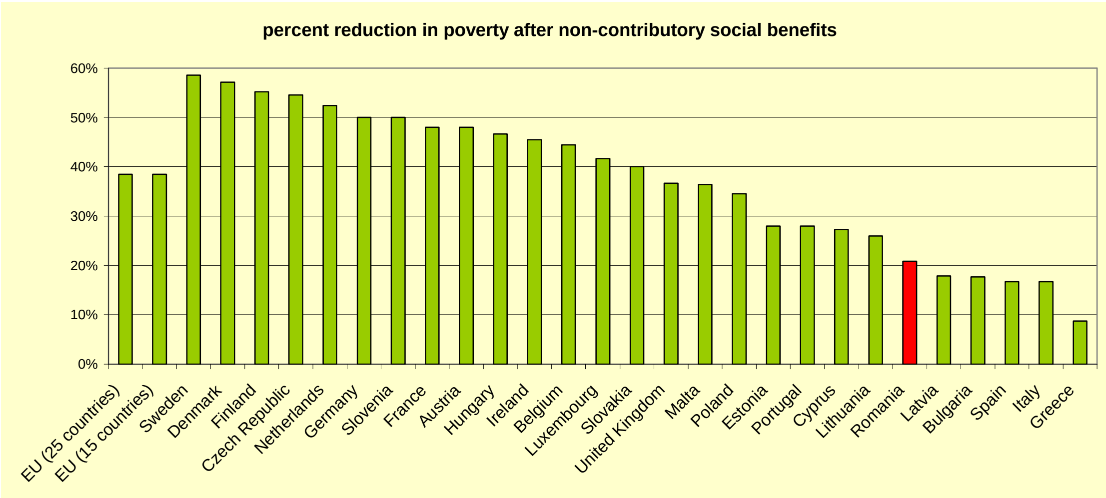
D. Social Outcomes

21. **Growth was highly successful in reducing poverty for the large majority of the population**. The rapid growth witnessed over most of this decade has led to a dramatic decline in absolute poverty to 5.7 percent in 2008. The number of absolute poor fell from 2.1 million in 2007 to about 1.2 million in 2008. Poverty remains concentrated among vulnerable groups, in particular in rural areas where 75 percent of the poor are found. Besides rural areas, children, in particular those of large familes, the youth, the Roma, the unemployed and the self-employed (especially in agriculture), are at higher risk of poverty.

22. **Poverty reduction gains are at risk, with both core and transient poverty expected to increase**. The onset of the crisis is expected to partially reverse the important gains in overall poverty reduction derived from past economic growth. Poverty is expected to rise to 7.4 percent of the population in 2009, and the proportion of children living in absolute poverty is projected to increase from 7.8 percent in 2008 to 10.7 percent in 2009. Although most of poor continue to reside in rural areas, poverty is expected to increase faster in urban than in rural areas (by 40 and 30 percent, respectively), and the self-employed (outside of agriculture) where the impact of the

crisis is expected to be most pronounced. The budget transfers needed to finance increased demands on social assistance from the chronically poor, the unemployed and those vulnerable to transient poverty will be a challenging task given the reduced fiscal space.

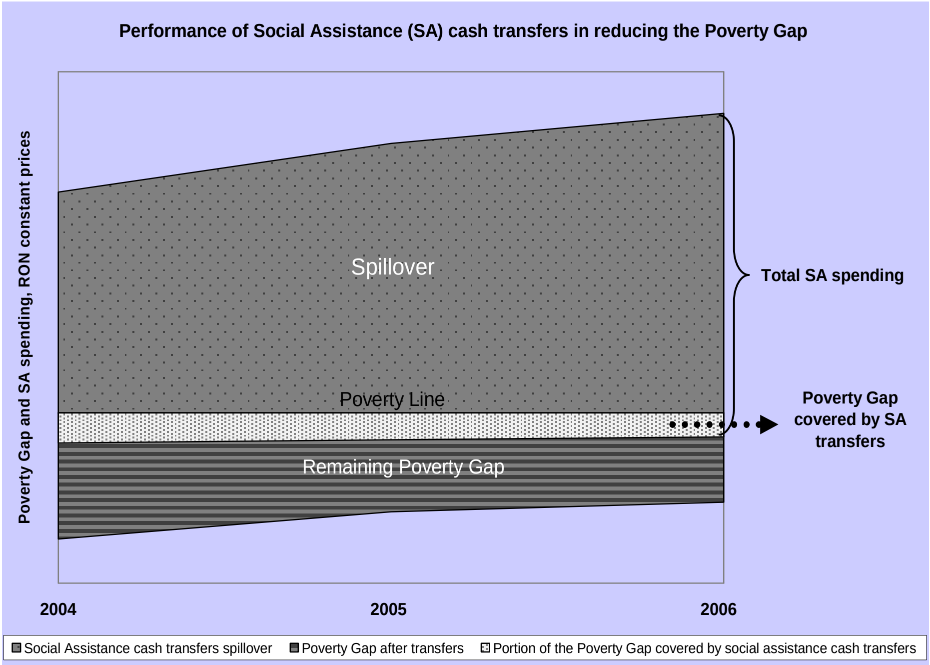
Figure 5. Effectiveness of Social Assistance Programs across EU member states



Source: World Bank Policy Briefs, 2009

23. **Social protection schemes do not address poverty well**. Romania's social protection expenditure per capita is the lowest in the EU, and spending on poverty-targeted programs is low in proportion to GDP and to needs; it has actually declined in recent years. Only a few safety net programs perform well, while the overall system of social assistance cash benefits performs less well than in other EU countries in reaching the vulnerable and in providing them with adequate protection (figure 5). Most of the social assistance benefits have a low adequacy, representing only 10-20 percent of the minimum wage, and cover less than 30 percent of the household consumption of the poorest beneficiaries. The total social assistance benefits are not cost-effective from a poverty reduction perspective: 13 RON are spent for 1 RON reduction in the poverty gap (not taking into account administrative costs). Leakages and inequity in social assistance programs are high (figure 6): only 17 percent of the social assistance benefits reach the poorest quintile, 29 percent of the poor are excluded from the system ("remaining poverty gap" in figure 6), and half of the funds spill to the wealthier quintiles. Spending on poverty-targeted programs has decreased relative to GDP in recent years. Well-targeted programs such as the Guaranteed Minimum Income Program (GMI) or income-tested family allowances are under-funded, leaving out 60 percent of the rural poor and 77 percent of the urban poor.

Figure 6. Effectiveness of Social Assistance Programs in Romania



Source: World Bank Policy Briefs, 2009

E. Economic Outlook

24. **The economy is expected to contract by about 4 percent in 2009** (Table 1). Domestic demand will contract as foreign direct investment and capital inflows, which previously helped finance high consumption and investment growth, will drop sharply. With no fiscal space and tight financing conditions, an easing of fiscal policy to cushion the downturn will not be possible.

25. **The Government has already initiated substantial measures to address the fiscal deficit.** The 2009 approved budget contains important spending cuts and revenue increases yielding around 3 percent of GDP in total. These measures include i) an increase of 3.3 percentage points in social contributions; ii) higher property taxes due to an overdue increase in appraisals; iii) removal of a reduced VAT rate for the purchase of a first house; iv) significant cuts in the public wage bill by reducing bonuses and other benefits and by eliminating 137,000 vacancies (previously used to grant higher allowances to existing staff); and v) substantial cuts in spending on goods and services as well as subsidies. It is estimated that the fiscal measures already approved in the budget would reduce the fiscal deficit to about 5.2 percent of GDP and the structural deficit would fall by about 1.7 percent of GDP.

26. **The Government has sought multilateral support, including from the IMF, the EC and the World Bank Group.** The Fund's program of support seeks to i) strengthen fiscal policy further to reduce the Government's financing needs and improve long term fiscal sustainability; ii) maintain adequate capitalization of banks and liquidity in domestic financial

markets; iii) sustainably reduce inflation; and iv) secure external financing and improve confidence.

Table 1: Selected macro indicators

	Actual				Projected		
	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
	Annual percentage change						
Output and prices							
Real GDP	4.1	7.9	6.2	7.1	-4.1	0.0	5.0
Domestic demand	8.3	12.8	14.3	8.9	-8.2	-3.3	6.0
Consumer price index (CPI av)	9.0	6.6	4.8	7.8	5.9	3.9	3.5
Unemployment rate	5.8	5.8	4.3	4.0	8.9	9.7	7.7
Nominal wages	17.0	18.9	22.6	23.6	5.9	3.8	5.2
Public sector wages	25.9	27.3	18.5	31.0	5.1	3.9	3.5
Private sector wages	14.7	16.5	23.2	21.2	6.2	3.8	5.7
	In percent of GDP						
Savings and investment							
Gross domestic savings	23.3	26.5	31.1	31.4	30.8	29.9	31.9
Gross national savings	14.4	16.1	17.3	19.0	23.2	23.4	25.7
General government							
Revenue	30.1	31.0	32.5	32.6	33.0	33.4	33.1
Expenditure	30.9	31.6	35.6	37.5	37.5	37.0	35.8
Fiscal balance	-0.8	-0.6	-3.1	-4.9	-4.6	-3.6	-2.7
Privatization proceeds	1.3	0.4	0.1	0.1	0.0	0.0	0.0
External financing	0.5	0.1	0.1	0.5	2.8	1.1	0.2
Domestic financing	-1.0	0.1	2.9	4.4	1.8	2.4	2.5
Structural balance [1/]	-0.6	-2.1	-4.2	-6.5	-3.8	-1.7	-1.2
Gross public debt (direct debt only)	15.6	15.4	17.5	20.1	23.6	25.7	25.7
	Annual percentage change						
Money and credit							
Broad money (M3)	36.5	28.1	33.7	17.6	6.6	6.5	11.5
Credit to the private sector	-	54.5	60.4	33.7	15.9	5.1	3.2
	In percent						
Interest rates							
Euribor six months	2.8	3.2	4.8	3.5	-	-	-
NBR policy rate	7.5	8.7	7.5	10.2	-	-	-
NBR lending rate (Lombard)	14.0	14.0	12	14.2	-	-	-
Interbank offer rate (1 week)	7.0	7.4	7.8	15.9	-	-	-
	In percent of GDP						
Balance of payments							
Current account balance	-8.9	-10.4	-13.8	-12.4	-7.5	-6.5	-6.2
Merchandise trade balance	-9.9	-12.0	-14.4	-13.5	-7.5	-6.6	-6.8
Capital and financial account	15.6	15.7	17.3	13.9	-2.4	3.3	7.8
FDI	6.6	8.9	5.8	6.7	3.1	3.7	3.7
International investment position	-29.9	-35.3	-40.9	-52.9	-56.8	-55.8	-54.1
Gross official reserves	22.0	23.4	22.1	20.5	23.4	26.1	25.6
Gross external debt	39.0	42.9	47.1	53.4	64.2	68.5	64.0
Exchange rates							
RON per euro (eop)	3.7	3.4	3.5	4.0	-	-	-
Real effective exchange rate							
CPI based (depreciation -)	17.9	7.6	9.0	-4.2	-10.3	-2.1	1.3
Nominal GDP (bn RON)	289.0	344.7	412.8	504.0	531.3	568.5	634.1
Nominal GDP (bn Euro)	79.7	97.8	123.6	136.8	119.7	118.8	130.7

[1/] Actual fiscal balance adjusted for automatic effects of internal imbalance (output gap) and external imbalance (absorption gap).
Source: IMF.

27. **Under the Fund's program, the fiscal deficit is expected to further narrow to 4.6 percent of GDP in 2009 from 4.9 percent of GDP in 2008.** Fiscal measures yielding an additional 1.1 percent of GDP are to be implemented in 2009 as prior actions for the IMF program, concentrating on expenditure reductions. The fiscal deficit for 2009 is thus expected to be 0.3 percentage points lower than 2008, at 4.6 percent of GDP. In order to safeguard the targets, spending plans will be back-loaded and their execution will be conditional on revenue performance. The structural fiscal deficit would decline by nearly 3 percentage points of GDP (from 6.7 percent to 3.8 percent of GDP). The authorities envisage additional adjustment efforts in 2010 to bring the deficit down to around 3.7 percent in that year, and to bring it to well below 3 percent of GDP in 2011 to meet the Maastricht deficit criterion.

28. **The current account deficit is projected to decline from 12.5 percent of GDP in 2008 to 7.5 percent in 2009 and further to 6.5 percent in 2010**. This adjustment process is expected to be driven primarily by a sharp import decline arising from the drop in domestic demand and the depreciation in the real exchange rate.

29. **The balance in the capital and financial account is expected to fall from a surplus of EUR18.8 billion in 2008 to a EUR2.7 billion deficit in 2009**. FDI is expected to decline considerably in 2009, and trade credit contracts will fall in line with import compression, consistent with developments in recent months. The capital and financial account is projected to reach a EUR3.8 billion surplus in 2010, on the back of a slight recovery in FDI and reduced capital outflows.

30. **Romania faces considerable balance of payments financing needs over the next 24 months.** Based on the projected current account deficit and stock of short term and maturing medium and long-term debt, Romania's gross financing needs would amount to EUR44 billion in 2009. Under the assumptions of average rollover rates for amortizing debt in 2009 of around 90 percent for banks and 70 percent for corporates, a financing gap of approximately EUR11¾ billion would emerge. For 2010 and the first quarter of 2011, the Fund's macro framework assumes that a strong adjustment program will reduce the financing gap to about EUR8¼ billion, bringing total financing gap under the program to EUR20 billion, as the current account is expected to continue to adjust and rollover rates and FDI to improve due to higher confidence in economic policies and the expected incipient recovery in the world economy. The financing gap for 2010 includes a build up in gross international reserves of about EUR3 billion, increasing reserves coverage to about 100 percent of short-term external debt at end-2010 from about 75 percent at end-March 2008, significantly reducing external vulnerabilities.

31. **Over the medium term, a gradual economic recovery is expected, whose pace and strength will reflect the restoration and broadening of the economic reform agenda initiated before EU accession.** Output is projected to follow a U-shaped adjustment pattern, and while positive growth is expected to resume by the second quarter of 2010, it would remain near zero in 2010. Beyond the economic stabilization and fiscal consolidation efforts under way, economic reforms will decide the evolution of the economy after the crisis, in particular how quickly and strong the economic recovery will be. In the *short-term*, Government priorities are to stimulate confidence in the economy, protect the poor and vulnerable from the effects of the crisis, protect employment, and contain the slowdown in demand, with focus on the financial system and fiscal policy.

32. **Consistent with the European Economic Recovery Plan, short-term actions are anchored on a *longer term strategy* aimed at fostering sustainable growth and employment by addressing the development challenges facing Romania**. The quality of the fiscal adjustment in reducing economic vulnerabilities and depth of the crisis would hinge on public sector reforms in the areas of public financial management, public administration, and macroeconomic management, complemented by governance and sector reforms to increase the efficiency of public spending and quality of public service delivery (notably in health, education, transport). The lack of sustainability of recent growth underscores the need for Romania to diversify its sources of growth in line with the recommendations of the Lisbon Agenda on enhanced competitiveness and business environment, better skills through education and innovation, and better infrastructure in transport, communication and energy; particularly important is capturing the growth potential of agriculture, a sector largely by-passed by growth over the past two decades. Finally, because the crisis will boost transient poverty, and the already significant core poverty will swell, economic growth must be accompanied by social policies to ensure social and spatial equity, through access to gainful employment and public services, and through well-targeted social assistance and sustainable social insurance programs. The severity of the crisis and the political support of the coalition Government offer a rare opportunity to address these structural and institutional reforms.

33. **The outlook is, however, subject to exceptional uncertainties and risks.** The recovery depends on global events, and on addressing structural challenges through a credible and sustained reform effort. In the near term, output could be further compressed through balance-sheet effects arising from a further RON depreciation and higher-than-expected inflation, especially if capital outflows are larger than anticipated. It would also be affected by a further worsening of global growth prospects, notably in Europe.

II. COUNTRY DEVELOPMENT PROGRAM

34. **Romania's overarching objective is to achieve convergence with the EU in terms of income and living standards.** With a GDP per capita of slightly over 40 percent of the EU 27 average, Romania has a large unfinished development agenda. The approach to pursuing the convergence agenda has been consolidated in the National Reform Program (NRP) for promoting sustainable and equitable economic growth in the context of the European Lisbon Strategy. The NRP, updated annually and reviewed by the European Commission, complements the four themes of the Lisbon Agenda – investing in people and modernizing labor markets, unlocking the business potential, especially of SMEs, investing in knowledge and innovation, and energy and climate change – with the need to improve the quality and management of administrative capacity and government expenditure in the context of prudent macroeconomic policies.

35. **The May 2009 Convergence Program of the Government reaffirms Romania's objective of joining the Eurozone in 2014.** The document emphasizes the importance of promoting sound macroeconomic management and coordination of policies to gradually correct the existing imbalances. The Convergence Program aims to reduce the budget deficit to less than