'19 WHITE BOOK

Foreign Investors Council

May 2019
Bucharest - Romania

PRE FACE

The past two years have been rather difficult for the business community in Romania, despite high growth rates and good revenues. Large investors in Romania, like FIC members, take a long-term view and the picture does not look particularly positive. There is a clear lack of trust between the business environment and the government.

The level of consultation, which was not particularly good to start with, has sunk to being almost non-existent. Companies have had their business plans turned upside down by a long list of emergency ordinances which have far exceeded their constitutional limits: the introduction of split VAT, the transfer of contributions from employers to employees and Emergency Ordinance No. 114/2018 (EO 114/2018) which hit several crucial sectors like banking, energy and telecoms. Legislation was adopted without dialogue, without impact assessments and without even justifying an emergency need. Each time the business community issued stern warnings that the laws will be damaging. Our voice was listened, but only when negative effects were imminent.

The Romanian judicial system is not our area of expertise, but we listen to and we read the reports of the European Commission (EC), the Venice Commission and GRECO. They have all signalled that things are moving in the wrong direction. The business community has taken notice. There can be no open and free markets without the rule of law and independent regulators. Several rounds of business sentiment surveys carried out twice a year within the FIC membership have confirmed that these worries are shared by all members. Moreover, the tensions in the labour market are growing and the competitiveness of the labour force is declining due to lack of investments in the educational system.

Companies have made profits but are increasingly doubtful about their long-term prospects. In 2016 and 2017 our community tried to imagine what it would take for Romania to become the 10th largest economy in the European Union (EU). It was the 17th in 2016. Structural reforms were on our mind; in infrastructure, human capital and in improved efficiency. We can note with satisfaction that Romania is on the trend we envisaged. In the past two years its GDP has outpaced that of Greece and Portugal. If Brexit happens, Romania will become the 14th economy of the EU. In our opinion this is the limit of the low hanging fruits of growth through consumption boosted by fiscal policy. From here on, Romania needs to carry out all the difficult reforms it has been delaying. It must build roads and improve the railways. It must invest in its energy infrastructure. It must open new hospitals and schools. It must convince a part of its diaspora that it is worth coming back. If it does all this, the possibilities are boundless. This country can grow to the point that in the 2030s it will be virtually indistinguishable from a western economy. But it must carry out those reforms if it wants to fulfil that potential, if it wants to break the middle-income trap and take several more million Romanians out of poverty. There is no other way.

Our community is worried about the current trajectory. We believe it needs correction. Romania does not yet have a fully modern economy, but it has the resources and people capable of developing it. Our companies will hopefully still be here when full convergence is achieved, and they will also support Romanians along this path. We hope that two decades from now, another FIC Board will contemplate these words and describe them as not ambitious enough.

The FIC Board of Directors

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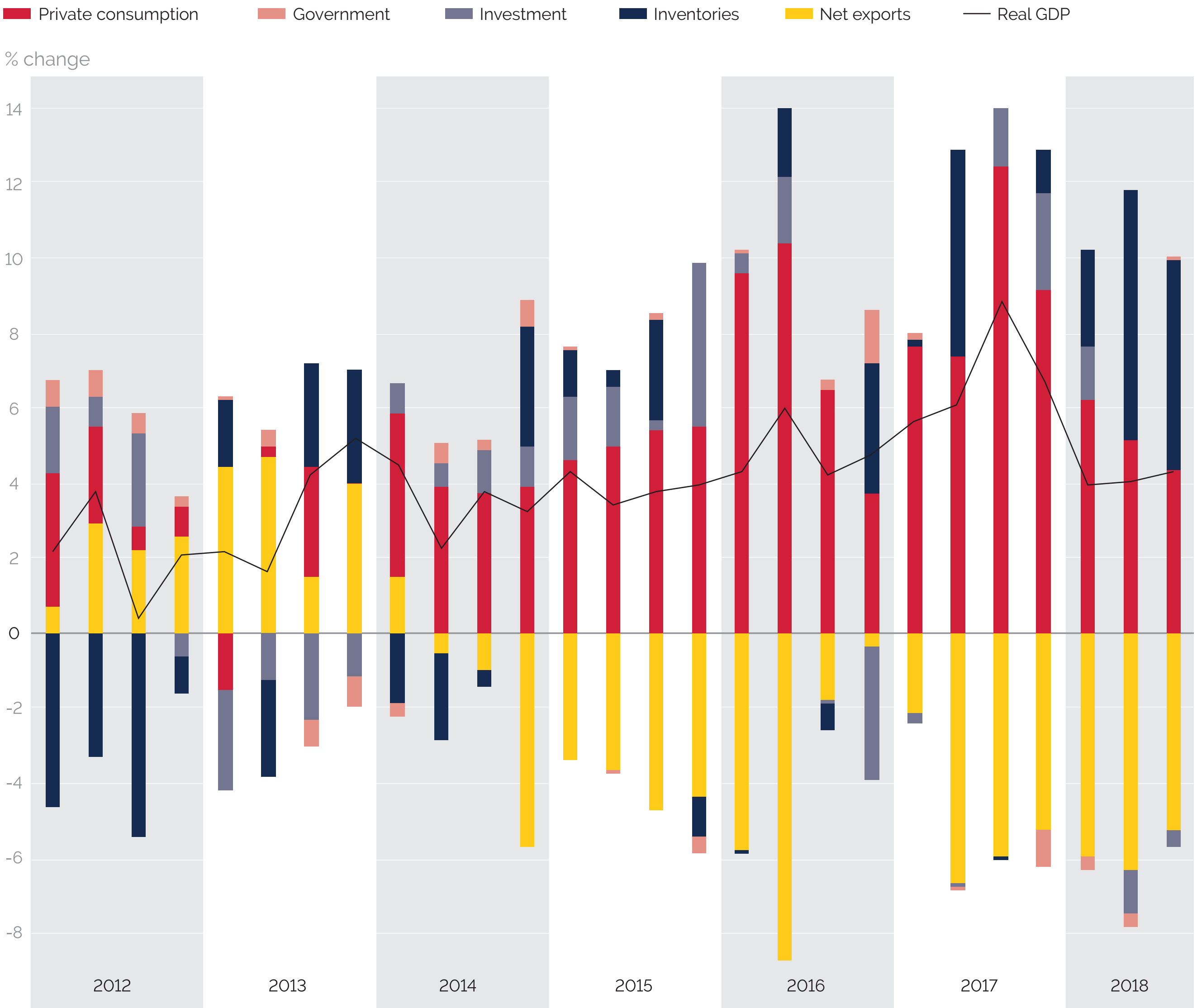
MACRO ECONOMIC OVERVIEW

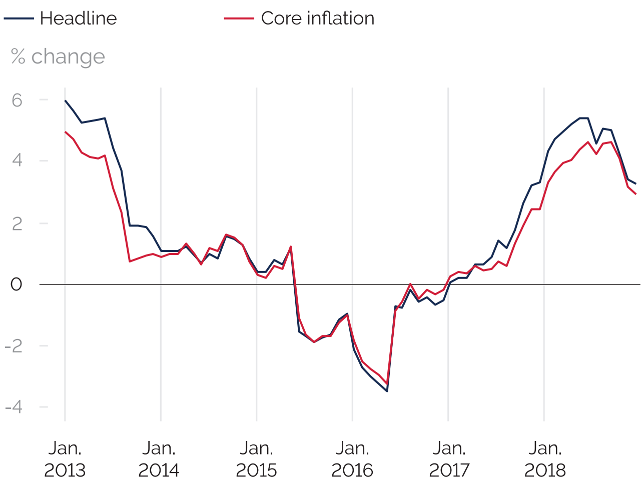
After growing by 6.9 % in 2017, the economy is estimated to have slowed down in 2018. Private consumption continued to be the major contributor to growth in 2017 and 2018, as consumers' purchasing power increased on the back of VAT and income tax cuts as well as public sector wage hikes. Investment has made a modest contribution to growth, driven principally by growing disbursement of EU funds and an improvement in industrial confidence over the past three years.

1. COMPONENTS OF GDP GROWTH



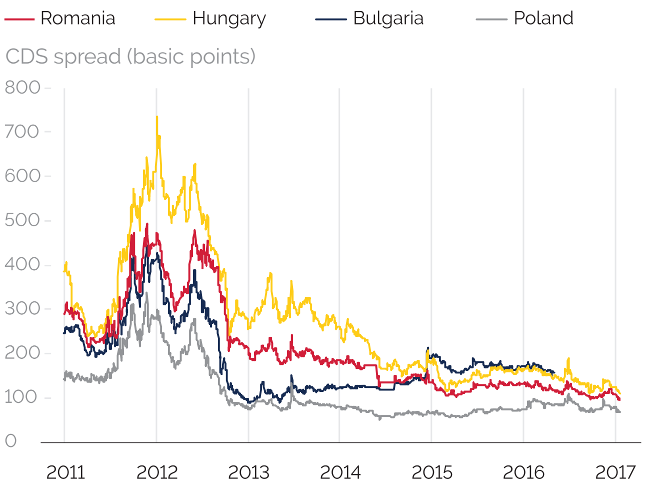
Source: National Accounts, National Bank of Romania

2. HEADLINE AND CORE INFLATION



Source: National Bank of Romania

3. COUNTRY RISK PREMIUM MEASURED BY CDS



Source: Bloomberg

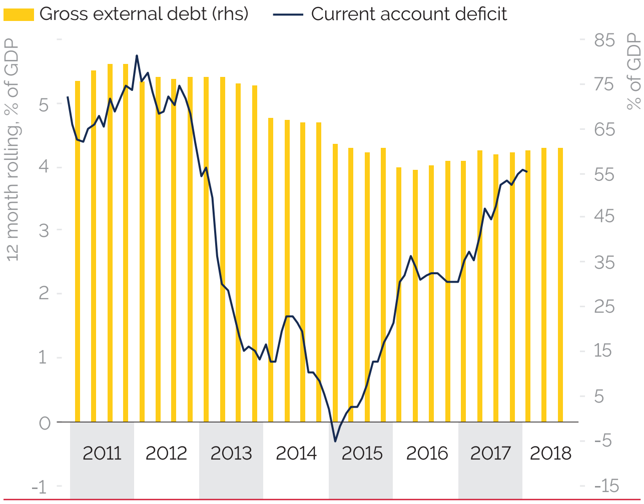
Net exports continued to make a negative contribution to growth. Rising consumption has boosted imports, while export growth fell behind, despite favourable demand conditions in the EU during most of the past two years. With 75% of its exports destined for EU countries, Romania remains highly dependent on European export demand.

Driven by the tightening labour market and rising household consumption, inflation peaked at a 5-year high of 5.4% in June 2018, well above the central bank's upper target of 3.5% (Figure 2). Consequently, the central bank has started to tighten its monetary policy, raising its main policy rate three times in 2018 from 1.75% to 2.50%. As a result, inflation has gradually receded to 3.3% in December 2018.

Following a significant decline since mid-2012, Romania's country risk premium, as measured by credit default swaps (CDS) has been stable at just over 100bps since 2015. While increasing slightly since early 2018 as a result of tightening global liquidity, Romania's CDSs have remained stable and comparable to regional peers. At the same time, the declining country risk premium helped support the ongoing stability of the currency (Figure 3).

External imbalances are rising but remain modest. The deterioration of the trade balance has led the current account deficit to increase above 4% of GDP at the end of 2018. External debt has stabilised at around 60% of GDP over the past two years, ending its downward trajectory since 2012 (Figure 4).

4. CURRENT ACCOUNT AND EXTERNAL DEBT



Source: National Bank of Romania

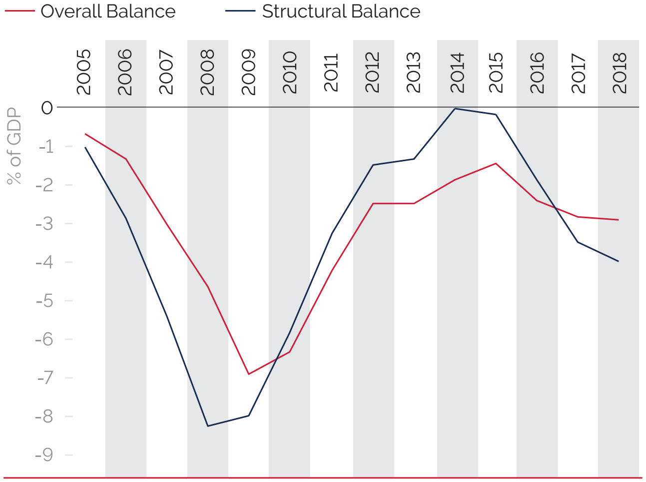
As a result of the deteriorating external position, the current account deficit is no longer fully covered by Foreign Direct Investment (FDI) inflows, as was the case prior to mid-2017. While FDI inflows have been robust over the past two years, funding of the current account deficit has become more reliant on portfolio flows, which are usually more volatile than FDI and prone to shifts in global market sentiment.

Policy response

Romania was successful in correcting imbalances arising following the start of the global recession in 2008, bringing the fiscal deficit down to below 2% of GDP in 2015 (Figure 5). Nevertheless, fiscal policies have loosened considerably since 2016, when the government undertook a series of tax cuts and wage increases. VAT was cut in steps from 24% to 19%, while income tax and social security contribution rates for individuals have been reduced. Meanwhile, public sector wages have risen substantially since the adoption of a unitary public sector wage bill in 2017. These measures have increased the fiscal deficit to almost 3% of GDP over the past three years, bringing the government close to breaching the EU's budget ceiling.

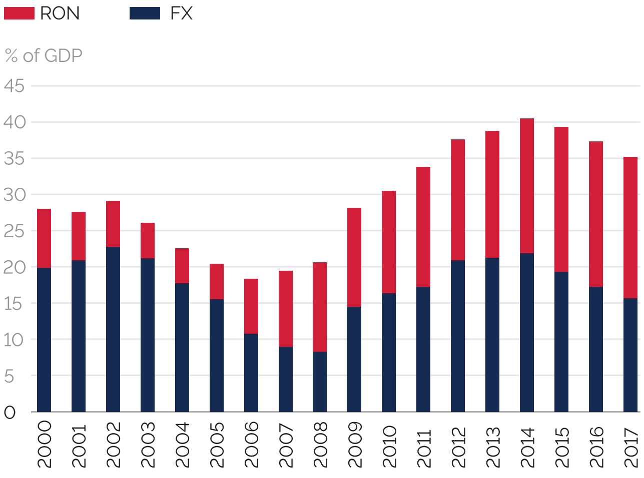
Public debt remains moderate by regional standards, standing at around 35% of GDP at the end of 2017. Despite improvements over the past few years, around half of debt is still exposed to foreign currency risk (Figure 6). However, the maturity structure of government debt has improved recently, partly as a consequence of favourable global liquidity conditions, with around 84% of total debt stock having a maturity in excess of one year.

5. FISCAL DEFICIT



Source: IMF, Ministry of Public Finance

6. PUBLIC DEBT



Source: IMF, Ministry of Public Finance

Outlook and Challenges Ahead

The FIC expects GDP growth to moderate in the following period. Growth is expected to be 3.2% in 2019, due to weakening policy stimulus and tighter monetary policy, although growth will continue to be supported by investment linked to EU funds. Downside risks, including the exacerbation of the current labour shortages, prolonged weakness in the eurozone, changes in global investor sentiment and domestic political and reform uncertainty, may hamper growth in the short term.

In the longer term, the diversified economy, large market size and scope for convergence within the EU (GDP per capita, PPP-adjusted, is 60% of the EU average) should allow growth rates of around 4% to be sustained, provided further structural reforms are undertaken.

To achieve this, Romania needs to further improve its business environment and make it more attractive for investors. While Romania's investment environment is better than regional peers, challenges remain. In the World Bank's Doing Business 2019 report, Romania ranked 52nd out of 190 countries, a deterioration of seven places over the previous year.

According to the EC's Cooperation and Verification Mechanism (CVM) report published in November 2018, judicial reforms over the past year have been uneven despite some positive steps in implementing the EC's recommendations. Pressure on the National Anticorruption Directorate and amendments to several justice laws on judicial appointments and dismissals have raised the concern of the EC.

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ENERGY

The energy sector in Romania is facing two major challenges which are policy driven: the lack of a proper long-term vision and legislative instability. The National Energy Strategy 2018-2030 is a rather vague document which does not fulfil its main purpose of clearly defining priorities and providing a solid framework within which companies can carry out their investment plans. A similar situation exists with the National Integrated Plan for Energy and Climate Change (PNIESC), where there has been a lack of methodological transparency showing inconsistencies with the National Strategy. The FIC believes that policy makers should strive to improve these two documents through substantial dialogue and to correlate them going forward.

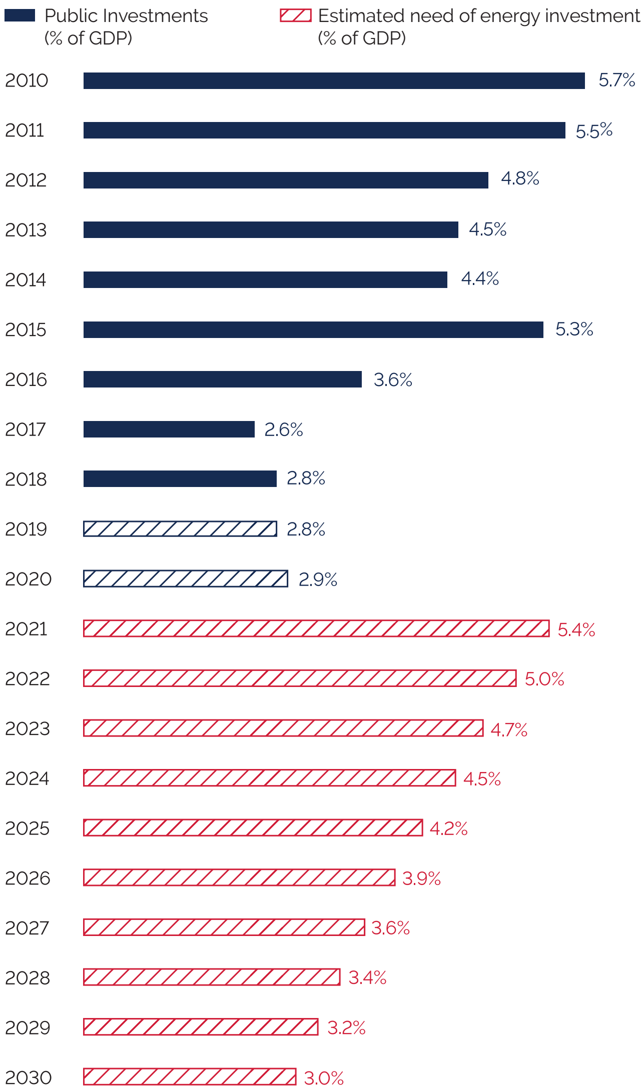
In terms of legislative predictability, the sector was also seriously negatively impacted in the past two years by several emergency ordinances and laws that were adopted without proper impact assessments and without consultations with the industry concerned. The legislation on offshore projects is a clear example of how a defective legislative process can lead to postponement of investments. Most investments in the energy sector are capital intensive and they require long-term visibility for market participants. Investment needs are very high, and the Romanian state does not have enough resources to make them all happen in the next few decades. Poorly developed regulation creates distrust among investors in a stable legislative framework in Romania and will lead over time to under-investment in the sector.

According to the PNIESC the total need of investments (public and private) in the Romanian energy sector was estimated at EUR 127 bln for 2021-2030. Assuming a constant rate of investment in those years and a normal GDP growth rate one can see that only the investment needs in energy, as share of GDP, would fully consume Romania's entire allocation for public investments. Thus, private investments have a major role in the development of the Romanian energy sector and they should be encouraged.

The latest example is the recent EO 114/2018 which brought fundamental changes to the entire market's structure and its functioning and introduced new taxes without any consultation with the companies affected. The subsequent EO 19/2019 amending this normative act further distorts the market by introducing some exceptions. The efforts undertaken to liberalise and deregulate the gas and electricity markets represented good progress. However, there was a need to implement social protection measures targeting vulnerable consumers. But the recent EOs do not seem to address this issue effectively, as they do not do enough to enable the sustainable achievement of this objective. Although the initial law was amended and some of its provisions softened in March 2019, following negative reactions from the business community and the EC, it still dented the trust of investors and the final version also failed to offer a sustainable long-term solution.

These initiatives represent a significant step backwards in liberalisation, as they introduce more government intervention on the Romanian energy market, seriously impede the development of the wholesale

PUBLIC INVESTMENTS AND ESTIMATED NEED OF ENERGY INVESTMETS IN ROMANIA



Source: Calculations based on AMECO, PNIESC, the Fiscal Council and FIC estimations on GDP market, discourage investments in the sector, reduce competitiveness (contrary to stated intentions) and threaten Romania's security of supply. The provisions strongly conflict with the EU single market principles of free trade and free movement of goods as documented by the letter of formal notice sent by the EC on incorrect implementation of certain requirements of the Gas Directive (Directive 2009/73/EC) and the Security of Gas Supply Regulation (Regulation EU 2017/1938).

Policy makers have stated repeatedly that the measures aimed at the energy sector in EO 114 and other legislation and regulations have been adopted in order to shield household consumers in Romania from increasing energy prices. The FIC has argued extensively in the past for a structural and well-thought-through framework for the protection of vulnerable consumers and still believes this is the only way forward.

Romania must plan and implement urgent social policy measures and instruments in order to tackle energy poverty and support vulnerable consumers. Energy poverty in Romania is addressed in a fragmented way and it is often unclear what responsibilities various public institutions have. The topic of vulnerable consumers appears sporadically in legislative initiatives but proposals lack coordination at national level. It is difficult to quantify the extent of energy poverty, because relevant data is unclear. Processes of monitoring and reporting of relevant data need to be established.

A FIC analysis of the little data which is available showed that there is a difference between the aid offered to vulnerable consumers at county level and that the aid seemed to be uncorrelated with the degree of vulnerability of such consumers.

A clear regulatory framework on vulnerable consumers and energy poverty is needed in Romania. The framework should clarify consistently the definition of vulnerable consumers and energy poverty thereby distinguishing between "energy poverty/vulnerable consumers" and general poverty, in order to better target individuals or communities that are facing difficulties in paying for energy supplies.

The FIC considers that measures to reduce energy poverty should be both social and market-oriented and should comprise:

- Reducing bureaucracy for granting aid to vulnerable consumers.
- Development of energy efficiency programmes dedicated to people at risk of energy poverty.
- Development of counselling programmes on how to reduce energy costs. These should cover ways to reduce consumption (e.g. use of more efficient heating methods, purchase of less energy-consuming household items), payment methods, ways of switching suppliers, and promotion of price comparisons.
- Financial measures that specifically target vulnerable energy consumers.

The FIC believes that only a constructive and substantive dialogue between policy makers and the industry on this highly sensitive topic can lead to long-term sustainable solutions. Failure to do this will only prompt forceful and drastic interventions on the market such as EO 114, which may be perceived as a short-term benefit for certain consumers but which brings the long-term cost of undermining investment and ultimately the future of Romanian's energy security.

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ENVIRON MENT

The business sector continues to be faced with lack of predictability concerning the legal and institutional framework on environmental issues, despite continued efforts to engage with public officials on environmental legislation and institutional topics. This has been most felt in the waste management sector, where the disproportionate regulation and enforcement of waste management rules against private companies as opposed to entities responsible for municipal waste collection have led to significant instability in the market. The FIC is concerned about the lack of impact assessments so urgently needed for enacting and implementing new legislation and about the authorities' lack of swift reaction to regulatory needs.

Although later than initially planned, at the end of 2017 the Government finalised the National Waste Management Plan (PNGD) for 2014 – 2020 and is currently taking steps to implement it. Following the adoption of the PNGD, the timely update of the county waste plans is necessary.

The amendments to the Waste Framework Directive imposed targets for preparing for re-use and recycling of municipal waste of 55% by 2025, 60% by 2030 and 65% by 2035. By comparison, for Romania, it is already estimated that the 50% target for preparing for re-use and recycling of municipal waste by 2020 will be missed.

Although official data showed that recovery and recycling targets for packaging waste were met up to 2013, since then the situation has steadily deteriorated. Between 2013 and 2015 the amount of packaging waste generated increased by 6% across the EU. In September 2018 it was revealed that Romania recycles only 14% of the quantity of waste generated and has one of the highest rates of landfilled waste: 69% (based on data reported to Eurostat for 2016). This makes it difficult to believe that the targets established by the new provisions which entered into force in Romania (60% for recycling and 65% for recovery) can be met in the next few years, under present conditions, because it is still difficult to recover packaging waste from households.

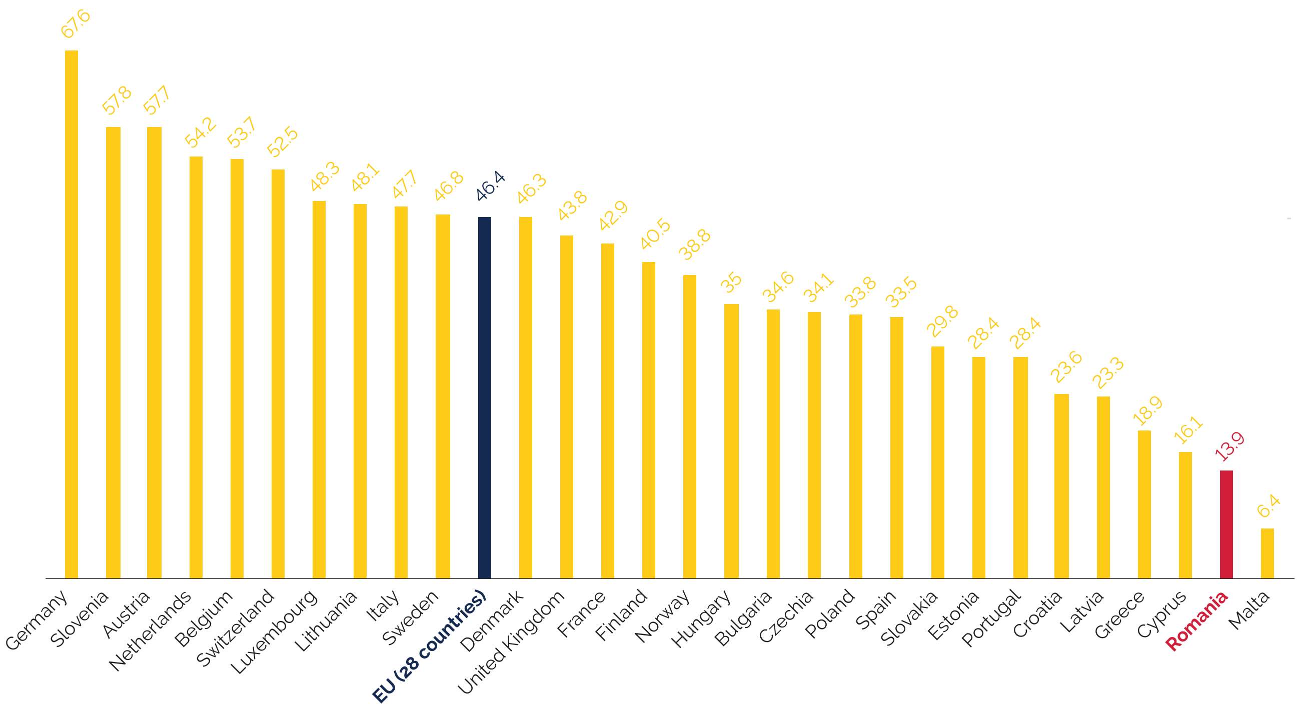
The recent modifications of the legislation on Waste Electrical and Electronic Equipment (WEEE) made no improvements and the changes fail to address the concerns expressed by industry, or to integrate its proposals. Instead, the problems identified in the previous legislation have been maintained or aggravated.

The FIC appreciates the transparency demonstrated by the Ministry of Environment's representatives during the transposition and implementation of revised EU-ETS legislation on climate change for 2013-2020. However, implementation of Commission Communication 2012/ C158/04 on compensation of indirect emissions for 2013 – 2020 has yet to occur, even though we are approaching the end of the 2013 – 2020 phase of the EU ETS.

Romania faced difficulties when meeting the ex-ante conditions, especially for the waste and infrastructure sectors. Even though the PNGD was approved by the Government at the end of 2017, the EC highlighted in July 2018 that the ex-ante condition had still not been fully fulfilled since no economic measures had been set out to achieve the targets for recycling. Moreover, in May 2018 the EC sent Romania a notification on the pre-suspension of payments for waste projects.

Since 2018, Romania has become a regional hub for sustainable development, which aims to ensure a sustainable future and the opening of national and international partnerships in order to implement the UN Agenda 2030. There have been several positive initiatives in Romania in relation to sustainability, such as the National Sustainable Development Strategy (NSDS) for 2013-2020-2030, the National Strategy on Climate Change and Low Carbon Economic Growth 2016 -2020 and the National Action Plan on Climate Change. Given the importance of sustainability, Romania should increase its focus on achieving the objectives set out in these documents. Permanent dialogue should take place between the public authorities and industry on how best to give incentives for responsible business conduct, as well as on specific sustainable development issues.

RECYCLING RATE OF MUNICIPAL WASTE (%) 2017



Source: Calculations based on Eurostat data

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FINANCIAL SERVICES

The banking sector has continued to consolidate through mergers and acquisitions which are in various stages of completion. This process may be stepped up, amid strong competition, high costs of staying in the market and decisions at group level on exiting certain markets. The bank business model continues to focus primarily on households, whereas lending to non-financial corporations is growing at a sluggish pace and sovereign exposure remains significant.

Private pension funds hold more than 90% of their assets domestically and retain a fairly low risk profile, with 75%-80% of all holdings invested in money market instruments and various bonds. As the banking sector continues the deleveraging process, pension funds provide the alternative capital for development. One possibility for further development is infrastructure investment, where pension funds could buy bonds in special projects, issued to support the country's developing infrastructure.
2018 was marked by intense discussions about the future of Pillar II pensions in Romania. The level of contributions was reduced to 3.75% of gross income (from 5.1% in 2017). Together with the overall transfer of contributions to the employee, this had the effect that most clients accumulated on average 12% less funds in their accounts.

For the capital market the last few years have been marked by positive steps towards Romania coming closer to Emerging Market status. However, additional progress will be needed, particularly in relation to new listings and transaction volumes on the stock exchange. During the last days of 2018, the Romanian Government adopted EO 114/2018, without consulting the business community and the industries affected and without an impact study. Such measures highlight the lack of public consultation and predictability within Romania's economy and discourage future investments in the financial services sector.

Companies from the financial services sector will be unable to muster sufficient resources to invest in developing financial infrastructure and education in order for Romania to reduce the existing gap with other EU Member States: Romania has the lowest degree of financial intermediation in the EU (26.4%), the lowest number of small and medium sized companies per 1,000 inhabitants (43), and the lowest digitalisation level.

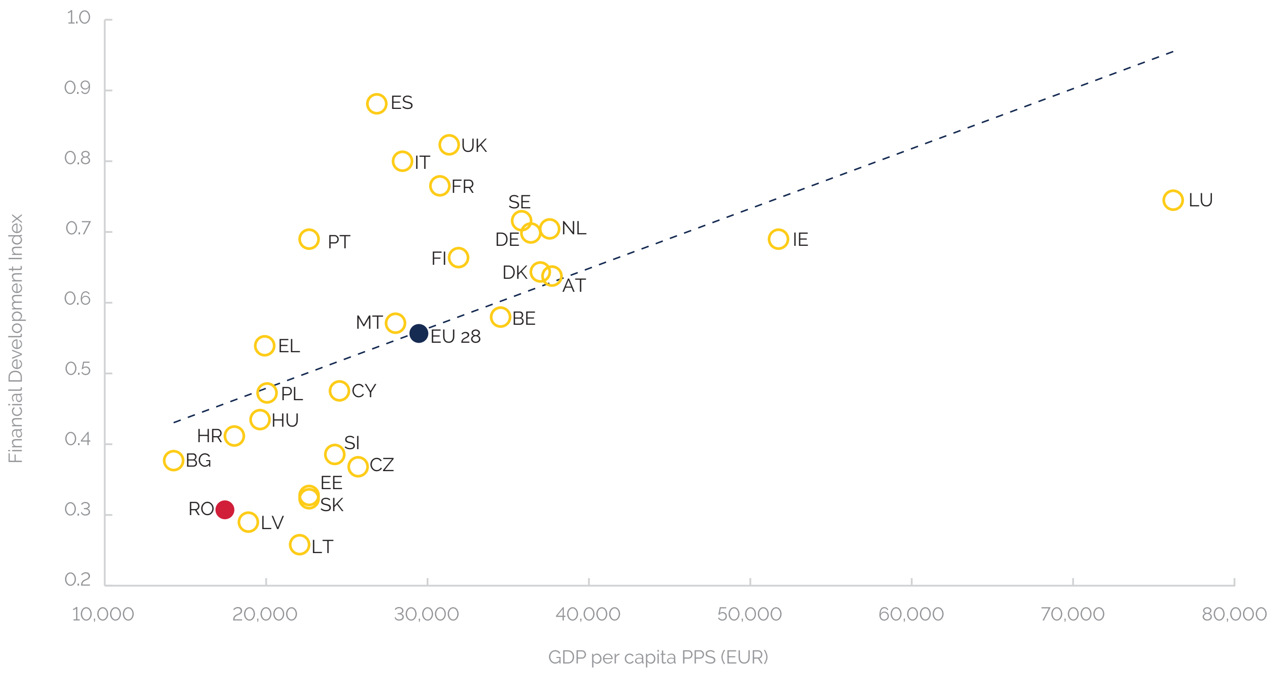
The main requirements for the effective functioning and development of the insurance sector are coordination of Romanian and European legislation, as well as the implementation of best practices in the field in order to improve consumers` confidence in the insurance industry and to ensure adequate protection of them. Although the Romanian insurance market ended 2017 with an approximately 3.5% increase in consolidated GWP compared to the previous year, insurance companies still face the challenging process of adaptation and market consolidation under the Solvency II regime requirements. The main strategies for stimulating the development of the insurance market in the next few years will focus on diversifying the business model of insurers, increasing the penetration of insurance products among consumers (including by digitalisation) and the adoption of a consistent legislative framework. In order to stimulate voluntary financial protection and boost the development of the life and health insurance market in Romania, the FIC recommends the application of a tax incentive for the purchase of life and health insurance policies with deductibility for both employees and employers.

Listing procedures should be formalised in a multi-year strategy approved by the Government, where companies being prepared for listing are named, with clear timelines and expected listing dates set for each of them. For the transactions to have high chances of success, stakes to be listed should be at least 20% of the total shares issued by these companies. Organisation of all IPOs and privatisations should be centralised under one government entity, which should help ensure the highest market standards for each transaction. Consequently, a formalised decision-making process related to initiation of the listing process should be established.

Financial literacy programs in Romania have been developed and supported by the private sector. They have been organised by banks, non-banking financial institutions, the stock exchange, asset managers, pension funds, insurers and their professional associations. The reach of these programs has constantly increased from year to year to a larger number of individuals and an extended geographical area.

Efforts to improve the level of financial education should be intensified, so that Romania does not have to wait another generation to benefit from the effects of financial literacy. Financial literacy projects run by the private sector have achieved good outcomes, but in order to be able to extend these nationally, to a larger number of individuals and a wider geographical area, the support and commitment of the public authorities is essential.

GDP PER CAPITA (PURCHASING POWER STANDARD-PPS) AND FINANCIAL DEVELOPMENT INDEX (2016)



Source: Calculations based on IMF and Eurostat data

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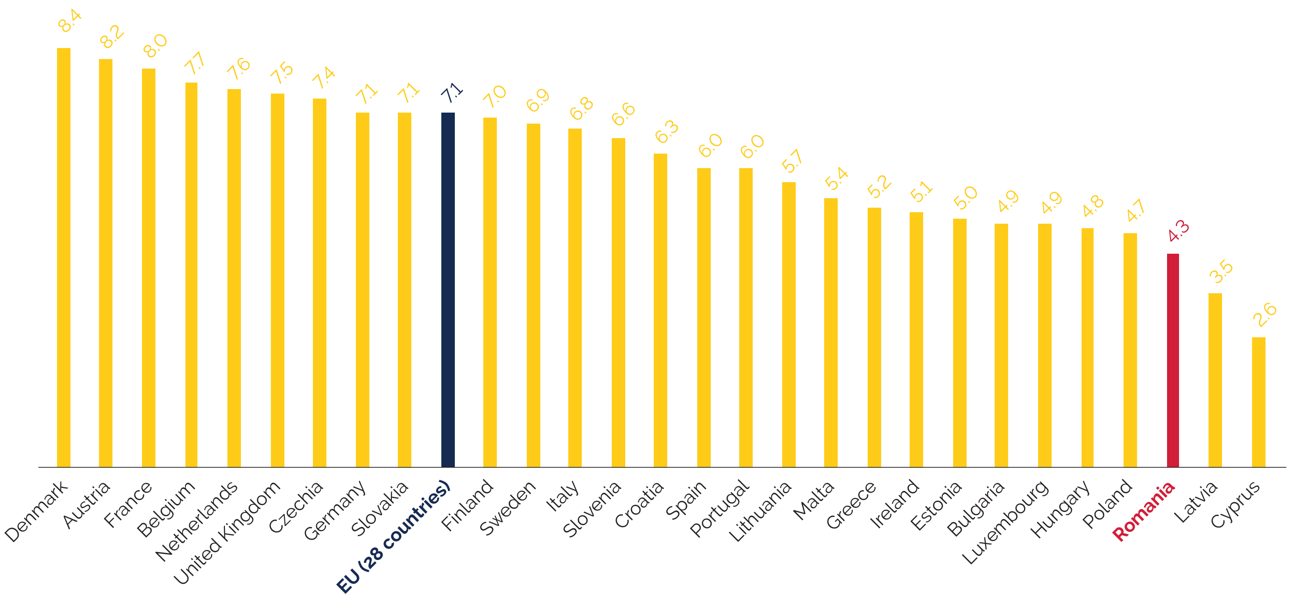
HEALTH CARE

The business community acknowledges that healthcare is now a priority for the Romanian authorities and that the total spending on healthcare has grown over the last four years, but it is still one of the lowest as a share of GDP within the EU countries. We acknowledge that in the past few years there have been some positive changes in the healthcare system. Nevertheless, the FIC is concerned that there is a lack of follow-up based on a long-term strategy which is highlighted by several challenges.

GOVERNMENT HEALTHCARE EXPENDITURE (%GDP) 2017

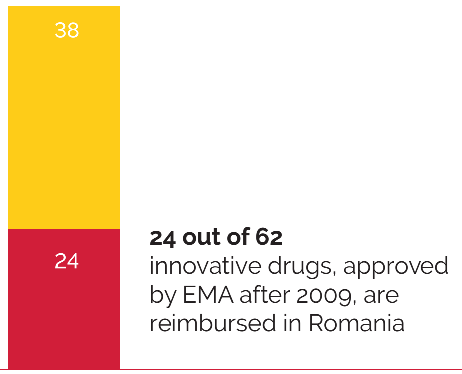


Source: Calculations based on Eurostat data

There is limited access to drugs as the number approved for reimbursement is comparable to the CEE average, but significantly behind western European standards. Moreover, on average, it takes 43 months to achieve permanent reimbursement in Romania after the approval of the European Medicines Agency (EMA), almost 50% longer than in Bulgaria or the Czech Republic.

Health infrastructure and resources remain of concern because investments in the building of regional hospitals has been delayed. The progress of reforms on this are limited by the poor planning and lack of administrative capacity.

LIMITED ACCESS TO DRUGS



Source: Calculations based on IQVIA,
Access to innovative medicines in Romania, 2018

There is a significant shortage of doctors and nurses because of migration. According to the Romanian Country Report issued by the EC (2019), “in 2016, there were 56,000 physicians in Romania which in per capita terms was the third lowest number in the EU”. Salaries in the public healthcare sector have increased, in order to retain staff, but this should be accompanied by an improvement in working condition and access to resources.

Introduced as a temporary measure in 2009, the claw back tax was amended several times (the latest version of the formula for calculating the tax was established through EO 77/2011), the claw back tax has become a tool through which the pharmaceutical industry has been required to take full responsibility for covering the funding deficit for reimbursed medicines in the context of under-financing of the reimbursed medicines budget. The claw back tax hinders investments by the pharma industry.

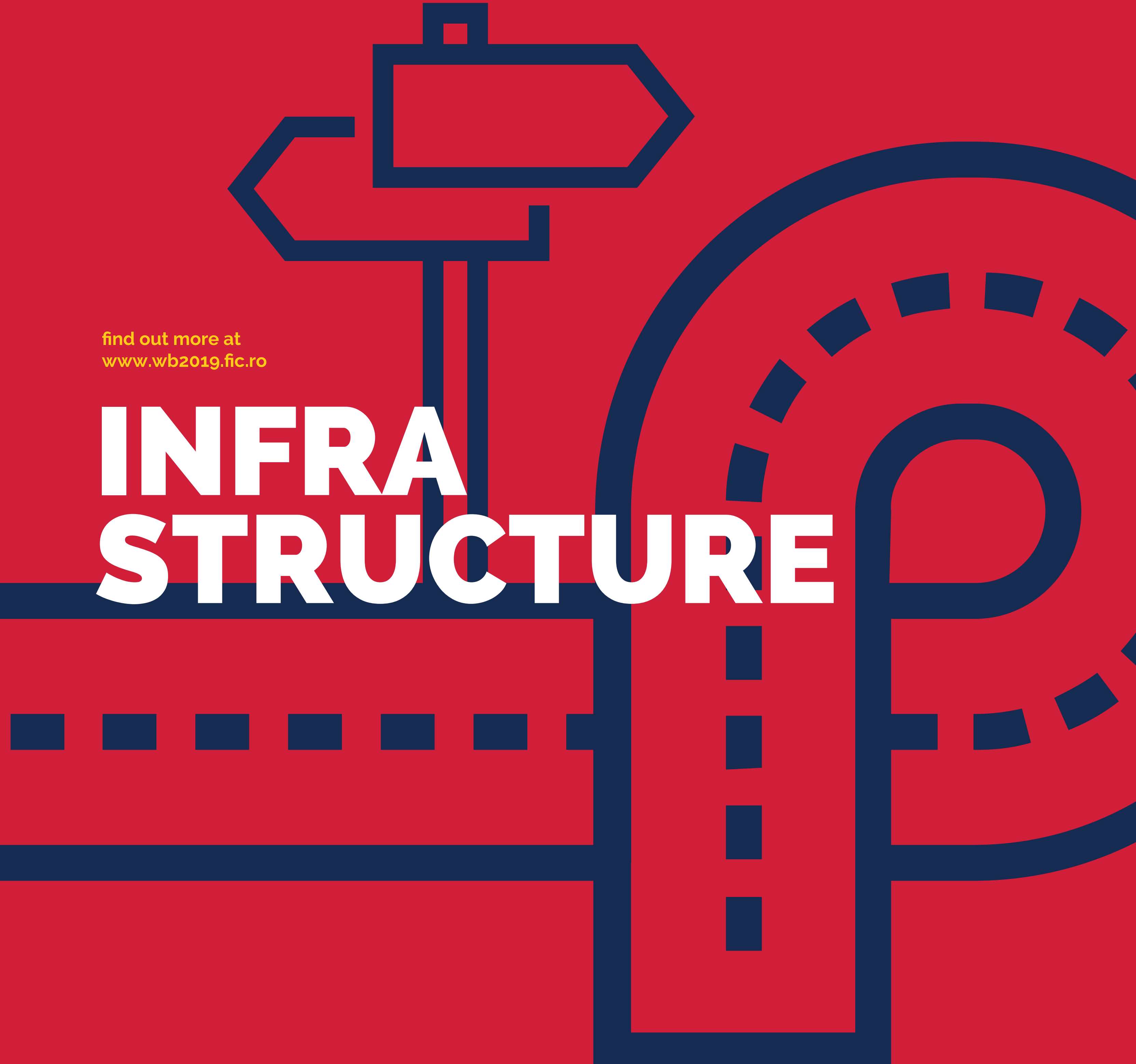
In order to address these problems FIC recommends the following:

An adequate level of funding should be assured for the healthcare system with a gradual increase in the share of GDP allocated to healthcare in order to reach the European average in the short run.

A range of measures should be adopted by the authorities in order to provide an adequate number of healthcare professionals within the Romanian healthcare system and reduce their migration. These should include performance related pay, improvement of access to continuous professional development, improvement of the performance appraisal process and human resources analysis.

Timely access should be provided to innovation, value-based healthcare, evidence-based decision making, and the development and implementation of eHealth solutions.

Prevention, health literacy and health promotion should become pillars of all health policies in Romania, with the aim of developing a unitary and integrated concept of prevention, treatment, education and health promotion, involving the main stakeholders in Romania.



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INFRA STRUCTURE

Quality infrastructure is critical for economic growth, and in Romania much still needs to be done to upgrade the country's infrastructure to European standards. Governments have acknowledged the important role that infrastructure plays, stating it to be a top priority. However, the pace of progress has been extremely slow, as improving infrastructure requires large amounts of resources. The state budget has limited funds allocated to infrastructure projects, absorption of EU funds for this purpose has been low and efforts to use alternative financing mechanism such as public private partnerships (PPPs) have not yet achieved results.

Efforts are being made to create a better administrative and legal framework for the development of infrastructure projects, such as the re-organization of the national road authority, the new PPP law, as well as the setting up of a sovereign fund.

In order for the Master Plan for Transport to be an effective roadmap for infrastructure development, several measures should be considered in terms of operational roll out. There should be a prioritisation of the most important projects over shorter periods (e.g. 5 years). Although not covered by the Master Plan, regional infrastructure development should also be made a priority.

Based on regional, national and European needs and objectives, clear infrastructure policy objectives need to be agreed at country level, for each type of infrastructure (transport, water, waste, energy, etc.). These should be the starting point for the prioritisation and coordination of large infrastructure projects over the short, medium and long term, coupled with the identification and securing of the best funding sources/funding mix for each project (EU funds, private/commercial funds, public funds).

In spite of significant investments made over the past few years from public funds, EU grants and other funds, Romania still needs to implement major investments in order to comply with EU standards and regulations, and ultimately improve the regional/municipal infrastructure. At the same time, the available funding for investments from national sources (central or local budgets, operators) is quite limited.

As well as developing a clear road map and prioritisation, financing these infrastructure projects is also one of the challenges that the Government is currently trying to address through basic budgetary financing, as well as aiming to achieve better absorption of EU funds.

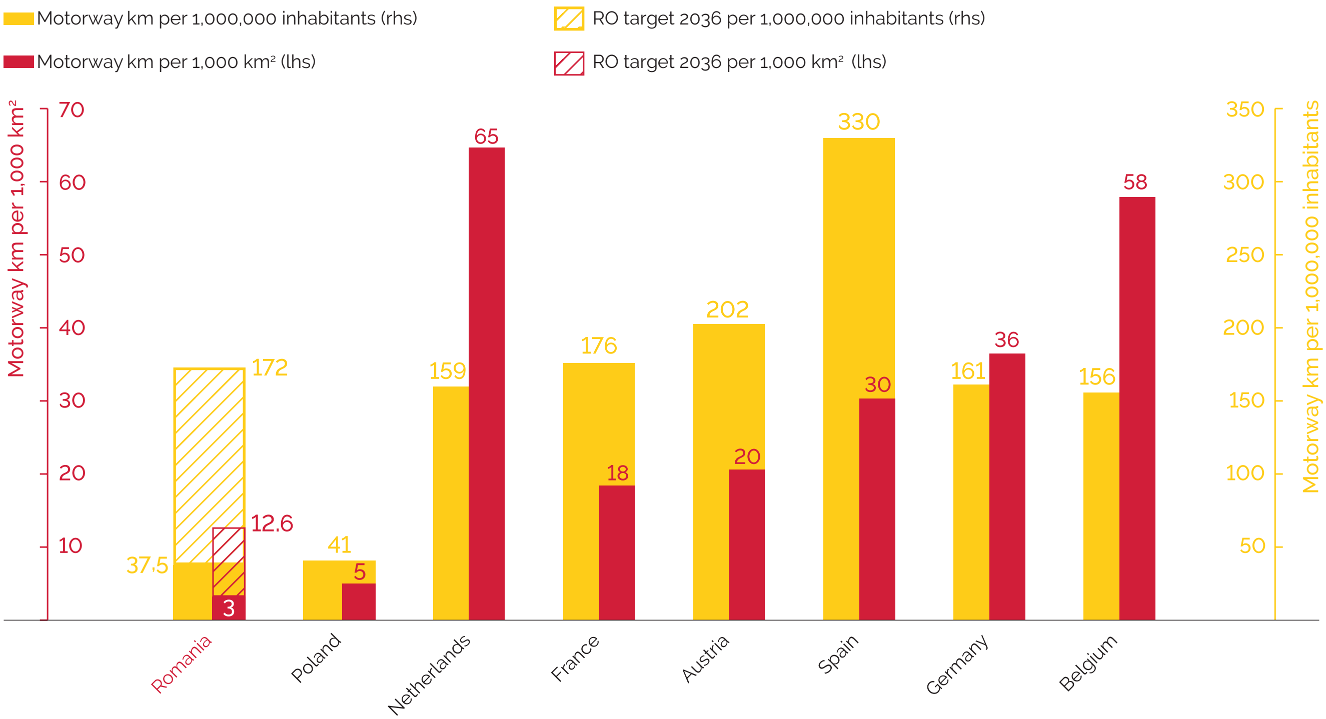
The progress in absorption of the funds allocated for 2014-2020 was slightly under the European average in May 2019. Romania had an absorption rate of 28% versus the European average of 31%. This still puts Romania in the bottom half of the pack, ranked 19 out of 28 member states. Considering the high investment needs Romania's rate of absorption should be much higher. Romania faces the risk of not being able to access significant amount for infrastructure projects, for failing to meet certain criteria.

Most infrastructure projects are by their nature very complex. Moreover, large infrastructure projects often require tailor-made, innovative solutions, which can only be provided by highly experienced and knowledgeable experts. Considering the need, the existing resources at the Government's disposal at times may not be sufficient to carry out multiple projects simultaneously.

FIC members would strongly welcome greater involvement in infrastructure projects by the private sector, because many aspects can be outsourced. The private sector has considerable expertise which the Government can use to facilitate the development of more infrastructure projects at a faster rate.

PPPs have been discussed and evaluated for some years as an alternative financing mechanism for Romania's infrastructure needs. They are even more relevant at present, given their potential role as a financing tool in the 2014-2020 EU funding programme. The FIC welcomes the resulting improvements both from a legal and an operational perspective.

MOTORWAYS NETWORK (2016)



Source: Calculations based on Eurostat data

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LABOUR

The intelligent use of human resources is the backbone of an ambitious plan the FIC has proposed for Romania to become the 10th largest economy in the EU in 2036. In order to achieve this goal, in the long term, the attractiveness and sustainability of the domestic labour market should be consolidated. It is essential for labour policies to take into consideration demographic trends and be closely integrated with educational policies. Romania's economic growth is at risk due to the current labour shortages which, in the absence of specific measures, will only increase in the next few years. With higher demand for work concentrated in a few regions where new businesses have developed or existing ones expanded, the market has started to see low or no supply of employable workers.

Given the rise in demand for labour, and consequent increase in its costs, in the medium-term it is important to avoid any measures that could destabilise the labour market or have negative effects on progress registered and on the trust of foreign investors in the Romanian business environment. In its current form, labour legislation is likely to continue to bring growing benefits.

In the past 2 years, social dialogue in Romania has reached a plateau in terms of institutional exposure. However, the institutional development of social dialogue has been carried out at the cost of jeopardizing the flexibility and, ultimately, the efficiency of the institutions involved (i.e. the Economic and Social Council - CES). The obstruction of social partners from actively and efficiently contributing to social dialogue is also caused by the organisation of very important meetings at very short notice.

The minimum wage has increased every year since its introduction in 2000, through Government Decision (GD) No. 296/1999. On average it has increased by 21% annually, in the last 6 years, and in many cases twice per year. The FIC believes that it is necessary to have a minimum wage policy and to be aligned with the practices in other EU countries. We also consider that it is essential for the framework of the minimum salary increase to be predictable, so that it is easier for businesses to plan ahead.

Given that a flexible working environment is extremely important to attract and keep investors, the FIC highlights the need to adapt labour legislation to this issue, through regulation of new types of individual employment contract, i.e on-call work or job sharing.

Public expenditure on social security services surpassed 40% of all general government revenues in 2018, making it by far the main cost in Romania's budget and amounting to 11% of GDP. Moreover, public wages and social transfers now account for 78% of fiscal revenues and social contributions, marking a steep, dangerous 23% increase in just 3 years. Consequently, maintaining a sound, coherent and, most importantly, sustainable system of social security services is of paramount importance for the health of public finances and that of the general macroeconomic balance.

Consequently, the public pension system on its own is not enough to secure adequate, sustainable pensions for future generations of Romanians. Therefore, the continued development of the private pension system launched in 2007-2008 is essential to improve the general capacity of the pension system to meet the expectations of the active population.

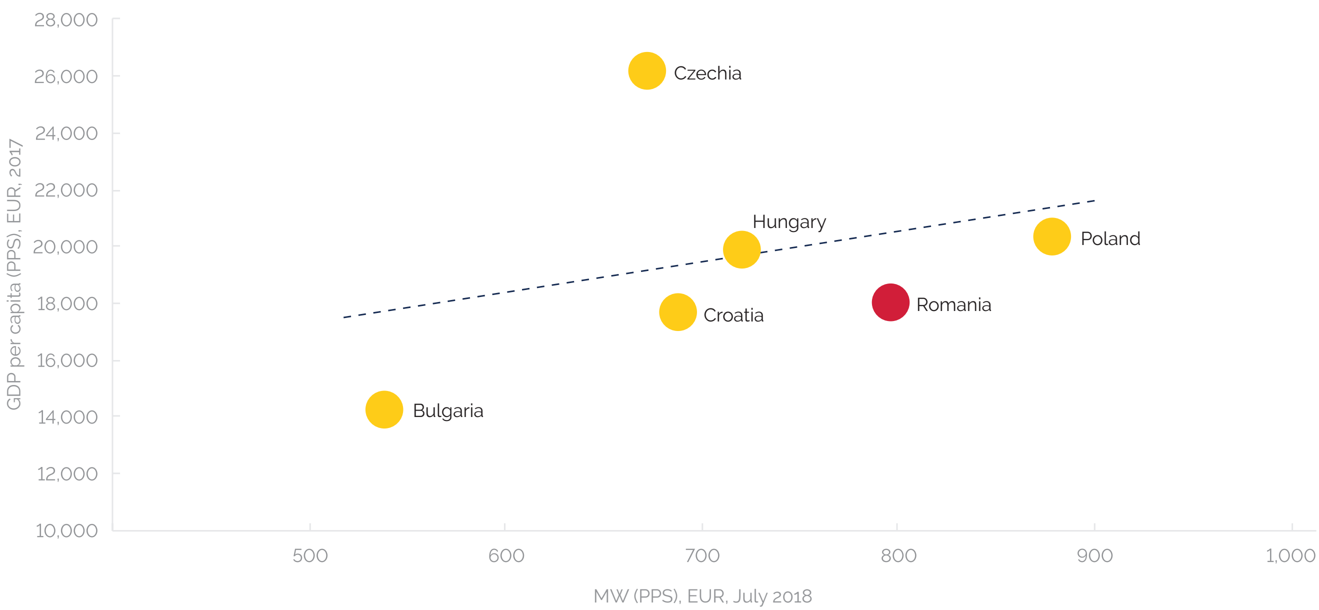
The FIC strongly believes that the Government's draft law issued at the end of 2018 for a new, revised public pension system – proposing a doubling of pension expenditure by 2021 – is unrealistic and will certainly be catastrophic for the country's public finances. We recommend that this draft law should be reconsidered and rewritten with a significantly more reasonable and realistic mindset with respect to the available financing resources.

The FIC also recommends the preservation of legislative stability in the private pensions sector and the protection of the system's general viability. We strongly recommend that the mandatory private pensions (Pillar II) system should remain. Further measures to encourage the growth in coverage of voluntary pension funds (Pillar III), including an increase in tax deductibility for employers' payments to these pension funds from the current EUR 400 per year to EUR 1,000 per year, are also desirable in the short to medium term.

One of the fundamental components of flexicurity is professional training, which is inextricably linked to a healthy labour market. Current legislation fails to do enough to encourage companies' involvement in initial training. The FIC's proposal is to encourage more flexible mechanisms, allowing companies to become more involved in training during schooling, so future employees (current students), may acquire practical knowledge during their studies. Consequently, the FIC supports legislative changes to promote dual education, apprenticeships, internships and on-the-job training.

Studies show that while half of current work can be automated, in the medium-term automation will transform blue collar/low skilled jobs into skilled, professional jobs. As people will work alongside machines, at least basic digital skills will be required at all professional levels. An extensive digital literacy program should be implemented across the country for the adult population allowing them to quickly redeploy to the more automated jobs of the future.

MINIMUM WAGE (PPS) AND GDP PER CAPITA (PPS)



Source: Calculations based on Eurostat

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TAXATION

Consultation between the state authorities and the business community is essential to review both draft legislation and the implementation of existing legislation. This will enhance the quality of legislation and support its uniform application. There have been some good examples of improved consultation. However, there is still a continuing problem of legislation being passed quickly, often at very short notice, and with little time for the business community to have effective input. Although the Ministry of Public Finance (MFP) has several structures designed to enable consultation with private stakeholders on different areas of interest in relation to public policies (e.g. the Directorate for Public Policy and Monitoring Legal Acts and the Unit for Communication, Public Relations, Mass-Media and Transparency), in practice there is hardly any real process of consultation with the business environment on these issues.

Furthermore, tax inspectors' interpretation of legislation changes frequently and new interpretations are also applied to the past. This means that, in practice, the rules can change unpredictably and dramatically. Recently, we have witnessed an increase in the number of cases in which tax inspectors have adopted an abusive and hostile interpretation of legislation.

A recent example of legislation being passed without proper consultation is the Romanian Government's decision to adopt EO 114/2018 during the last days of 2018, without consulting the business community and the industries affected and without an impact study. EO 114/2018 has a significant impact on major industries in Romania like banking, telecoms, energy, capital markets, private pension providers, the construction sector and ultimately on the entire economy.

The business sector was astonished by the antagonistic way the measures were presented and the discourse that accompanied them, which blamed the private sector, especially foreign companies, for the State's inability to collect taxes. The sectors which were accused are among the largest contributors to public budgets, and which also make a significant contribution to the Romanian economy ensuring e.g. energy supplies, telecommunication services, financing or the management of private pensions for millions of citizens.

Instead of focusing on solving essential problems related to collection, such as fighting fiscal evasion related to VAT and excise duties in sensitive sectors (e.g. tobacco, alcohol, and grain), as well as combatting undeclared work, for example in the construction sector, the tax authorities often carry out quite aggressive fiscal inspections on taxpayers which are some of the most important contributors to the state budget. These inspections can often last for long periods, disrupting business and ultimately hampering the ability of these businesses to generate revenue.

The fiscal authorities often focus aggressively on companies that are large contributors to the budget. This creates a risk of seriously undermining Romania's image in the international business environment, the media and diplomatic circles, as well as with EU authorities.

The FIC recommends the setting up of a paid access database tool (with full respect for the confidentiality principle), bringing together all binding and non-binding tax rulings issued/to be issued by the MFP, in its capacity as legislative authority, in connection with the interpretation of each article of the Fiscal Code, the Fiscal Procedural Code, the Accounting Law and any related secondary legislation, in order to normalise and create a unitary approach to the interpretation of the relevant legal provisions by both tax inspectors and taxpayers throughout Romania.

Practice has shown that tax inspection reports and assessment decisions issued upon the closure of tax audits are frequently cancelled later in courts, following appeals filed by taxpayers. In these situations, the National Agency for Fiscal Administration (ANAF) has had to assume a series of costs, not only in the form of compensatory damages paid to taxpayers, but also in terms of time and resources allocated to litigation which they lose.

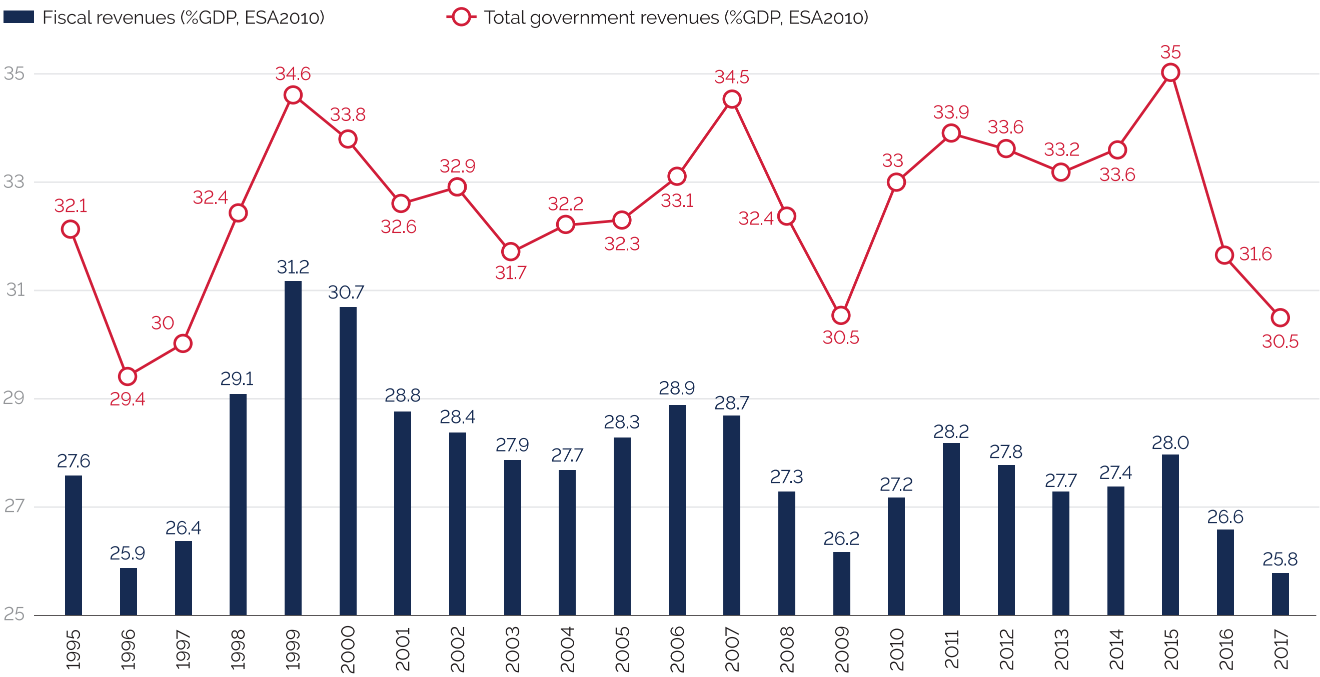
A consolidated database with traceability features for each file at the different courts in Romania, bringing together the tax decisions and rulings issued by the

Romanian courts, would bring two main benefits:

1. It would lead to an improvement in ANAF's resource allocation process and a better assessment of costs vs. opportunities and
2. It would assist unitary application of legislation in Romanian courts, in proceedings judging the same underlying principle.

Tax evasion creates unfair competition, putting those who comply with the law at a disadvantage. The FIC welcomes and supports the MFP's and ANAF's on-going work to tackle tax evasion and tax fraud, smuggling and counterfeiting. However, tax audits are not always focused in the right way to enhance revenue collection for the state budget. Tax evasion and smuggling, affecting both direct and indirect taxes, continue to be a problem. Reform of ANAF should continue, to eliminate the practical deficiencies in fiscal administration, as well as to create an integrated public IT system connecting different authorities (such as fiscal, health, local administration, courts, and the land registry).

FISCAL REVENUES



Source: Presentation Ionuț Dumitru, President of the Fiscal Council, 2018

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TECH NOLOGY& COMMUNI CATIONS

The penetration of broadband services continues to be a key challenge in Romania, despite the progress registered in the last few years. Although Romania ranks among the first countries in Europe for ultrafast broadband penetration (at least 100Mbps), the national coverage with NGA technologies remains significantly lower than in other EU member states and is still very much limited to urban areas. Considering the objectives undertaken through the EU Digital Agenda updated recently by the EC, broadband penetration and coverage should be treated as a key priority within government strategies. The development of fixed broadband networks, as well as of 5G networks should be supported by the Romanian authorities.

A simplified authorisation regime should be created for the deployment of communications networks, as a derogation from the general regime. We strongly recommend that the Ministry of Regional Development and Public Administration (MDRAP) should involve all relevant stakeholders that can provide useful input into this process.

When aligning local legislation to the e-IDAS Regulation, both the public authorities and the business environment embarked in a roller coaster journey during 2017-2018. The Ministry of Communications and Information Society (MCSI) submitted for public consultation three versions of the draft law on electronic signature, each with a different approach. In parallel, another draft law on electronic signatures was initiated by the Parliament.

In 2017, the Ministry of Internal Affairs (MAI) published a draft legislation on electronic IDs (eIDs) for consultation with the aim of issuing the first eID by mid-2018. However, the draft has not yet passed Parliament. eIDs could be used by citizens for authentication and signing in relations with public and private institutions, if they include an authorised signature. So, they represent important tools for Romania's digitalisation.

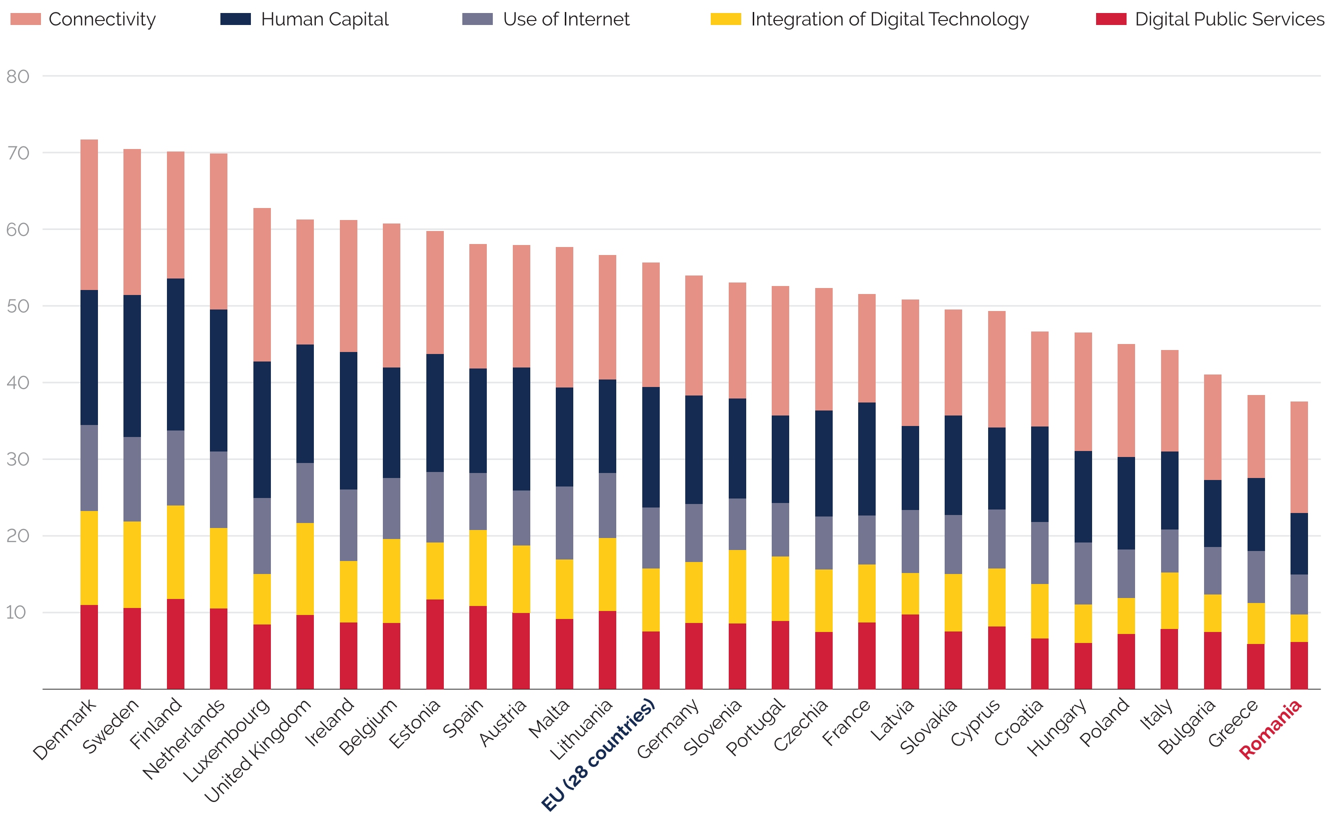
The digital society is undergoing major changes. As more and more of our day-to-day activities go electronic and digital, very large volumes of data about us become available. In this context, a user centric privacy framework must be based on a correct understanding of the user's privacy interests. There is a need to provide a consistent user privacy experience that will establish familiarity with the privacy implications of applications and services, empowering the user and leading to better privacy management. The National Authority for the Supervision of Personal Data Processing (ANSPDCP) should ensure transparent and predictable implementation of the legislation on data protection. Adoption of guidelines should lead to the required increase in transparency.

In order to build trust in electronic transactions, which is key to economic and social development, relevant national law-makers, either from the Government or from Parliament need to speed the consultation and approval process for the draft legislation on electronic signatures, for the benefit of consumers, businesses and public authorities.

The Digital Single Market (DSM), a flagship policy undertaken by the EC, seeks to eliminate current barriers and fragmentation within the single market, build a better online service for consumers and businesses, increase trust and boost cross-border e-commerce. The EC expects the DSM to contribute with EUR 415 billion to Europe's economy, along with creating new jobs and remodelling public services. Working within the Digital Agenda for Europe 2020 targets, Romania has set ambitious goals through its National Strategy on the Digital Agenda 2020, i.e., at least 30% of citizens to make online purchases by 2020 and at least 5% of citizens to make online cross-border purchases. At the same time, the strategy plans that at least 20% of SMEs will carry out transactions in the electronic environment by the same date.

The authorities should take steps towards the swift passing of a business & customer orientated national policy framework on promoting e-commerce. This should support them in reaching the three main objectives set out in the Area of Action 3 – E-commerce, Research & Development and Innovation in ICT within Romania's National Strategy on the Digital Agenda 2020.

DIGITAL ECONOMY AND SOCIETY INDEX (DESI) 2018



Source: European Commission

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orange	ROCKWOOL	STEELMET ROMANIA S.A.	Up ROMANIA
parmalat	rompetrol KazMunayGas Group Member	STRATUM	upc
PEPCO	RSM	TAXHOUSE Taxand	URSUS Breweries
PEPSICO	SAINT-GOBAIN GLASS	T · ·	VALVIS HOLDING
OMV Petrom	schönherr	TenarisSilcotub	VEOLIA
PIRELLI	SIEMENS	TIMKEN	VIENNA ENERGY —FORȚĂ NATURALĂ—
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Provident	sodexo Making every day a better day	TUBORG	Wienerberger Cărămizi. Create pentru noi.

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