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The World Bank

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A

PROPOSED LOAN

IN THE AMOUNT OF EUR 600 MILLION (EQUIVALENT TO US$641.7 MILLION)

ANDA PROPOSED GRANT

FROM THE IBRD FUND FOR INNOVATIVE GLOBAL PUBLIC GOODS SOLUTIONS

IN THE AMOUNT OF US$24.2 MILLION

TO

ROMANIA

FOR THE

FIRST PROGRAMMATIC INCLUSIVE AND GREEN GROWTH DEVELOPMENT POLICY FINANCING

June 13, 2022

Macroeconomics, Trade and Investment and Energy and Extractives Global Practices

Europe and Central Asia Region

GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of May 31, 2022)

Currency Unit

US$1.00 = Ron 4.60

ABBREVIATIONS AND ACRONYMS

AC	Heat Aid	LDP	Letter of Development Policy
ADR	Authority for Digitalization	LGBTI	Lesbian, gay, bisexual, transgender, and intersex
ANAP	National Agency for Public Procurement	LTRS	Long-term building renovation strategy
ASA	Advisory Services and Analytics	MDTF	Multi-Donor Trust Fund
CAD	Current Account Deficit	MFD	Maximizing Finance for Development
CCAP	Climate Change Action Plan	MS	Member States
CF	Cohesion Fund	MTEF	Medium-Term Expenditure Framework
CPF	Country Partnership Framework	MOF	Ministry of Finance
DPF	Development Policy Financing	NATO	The North Atlantic Treaty Organization
DPL	Development Policy Loan	NBR	National Bank of Romania
DSA	Debt Sustainability Analysis	NGO	Non-Governmental Organization
DSM	Demand-side management	NPL	Non-performing loan
EC	European Commission	NRRP	National Recovery and Resilience Plan
ECA	Europe and Central Asia	ONAC	National Office for Centralized Procurement
EE	Energy Efficiency	PCE	Private Capital Enabled
EIA	Environmental Impact Assessment	PDO	Program Development Objective
ERDF	European Regional Development Fund	PER	Public Expenditure Review
EU	European Union	PFM	Public Financial Management
FCV	Fragility, Conflict, and Violence	PP	Public Procurement
FDI	Foreign Direct Investment	PPP	Public Private Partnership
FDPs	Forcibly Displaced Persons	RAS	Reimbursable Advisory Services
FEG	Fiscal Effectiveness and Growth	REACT-EU	Recovery Assistance for Cohesion and the Territories of Europe
FSA	Family Support Allowance	RI	Results Indicator
GBV	(Sexual and) Gender-Based Violence	RON	Romanian Lei

GDI	Graduation Discussion Income	RRF	Resilience and Recovery Facility
GDP	Gross Domestic Product	SCD	Systematic Country Diagnostic
GDTPD	General Directorate of Treasury and Public Debt	SDDS	Special Data Dissemination Standard
GEO	Government Emergency Ordinance	SDR	Special Drawing Rights
GHG	Greenhouse Gas	SEA	Strategic Environmental Assessment
GMI	Guaranteed Minimum Income	SEAP	Public Procurement Electronic System
GNP	Gross National Product	SOE	State-Owned Enterprise
GPG	Global Public Goods	SRI	Social Reference Indicator
GRID	Green, Resilient and Inclusive Development	TA	Technical Assistance
GRS	Grievance Redress Service	TF	Trust Fund
GSG	General Secretariat of the Government	UCA	Universal Child Allowance
IBRD	International Bank for Reconstruction and Development	UN	United Nations
ICR	Implementation Completion and Results Report	UNECE	United Nations Economic Commission for Europe
ICT	Information and Communications Technology	UNHCR	United Nations Refugee Agency
ID	Identity Document	VAT	Value Added Tax
IDA	International Development Association	VMI	Minimum Inclusion Income
IFC	International Finance Corporation	WB	World Bank
IFI	International Financial Institution	WBG	World Bank Group
IMF	International Monetary Fund	WHO	World Health Organization
INECP	Integrated National Energy and Climate Plan	Y-O-Y	Year-on-year
IOM	International Organization for Migration		

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SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Programmatic	If programmatic, position in series
P178912	Yes	1st in a series of 2

Proposed Development Objective(s)

The Program Development Objective (PDO) of the proposed series is to support the Government of Romania's efforts to: 1) strengthen inclusion and fiscal management; and 2) foster decarbonization and climate resilience.

Organizations

Borrower:	ROMANIA
Implementing Agency:	Ministry of Finance

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Financing	**665.90**

DETAILS

International Bank for Reconstruction and Development (IBRD)	641.70
Trust Funds	24.20
IBRD Fund for Innovative GPG Solutions	24.20

INSTITUTIONAL DATA

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Overall Risk Rating

Moderate

Results

Indicator Name	Baseline	Target
RI#1: Share of FDPs from Ukraine with government recognized IDs	0 (2021)	90% of FDPs (2024)
RI#2: Cumulative share of women FDPs from Ukraine that use healthcare services as a share of those registered	0 (2021)	40% of registered FDP women (2024)
RI#3: Access to Minimum Inclusion Income Program (component of VMI – or Venitul Minim de Incluziune)	165,205 families (2021)	Increase by at least 40% (2024)
RI#4: Share of FDPs from Ukraine aged 15-64 in employment as a share of FDPs from Ukraine registered with the National Agency for Employment	0 (2021)	40% of FDPs aged 15-64 of which: 50% are women (2024)
RI#5: Share of hosting schools in total schools hosting FDPs from Ukraine implementing integrated measures for students and inclusive training for teachers	0 (2021)	75% (2024)
RI#6: Unitary pay scale for local governments	NA (2021)	Established (2024)
RI#7: Number of ministries adopting program-based budgeting	0 (2021)	At least 2 (2024)
RI#8: Value of the pension point[1]	1,442 Ron (2021)	Increase by up to 100% of inflation and 50% of real wage growth annually (2024)
RI#9: New renewable capacity contracted, of which Electricity generation capacity Green hydrogen generation capacity (electrolyzers)	0 MW (2021) 0 MW (2021) 0 MW (2021)	1050 MW (2024) 950 MW (2024) 100 MW (2024)

[1] The pension point is a monetary indicator (expressed in Ron) which, multiplied by the number of pension points, gives the value of the pension for an individual pensioner. The number of points is a function of the years of contribution and the amount contributed to the public pension fund. Currently, the value of the pension point is 1,442 Ron.

RI#10: Surface area of buildings to undergo energy efficiency renovation for which financing is secured	0 m^2 (2021)	2,170,000 m^2 (2024)
RI#11: New area under afforestation or reforestation works	13,912 ha (2021)	Increase by at least 11,000 ha (2024)

IBRD PROGRAM DOCUMENT FOR A PROPOSED DEVELOPMENT POLICY FINANCING TO ROMANIA

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed operation in the amount of US$665.9 million is the first in a programmatic series of two operations to support the Government of Romania to enhance inclusion; strengthen fiscal management; and foster decarbonization and climate resilience.** The financing of the operation comprises a EUR 600 million IBRD loan (equivalent to US$641.7 million) and a US$24.2 million grant from the IBRD Fund for Innovative Global Public Goods (GPG) Solutions. Romania is an upper-middle-income country that continues to see substantial poverty and inclusion challenges, as reflected in the forthcoming Systematic Country Diagnostic (SCD) Update as well as the 2018 SCD. Regional income and service delivery disparities are wide, the impact of social transfers on reducing poverty and inequality is among the lowest among European Union (EU) countries and the population is the poorest and among the most unequal in the EU, with 10 percent of the population estimated to be poor (using the international poverty line of $5.50 in 2017 Purchasing Power Parity terms) and with a Gini coefficient of equivalized disposable income of 33.8 in 2020, above the EU average of 30. Hence, the inclusion agenda is paramount in the country, gaining added significance with the war in Ukraine and the unprecedented influx of forcibly displaced persons (FDPs) into Romania.[2] The country has also been running a large structural fiscal deficit, averaging 3.5 percent of GDP during 2010-21, fueled by tax cuts and untargeted permanent spending increases. With the economic and humanitarian spillovers of the war, spending pressures are on the rise. The war has also raised issues of energy security and independence, adding to the debate on the sector's role in achieving reduced greenhouse gas (GHG) emissions.

2. **The proposed Development Policy Financing (DPF) series supports the Government's efforts in addressing inclusion and other structural constraints impeding development progress in Romania.** The key constraints to growth and prosperity identified in the SCD Update include weak institutions (resulting in low tax collection rates and spending inefficiencies), limited coverage and adequacy of social assistance, unequal access to quality public services, concerns on quality and quantity of labor, infrastructure and other impediments to the business environment and slow progress on climate change. The proposed Development Policy Loan (DPL) series supports the Government's efforts in many of these areas. First, it supports key structural reforms, such as those related to public pensions and wages, which are critical for strengthening fiscal management and addressing medium-term fiscal sustainability and inclusion challenges. Second, the measures supported by the DPL will unlock EU funding and promote private investment in the coming years, primarily in renewable energy, and energy efficiency and forestry, supporting infrastructure development and the business environment. Third, the DPL is complemented by technical assistance in several areas, including social assistance, pension and wage reforms, tax policy, and tax administration which will support institutional strengthening of the public sector. The support for institutional strengthening is in line with the Country Partnership Framework (CPF) for Romania, as a country above the IBRD Graduation Discussion Income (GDI) level, and the operation also meets the CPF filters for WBG financing, namely (i) developing innovative solutions that benefit the most poor and vulnerable, including Roma; (ii) maximizing finance for development, including catalyzing private sector investment or leveraging additional resources (e.g., better use of EU funds); and/or (iii) contributing to regional and global public goods. Fourth, the successful integration of FDPs could support labor supply in Romania. Fifth, the adaptation and mitigation efforts

[2] Inequality is visible across population groups with self-employed, single elderly and the Roma population at a higher risk of poverty.

supported by the DPL series will help support the climate change agenda. Finally, the innovative advancement of global public goods agenda through the DPL has enabled additional grant financing to the operation.

3. **The operation will benefit from a proposed grant from the IBRD Fund for Innovative Global Public Goods Solutions (the "GPG Fund") in parallel to the IBRD loan**. The proposed allocation of resources from the GPG Fund recognizes the program's support to FDPs and host communities and for efforts aimed at climate change mitigation and adaptation (Box 1). GPG funding will be approved by the Board of Executive Directors as part of this complete package. In addition, the World Bank will consider setting up a Multi-Donor Trust Fund (MDTF) to receive donor contributions and to channel grant co-financing under this DPL series to further support the Government's program.

4. **The influx of FDPs can support growth, if adequate short- and medium-term actions are taken to integrate the FDPs and mitigate the impact on host communities.** Over a quarter of Ukraine's population is estimated to have fled their homes since February 24, 2022, making this the fastest growing refugee crisis since the World War II.[3] Romania is the second largest recipient of FDPs after Poland, with an estimated 1,040,000 arrivals and 115,000 remaining in the country as of end-May 2022, according to the Government's estimates. The majority of the FDPs are women and children. The FDP arrivals include significant vulnerable groups that will require tailored support, including those with serious health conditions and disabilities.[4] In the scenario where the FDPs decide to stay, and the Government enables their integration into the Romanian society and labor markets, while simultaneously supporting the host communities, the influx can provide an opportunity in boosting the Romanian labor force.

Box 1: IBRD Fund for Innovative Global Public Goods Solutions

In line with the 2018 IBRD-IFC Capital Package, IBRD launched the IBRD Fund for Innovative GPG Solutions in June 2019 as a three-year pilot. The main objective of the GPG Fund is to incentivize innovative solutions for delivering GPGs by using concessional financing to support IBRD operations that generate global or regional benefits. Governors have approved transfers from IBRD surplus to the GPG Fund for a total three-year funding of US$85 million. In years 1 and 2 of the pilot (FY20-FY21), four projects that promote innovative solutions for addressing climate change mitigation and adaptation, and spillover effects of FCV situations were selected to receive the allocation. Projects were selected based on additionality, innovation, replicability, and sustainability criteria. Additional projects have been selected to benefit from this financing in FY22. An evaluation of the pilot is ongoing and will provide useful lessons to improve the design of the GPG Fund.

5. **Enhanced fiscal management remains a central priority in the context of additional spending needs to accommodate the influx of FDPs and mitigate the impact of rising prices.** The COVID-19 pandemic significantly increased the already high fiscal deficit to 9.3 percent of GDP in 2020 which led to a sharp increase in public debt to 47.2 percent of GDP in 2020, up from 35.3 percent in 2019. More recently, because of the war in Ukraine, public debt continued to rise due to the support to vulnerable households and small businesses given the impact of higher energy prices, while also spending for social services and assistance to FDPs. Endemically low tax collection (26-27 percent of GDP budget revenue collected from taxes, the second lowest in the EU) due to tax loopholes and low tax administration capacity exacerbates the fiscal situation. The public pensions fund runs an annual

[3] UNHCR April 27, 2022, Ukraine Situation Flash Update # 10.
[4] IOM Displacement Survey, from March 25 - April 8, 2022.

deficit of around 2 percent of GDP (which could increase to 5 percent of GDP if reforms are not undertaken) raising questions about its sustainability, while the pension benefit formula is complex and non-transparent, leading to inequities among cohorts of pensioners. The budget execution and formulation processes are largely input-based, lacking a performance–driven culture. With the added fiscal pressures, the deficit is expected to remain high at around 7.1 percent of GDP in 2022.[5] The direct cost of provision of public services to FDPs is estimated at 0.53 percent of 2022 GDP, assuming that 12-15 percent of FDPs remain in Romania. In addition, the cost of the measures[6] to shield consumers and industries from the impact of higher energy prices is estimated at 0.25 percent of 2022 GDP. The authorities are planning to recover a share of the additional costs of the social protection measures extended to shield households from the higher energy prices through a surcharge imposed on the windfall profits of energy companies, higher dividends from energy SOEs and from higher VAT and excise collections as a result of higher prices.

6. **Accelerating the energy transition will increase resilience to climate change and enhance energy security, although the war in Ukraine could potentially delay the process.** Romania's vulnerability to climate change is relatively high, while its readiness to adapt is rated as relatively low.[7] By 2050, monthly maximum temperatures are expected to rise by 1.2°C-3.9°C, leading to more frequent and persistent heat waves, an increase in the annual number of hot days by 12.9 days, and more intense and frequent spatially extended droughts (impacting hydropower generation, among other effects). Increasing locally produced renewable energy and boosting energy efficiency in buildings will contribute to achieving the decarbonization objectives. It will also reduce dependence on energy imports and strengthen climate change adaptation efforts, including reduced dependence on hydropower (which accounts for about 20 percent of total electricity production). However, the energy crisis as a result of the war in Ukraine poses risks to the energy transition process, reopening the debate on the decommissioning of coal-fired power plants and the use of fossil fuels, and distracting from the broader decarbonization agenda.

7. **Addressing these challenges is compounded by the limited institutional capacity of the public sector in Romania.** Limited government coordination and lack of alignment between strategic priorities and investments continues to reduce effectiveness of public institutions. The European Public Administration Country Knowledge assessment[8] ranked Romania's coordination capacity as medium with high fragmentation, a low level of inter-institutional coordination and low consistency of reforms and policy making. These institutional weaknesses result in inefficient spending, limited absorption of EU funds, and inadequate public service delivery. Institutional constraints account for at least half of the top-cited constraints to private sector growth.[9] This DPL series supports institutional strengthening in key areas of engagement (such as fiscal management, tax regulation, and public service delivery) through policy changes along with complementary technical assistance and Reimbursable Advisory Services (RAS) programs.

[5] World Bank Staff estimates.
[6] Currently approved until March 2023.
[7] 2021-2025 WBG Climate Change Action Plan.
[8] European Commission 2018. Public administration characteristics and performance in EU28: Romania. https://op.europa.eu/en/publication-detail/-/publication/90311e18-95fe-11e8-8bc1-01aa75ed71a1/language-en
[9] World Bank Group 2019. Enterprise surveys. Romania 2019 – Country profile. https://espanol.enterprisesurveys.org/content/dam/enterprisesurveys/documents/country/Romania-2019.pdf

8. **The Program Development Objective (PDO) of the proposed series is to support the Government of Romania's efforts to: 1) strengthen inclusion and fiscal management; and 2) foster decarbonization and climate resilience.** Under strengthening inclusion, the first pillar includes the emergency response to accommodate the influx of FDPs from Ukraine along with addressing long-standing challenges related to the targeting and adequacy of social assistance programs that have reduced the impact of social assistance in reducing poverty and inequality. Together these measures strengthen overall inclusion through structural reforms that advance fiscal redistribution while also integrating FDPs through measures that protect human capital. The first pillar also addresses structural inefficiencies that have contributed to Romania's fiscal imbalances and have undermined fiscal management. The second pillar fosters decarbonization by tackling key legislative gaps with respect to renewables, strengthening energy efficiency in buildings and deepening carbon sinks while also supporting the mobilization of private capital at scale. The operation will also support Romania's energy independence and security via increased investments in renewables (thereby, supporting green growth while also boosting the EU fund absorption) and by optimizing energy consumption with energy efficiency measures (thereby, improving competitiveness of industries). The actions supported by the DPL series benefit from significant Bank engagement through technical assistance.

9. **The proposed operation builds on the World Bank Group's (WBG) Green Resilient and Inclusive Development (GRID) approach and the WBG Strategy for Fragile Conflict and Violence (FCV) 2020-2025 and is private capital enabling (PCE).** In addition to the Paris Agreement, Romania's green transition agenda is anchored in the European Green Deal, the EU's joint Nationally Determined Contributions, as well as the 2021-30 Integrated National Energy and Climate Plan. The actions to support the integration of the FDPs and host communities are aligned with the WBG FCV Strategy 2020-2025, specifically with pillar 4, "Mitigating the spillovers of FCV," and pillar 1, "Preventing violent conflict and interpersonal violence." This DPL series is also aligned with the strategic framework of the "WBG Response to Global Impacts of the War in Ukraine – A Proposed Roadmap" (April, 2022) that discusses the short- and medium-term responses to the war. The proposed operation is private capital-enabling under the Maximizing Finance for Development (MFD) framework, as it supports the legislative and regulatory changes to unlock private investment in renewables and fosters the revitalization of the building renovation market.

10. **The operation faces moderate risks.** Among the risk categories, political and governance risk is deemed to be substantial, while technical design risk is low. All the remaining risk categories are rated moderate. Political risks are mitigated, in part, by the Government's commitment to the policies being supported by this DPL series, the strong backing of the European Commission (EC) for these reforms and the Bank's strong policy dialogue with the Government of Romania.

2. MACROECONOMIC POLICY FRAMEWORK

11. **Romania has made impressive strides in raising its economic performance over the past two decades, albeit characterized by volatility.** Romania's real GDP per capita grew by 4.5 percent a year on average in the last two decades, albeit masking large growth volatility. The 2000s were a period of fast but unsustainable growth, driven by procyclical fiscal policies that boosted domestic consumption. The global financial crisis led to a painful adjustment in output in 2009-10, but the growth cycle gradually resumed, boosted increasingly again by procyclical fiscal policies that created new macroeconomic imbalances. Despite 15 years of EU membership, infrastructure is still inadequate given Romania's income level, constraining private investment and productivity.

Productivity is further hindered by unsustainable wage dynamics and an aging and shrinking labor force. The ongoing crises due to impact of spillovers from the war in Ukraine may also imply longer-term scarring, further lowering the country's potential growth.

2.1. RECENT ECONOMIC DEVELOPMENTS

12. **In 2021, Romania's output recovered to pre-pandemic levels, as growth rebounded strongly to 5.9 percent.** Romania experienced one of the mildest recessions in the EU during the COVID-19 pandemic, contracting by 3.7 percent in 2020. The recovery was driven by private consumption (up 7.9 percent y-o-y in 2021), while higher prices of raw materials and energy have tempered investment dynamics (up 2.3 percent y-o-y). On the supply side, services recovered, benefiting from the gradual reopening of the economy. Growth was led by the ICT sector (13.4 percent y-o-y), which benefited from the households adapting to remote work needs and businesses adopting digital technologies. Industry bounced back in 2021, but growth decelerated towards the end of the year, down to 5 percent y-o-y.

13. **Recent inflationary pressures led to monetary policy tightening.** To moderate the impact of the COVID-19 pandemic in 2020 and to support recovery, the National Bank of Romania (NBR) pursued quantitative easing measures, including purchasing of government bonds from the secondary market, and repo operations to provide liquidity to credit institutions. The monetary policy rate was cut from 2.5 percent in February 2020 down to 1.25 percent in January 2021. Inflation averaged 2.6 percent in 2020 but started accelerating in 2021 amidst rising energy prices and supply bottlenecks. The war in Ukraine contributed to inflation accelerating to 13.8 percent in April 2022, led by soaring electricity, gas, and central heating prices (up 40.8 percent). Food prices were up by 13.5 percent, with components such as milling products and edible oil prices increasing by 27.3 percent and 38.2 percent, respectively. Inflationary pressures prompted the NBR to gradually increase the policy rate to 3.75 percent in early May 2022. International energy prices have soared and are expected to rise more than 50 percent[10] in 2022 from already high price levels in 2021, with natural gas prices in Europe projected to more than double their 2021 levels. In response to this situation, the government capped energy prices (gas and electricity) to lower tariffs for minimum consumption thresholds for households and companies until March 2023. This will, however, add to fiscal pressures. The pressure on the exchange rate increased at the beginning of the war but subsided subsequently. The RON depreciated by 1.2 percent y-o-y against the Euro as of April 2022.

14. **The current account deficit (CAD) widened, driven by the deteriorating trade deficit.** During the pandemic, the CAD remained relatively stable compared to pre-pandemic trends, at around 5 percent of GDP, as imports contracted in line with exports. Trade volumes recovered in 2021 benefitting from the gradual reopening of the EU economies, but import recovery outpaced the export rebound, in part due to the recent global value chain disruptions and cost-push inflation adversely impacting trade. The deterioration of the primary and secondary income balance and external price increases added to the current account pressures, leading to a widening of the current account to 7.1 percent of GDP at end-2021. The CAD is primarily financed by a combination of FDI (around 2.5 percent of GDP), portfolio investment (around 1.3 percent of GDP) and capital account net inflows (around 2.2 percent of GDP). Foreign exchange reserves remained relatively stable and provided a cover

[10] Commodity Markets Outlook, World Bank, April 2022

of 4.2 months of imports of goods and services at end-March 2022 compared to 4.5 months at end-2019 prior to the pandemic.

15. **Following the increase in fiscal deficit during the pandemic, the authorities have started fiscal adjustments, but Russia's invasion of Ukraine is slowing down the consolidation efforts.** Romania had high structural fiscal deficits already prior to the pandemic and has been under the EU excessive fiscal deficit procedure since 2020. The increase in the public wage bill and pensions have primarily contributed to the widening structural fiscal deficit. Despite a lower fiscal stimulus than in other EU Member States, Romania's fiscal deficit surged to 9.3 percent of GDP at the end of 2020 and remained high in 2021 at 7.1 percent. The fiscal deficit decreased in 2021 supported by higher revenue collection, in line with the rebound in the economy, and a curtailment in spending, including a public wage freeze. The high deficits over the past two years added close to 15 percentage points to the public debt, increasing its stock from 35.3 percent of GDP in 2019 to 48.8 percent in 2021.

16. **The bank-dominated financial system remains sound and resilient.** The banking sector – which accounts for 56 percent of the financial system – has assets estimated at 53.5 percent of GDP (June 2021), less than half of peer countries (Poland, Hungary) and approximately a fifth of the EU-27 average. Financial intermediation is shallow in all segments, resulting in the lowest loan and deposit (26 and 37 percent of GDP, respectively, in 2020) penetration in the EU. The share of green assets in the banks' portfolios is currently at about 3 percent, less than half the Euro area average. The COVID-19 crisis stressed the financial system in Romania through the high exposure to government securities (mainly local-currency-denominated), which accounted for around 21 percent of the banking sector's aggregate assets, increasing bank portfolio sensitivity to interest rate changes. On a positive note, Romania's banking system's non-performing loan (NPL) ratio remained low at 3.8 percent at the end of 2020 and decreased marginally to 3.6 percent as of September 2021. The pre-pandemic non-performing loan coverage by provisions was well above the EU average and remained high at 65.7 percent as of September 2021 compared to the EU average of 44.3 percent. Romania remains vulnerable to capital flows fluctuations: FDI fell by 60.4 percent in 2020, mainly amid a drop in intercompany lending reflecting the adverse effects of the pandemic. However, FDI recovered to the pre-pandemic levels in absolute terms in 2021.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

17. **Romania's economy is projected to grow at 2.9 percent in 2022, with the pace of growth moderated by the spillovers from the war in Ukraine, and with risks tilted to the downside.** Romania's short-term growth prospects have been eroded by the Russian invasion of Ukraine and the associated sanctions, resulting in higher inflation, uncertainty, and further disruptions to supply chains. The growth outlook depends on the evolution of new COVID-19 variants amidst high vaccine hesitancy (only 50 percent of adults in Romania have received two vaccine doses, compared to the EU average of 83 percent, as of mid-April 2022); the dynamics of global prices and domestic inflation, especially related to energy and food; and the duration and severity of the war in Ukraine, and its impact on the European economy (Table 1). Structural reforms, especially in the energy sector, supported by this DPL are expected to boost investment, while adequate integration and inclusion of FDPs would help harness the medium-term growth-enhancing potential of migration by boosting Romania's declining labor force. Romania's capacity to increase its absorption of EU funds will be critical for a sustainable, green, and inclusive recovery, as the country is expected to receive up to EUR80 billion in EU funding by 2027 (37 percent of 2020 GDP)

under the Resilience and Recovery Facility (RRF), the multiannual financial framework 2021-2027 and other programs.

18. **Inflation is expected to remain elevated over the medium term due to energy and food price pressures.** Inflation is expected to remain high in 2022, averaging about 12.7 percent, driven by the recent spike in energy prices and second-round effects stemming from the impact of the war in Ukraine. Energy accounts for around 13 percent and food for nearly 40 percent of Romania's average consumer basket, with higher prices risking an increase in the already high poverty rates. Currently, Romania imports around 20 percent of its gas consumption, mainly from Russia, especially during the winter months. An additional impact could come from the supply disruption of agricultural commodities and fertilizers due to the war in Ukraine and sanctions on Russia and Belarus, putting pressure on food prices. Romania's imports from Ukraine averaged 7 percent of total agricultural raw materials imports from 2017 to 2019. At the same time, Romania itself is a top producer and exporter of wheat, corn and sunflower in the EU. Unless the war in Ukraine is significantly prolonged, the price pressures are expected to moderate in the medium term.

Table 1. Romania: Key Economic Indicators (% of GDP unless indicated otherwise)

	2018	2019	2020	2021e	2022f	2023f	2024f
Real economy							
GDP nominal in US$, billions	241.5	249.9	249.5	284.1	295.7	324.9	348.6
Real GDP growth	4.5	4.2	-3.7	5.9	2.9	3.7	3.9
Private consumption	7.7	3.9	-5.1	7.9	3.9	4.8	4.9
Public consumption	6.8	7.9	5.9	6.8	7.1	5.4	5.3
Gross Fixed Capital Investment	-1.1	12.9	4.1	2.3	4.9	8.1	8.2
Exports, Goods and Services	5.3	5.4	-9.4	12.5	5.3	6.5	6.8
Imports, Goods and Services	8.6	8.6	-5.2	14.6	7.4	8.3	8.4
Unemployment rate (ILO definition)	5.3	4.9	6.1	5.6			
GDP deflator (2015 = 100)	113.9	121.6	126.3	132.9	138.7	144.5	148.5
Selected monetary accounts							
Base money (% change) 1/	11.6	17.8	21.9	20.5	…	…	…
Credit to nongovernment (%change, y-o-y)	8	6.6	5.5	14.8	…	…	…
Interest (key policy rate, in percent) 2/	2.5	2.5	1.5	1.75	3.75	…	…
CPI (% change, avg.)	4.6	3.8	2.6	5.1	12.7	8.6	4.2
Balance of payments							
Current account balance	-4.6	-4.9	-5	-7.1	-7.2	-6.3	-5.7
Exports (goods)	30.2	28.3	26.3	29.2	31.6	31.7	32.1
Imports (goods)	37.7	36.3	34.9	38.9	42.2	42.3	42.8
FDI	2.3	2.2	0.9	2.3	1.8	2.3	2.3
Gross Reserves (in EUR billions) 3/	36.8	37.5	42.5	45.8	…	…	…
in months of next year's imports	4.8	4.5	5.6	4.9	…	…	…
in percent of short-term external debt	116.6	105.6	127.8	124.8	…	…	…
Exchange rate (RON/EUR, average)	4.65	4.75	4.84	4.92	…	…	…

Source: Ministry of Finance; National Bank of Romania; Eurostat; IMF; Bank staff estimates. As of late May 2022.
Legend: 1/ Comprises currency in circulation plus overnight deposits; 2/ as of May 2022; 3/End of Period

19. **The current account deficit remains elevated in 2022 but is projected to decline in the medium term.** The spillovers from the war in Ukraine are affecting Romania's trade mainly through higher import prices, mainly for energy and food, and second-round effects. The direct impact is expected to be limited, as Russia accounted for only 1.5 percent of Romania's exports of goods and 3.2 percent of imports from 2017 to 2020. However, the second-round effects could be substantial, given the importance of Russian gas to some of Romania's main trading partners, mainly Germany. The secondary income surplus may decrease reflecting lower remittances from major EU economies, while the primary income balance may benefit from companies relocating operations to Romania

in the context of the war in Ukraine. In the medium term, the CAD is expected to converge to the pre-pandemic, pre-invasion levels, as import price growth eventually decelerates.

20. Medium-term fiscal consolidation remains critical, but a reduction of the fiscal deficit in 2022 is not imminent due to additional fiscal pressures resulting from the war and the high energy and food prices. Government spending is expected to increase this year for a number of items, in particular the direct costs related to the influx of FDPs (estimated at 0.53 percent of 2022 GDP, assuming that 12-15 percent of FDPs remain in Romania)[11], increased spending for poorer households to protect them from the high food prices and, to some extent, the cost of energy subsidies to shield households and firms (although most of this cost will be borne by the energy companies). In this context, the EU is expected to cover part of these costs and a high EU funds absorption rate would alleviate some of the short- and medium-term fiscal pressures. As the COVID-19 crisis has subsided in recent months, public spending to limit its health and economic consequences is expected to decline considerably unless a new wave hits the country. Renewed attention to fiscal consolidation efforts is needed, particularly aimed at reducing inefficient expenditures and strengthening revenue mobilization, as Romania has the second lowest tax revenues in GDP in the EU, at around 27 percent in 2020. Reforming the pension system and the public sector wage and employment framework; introducing elements of performance budgeting; eliminating tax loopholes; and strengthening tax administration are key for strengthening fiscal management and for placing the fiscal deficit on a sustainable downward medium and long-term path and stemming the increase in public debt. Prior to the invasion of Ukraine, the deadline to end the excessive deficit (specifically, to bring the fiscal deficit to below 3 percent of GDP under existing EU fiscal rules) was extended to 2024. Fiscal financing needs are projected at 13.5 percent of GDP in 2022, with most of the financing coming from domestic sources. Disbursements by bilateral and multilateral creditors are projected at 0.9 percent of GDP, and the proposed operation accounts for 0.18 percent of the 2021 GDP (Table 2). Further external financing will come from the EU under the National Recovery and Resilience Plan (NRRP) and commercial creditors.[12]

21. The debt sustainability analysis indicates that public debt will gradually stabilize in the baseline scenario. Public debt is assessed as sustainable and is projected to gradually stabilize, reaching 53.2 percent of GDP by end-2024 in the baseline scenario, below the 60 percent threshold set forth by the Maastricht Criteria.

[11] World Bank Staff estimates. The share of FDPs that remain in Romania has varied between 12 and 15 percent since the start of the war in Ukraine. The estimated cost of the provision of services to FDPs includes the estimated cost of housing (0.09 percent of 2022 GDP), daily allowance for food and water (0.09 percent), benefits for the host communities (0.20), access to education (0.06), health (0.03) and other services (0.06), including transport, social assistance, psychological help, special needs for disabled FDPs, etc. The fiscal cost of providing services to FDPs (excluding investment costs) could vary from 0.1 percent to 1.7 percent of 2022 GDP, assuming that the number of FDPs remaining in Romania varies from 25,000 to 500,000, respectively. The estimated cost of 0.53 percent of GDP assumes 150,000 FDPs remain in Romania. The Romanian Government is making arrangements to host up to 500,000 FDPs. Romania is likely to also receive financial support to partly cover costs of FDPs from the EU, and other multilateral and bilateral donors as discussions take place in this respect. The European Commission (EC) has responded to the Ukraine crisis, both through a directive that grants refuge to those seeking protection from the war and through financial and technical support to member states as they respond to the arrival of FDPs. The EU has set up structures through which existing funds that have not yet been fully committed under the 2014-2020 Cohesion policy and Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU) initiative can be redeployed to support FDP populations. However, reprogramming and the need for reallocation of funds to assist people fleeing Ukraine reduces the magnitude of funds that are available to Romania for other development purposes, raising financing needs that would be partly supported through this DPF. Low absorption capacity also poses implementation challenges.

[12] The grant element of the NRRP and other EU financing is included under non-tax revenues while the loan share is included as a financing item.

Given the geopolitical situation in the region and the uncertainty surrounding its impacts, the projections are subject to a degree of uncertainty. Debt levels are most vulnerable to growth and primary deficit shocks: difficulties in containing the fiscal deficit could push public debt close to 56 percent of GDP by end-2024, while a combined macro shock (see Figure 1 and footnote 9) could raise public debt to around 63.5 percent of GDP. Relatively high shares of foreign-currency-denominated debt (51.3 percent at end-2021) present additional risks, although most non-local-currency-denominated debt is issued in Euros (43.4 of total public debt). In terms of maturity, the share of short-term debt[13] increased to 5.1 percent of total public debt in 2021 from 3.1 percent at end-2019 but remains significantly below levels registered during the financial crisis of 2008-09, continuing to mitigate refinancing risk. Interest rate risks are mitigated by the high share of debt with a fixed interest rate at 94.6 percent as of end-2021. Nevertheless, a volatile and uncertain economic and geopolitical environment coupled with existing macroeconomic vulnerabilities emphasizes the need for increased attention to the management of public debt over the medium term. The Government's debt management strategy for 2021 –2023 aims to diversify debt instruments in local currency, lengthen maturities, maintain a comfortable level of reserves and prepare to issue green bonds.

22. Romania's macroeconomic policy framework is adequate for this operation. The Government implements a macroeconomic policy mix aimed at reducing the fiscal deficit and containing imbalances, while advancing on the structural reforms. The Government's response to the impact of the COVID-19 pandemic was rapid and effective in spite of the limited fiscal space. While government support cushioned households' welfare and limited adverse consequences on the economy and the labor market, it also led to an increase in the fiscal deficit to a record high in 2020. Growth rebounded in 2021 and the Government consolidated its fiscal position. In response to inflationary pressures, the central bank raised policy rates. The Government remains committed to fiscal prudence, as evidenced by its commitment to undertake politically difficult reforms to public sector wages and pensions, which are supported under the second operation in this series. The Government is also mobilizing effectively to support the short-term needs and longer-term integration of FDPs from Ukraine and shield poor households from the high energy and food prices. The Government's commitment to the ambitions of the European Green Deal is evident in its efforts to increase the share of renewables and support energy efficiency and carbon sinks. Going forward, the key risk stems from the duration and intensity of the war in Ukraine. The risk is mitigated, in part, by the Government's efforts to maintain macroeconomic stability, support recovery, integrate the FDPs and build fiscal space.

[13] Below one year of maturity.

Table 2. Key Fiscal Indicators, (as % of GDP)

	2018	2019	2020	2021e	2022f	2023f	2024f
Total Revenues	**32.0**	**31.9**	**32.7**	**32.8**	**33.1**	**33.4**	**33.7**
Tax Revenues	26.7	26.7	27.0	27.7	28.2	28.5	28.8
Direct Revenues	4.9	4.8	4.7	4.9	10.4	10.6	10.7
Social Insurance Contributions	11.4	11.3	11.9	11.8	5.4	5.2	5.4
Taxes on Goods and Services	9.6	9.6	9.6	10.5	11.9	12.2	12.2
Taxes on International Trade	0.2	0.1	0.1	0.1	0.2	0.2	0.2
Other Taxes	0.8	1.0	0.8	0.5	0.5	0.5	0.5
Non-Tax Revenues	4.3	4.0	4.1	4.0	3.9	4.0	4.0
Other Revenues	1.0	1.2	1.6	1.1	1.0	0.9	0.9
Total Expenditures	**34.8**	**36.2**	**42.0**	**39.9**	**40.2**	**39.0**	**38.4**
Current Expenditures	30.7	31.6	36.0	34.4	34.6	33.6	32.9
Wages and Compensation	11.0	11.3	12.1	11.1	11.0	10.6	10.5
Goods and Services	5.2	5.6	6.0	5.9	5.7	5.6	5.6
Interest Payments	1.0	1.1	1.4	1.5	1.6	1.6	1.7
Current Transfers	13.2	13.3	15.5	15.9	16.3	15.8	15.1
Pensions	5.8	5.7	6.1	6.3	6.4	6.5	6.5
Capital Expenditures	2.7	3.5	4.6	4.4	4.9	5.0	5.1
Other Expenditures	1.4	1.1	1.4	1.1	0.7	0.4	0.4
General Government Balance	**-2.8**	**-4.3**	**-9.3**	**-7.1**	**-7.1**	**-5.6**	**-4.7**
Primary Balance	-1.8	-3.2	-7.9	-5.6	-5.5	-4.0	-3.0
Public Financing Needs	**7.4**	**8.6**	**14.1**	**11.1**	**13.5**	**11.7**	**10.2**
Fiscal Balance	2.8	4.3	9.3	7.1	7.1	5.6	4.7
Amortization	4.6	4.3	4.8	4.0	6.4	6.1	5.5
Public Financing Sources	**7.4**	**8.6**	**14.1**	**11.1**	**13.5**	**11.7**	**10.2**
Domestic	5.1	6.3	7.7	7.7	9.4	8.1	7.1
External	2.3	2.3	6.4	3.4	4.1	3.6	3.1
Government consolidated gross debt	**34.7**	**35.3**	**47.2**	**48.8**	**51.1**	**52.7**	**53.2**

Source: Eurostat, World Bank projections based on Ameco and MoF data
Note: Data on an accrual basis

Table 3. External Financing Requirements and Sources, (as % of GDP)

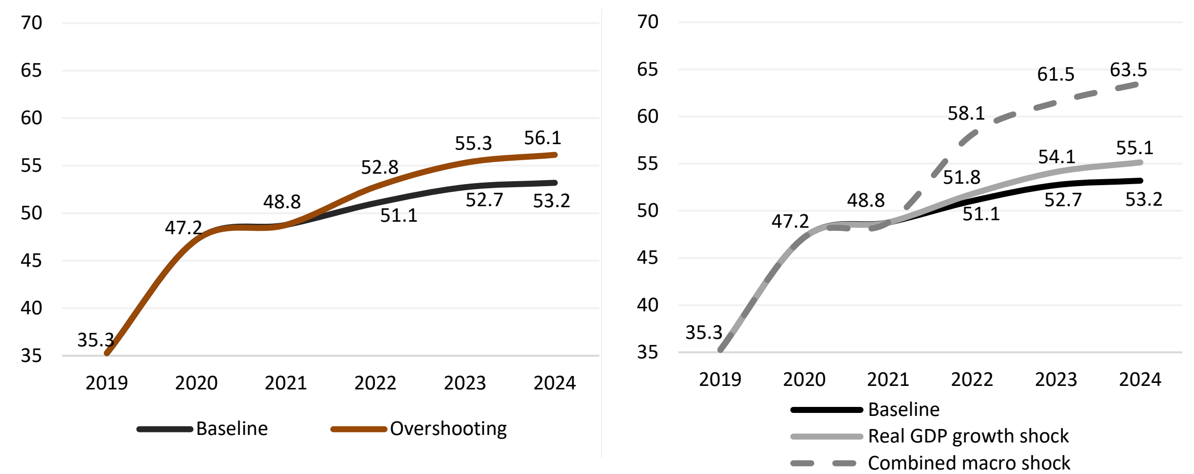
	2018	2019	2020	2021e	2022f	2023f	2024f
External Financing Needs	**27.2**	**25.9**	**28.2**	**28.0**	**26.3**	**23.8**	**21.8**
Current Account Deficit (positive number stands for deficit)	4.6	4.9	5.0	7.1	7.2	6.3	5.7
External Amortization	22.6	21.0	23.2	20.9	19.1	17.5	16.1
Financing Sources	**27.2**	**25.9**	**28.2**	**28.0**	**26.3**	**23.8**	**21.8**
External borrowing (new and debt rollover)	24.8	24.0	29.6	27.1	25.5	21.7	19.7
Foreign Direct Investment (net)	2.3	2.2	0.9	2.3	1.8	2.3	2.3
Change in Reserves (-)	0.1	-0.3	-2.3	-1.4	-1.0	-0.2	-0.2

Source: National Bank of Romania, European Commission, World Bank estimates and projections
Legend: External Financing Needs defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period

Figure 1. Romania Public Debt Sustainability

a. Public debt in % of GDP, under alternative fiscal overshooting scenario

b. Public debt in % of GDP, under different shocks



Source: World Bank simulations based on MoF and Eurostat historical data[14]

2.3. IMF RELATIONS

23. **The last IMF Article IV review for Romania was approved in August 2021.** The Article IV Staff Assessment acknowledged the role of the fiscal, monetary, and financial policy easing in helping to curb the economic downturn and keep unemployment muted. It also stressed the importance of successfully implementing the reforms supported by the National Recovery and Resilience Plan and investment projects to bolster Romania's medium-term growth prospects and support fiscal consolidation. An IMF Article IV assessment has been launched in February 2022, with a mission planned for June 2022 and IMF Board targeted for September 2022. The Bank and Fund teams collaborate closely on macroeconomic, fiscal and debt issues and hold regular discussions.

3. GOVERNMENT PROGRAM

24. **The Government's program for 2021-2024 aims to build a cohesive and open society that benefits from an improved education and health system, and from reduced inequalities between men and women and between urban and rural areas.** At an operational level, the Government's program aims to implement the reforms included in the NRRP. The NRRP is a Government document outlining its reform and investment priorities,

[14] The overshooting scenario reflects a fiscal deficit increase to 8.9 percent of GDP in 2022 due to difficulties in curbing government spending as planned and a higher deficit for 2022-2024 averaging 6.9 percent of the projected GDP. The real GDP shock scenario simulates a trajectory 1.5 p.p. below the baseline in 2022, 1.2 p.p. below in 2023 and an average GDP growth of 2.3 percent for 2022-2024. The combined macro shock reflects (a) a moderate economic recovery; (b) overshooting of the fiscal deficit; (c) a real exchange rate depreciation of about 13 percent (which equals the maximum 10-year average) in 2022; and (d) an interest rate hike of 331 basis points.

proposing programs and projects that support resilience and crisis preparedness and promote adaptability, sustainability and inclusive growth through major reforms and key investments. It is also a prerequisite for accessing funds from the European Resilience and Recovery Facility. The NRRP is primarily focused on six pillars: (i) green transition; (ii) digital transformation; (iii) smart, sustainable and inclusive growth; (iv) social and territorial cohesion; (v) health, and economic, social and institutional resilience; and (vi) policies for the next generation, children and the youth. The key reforms that will be undertaken in these six areas include pension reforms; judicial reforms; public administration reforms; tax reforms; reform of the social inclusion programs and the minimum wage; education and healthcare reforms; and decarbonization reforms, particularly in energy and transport.

25. **The Bank has been providing support to the Government of Romania in many of these key reform areas over several years, both prior to and during the formulation of the NRRP.** These include the decarbonization and climate resilience measures, the long-term renovation strategy, social inclusion measures, reforms in education and health sectors, and fiscal and pension reforms. Given the long-term engagement of the World Bank with the Government of Romania in these key sectors, the outputs of the Bank's technical assistance helped shape the Government priorities, which were then formalized in the NRRP. In addition, the European Commission has asked the Bank to support the NRRP implementation by providing technical assistance and just-in-time advice to the Ministry of European Investments and Projects, which coordinates and monitors the implementation of the Plan.

26. **The Government's program to support the FDPs from Ukraine was set up swiftly and is evolving.** The Government's coordination structure for the response to this humanitarian crisis was established on the first day of the war in Ukraine with the setting up of three task forces. These included: (i) the high-level decision-making Taskforce, (ii) an operational taskforce, called "Ukraine Commission"[15]; and (iii) a Humanitarian Assistance Strategic Coordination Group to focus on the strategic framework of humanitarian response and to facilitate the inter-agency cooperation among national, European and international partners. Romania has elected to structure its response to the FDP crisis through two layers of intervention: (i) Emergency Response, and (ii) Protection Response. The first layer of response essentially deals with providing immediate humanitarian aid to incoming FDPs while the second layer of response will be targeted at the medium- to longer-term integration of FDPs who plan to stay on in Romania. The plan for the second phase has been drafted and will be discussed with the Office of the United Nations High Commissioner for Human Rights, the European Commission, the Romanian Red Cross, United Nations High Commissioner for Refugees and other international agencies prior to adoption.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

27. **The proposed operation supports the Government in all of the six pillars of the NRRP, facilitating a larger absorption of EU Funds.** The measures implemented to facilitate the access of the FDPs to social services and the labor market and their integration in the host communities are aligned with the NRRP pillars of smart, sustainable and inclusive growth; social and territorial cohesion; health, and economic, social and institutional resilience; and policies for the next generation, children and the youth. The pensions, social assistance, public pay

[15] The establishment, functioning and duties of the "Ukraine Commission" was set up through the Government Decision no. 194/2022.

and budget reforms promote smart, sustainable and inclusive growth. The tax reforms advance the digitalization of the public sector, while the measures aimed at improving energy efficiency in buildings, promoting renewable energy, decarbonization and reforestation are in line with the green economy pillar of the NRRP, and will facilitate the absorption of EU Funds channeled under the RRF to incentivize the post pandemic economic growth and green transformation. The proposed operation is also contributing to the Government's program explicitly developed for FDPs from Ukraine.

28. **The design of this operation incorporates both general and country-specific lessons from past operations.** The 2019 Implementation Completion and Results Report (ICR) on the previous programmatic Fiscal Effectiveness and Growth (FEG) DPL series included the following lessons: (i) DPLs require Government ownership and leadership of reforms to ensure sustainability; (ii) legislative reforms supported by DPLs would benefit from outreach to relevant parliamentary commissions and inclusion of key parliamentarians in capacity building programs; (iii) the use of emergency ordinances could be more selective; (iv) the RAS program was critical for the design and implementation of the DPL program; and (v) reforms affecting market functioning should be contingent on the capacity of regulatory agencies to prevent market distortions. The following lessons have been incorporated in the current operation: it is underpinned by significant analytical work; capacity building efforts and technical assistance are being provided on most of the reforms, mostly through RAS and ASAs; and the DPL series is designed as a programmatic series to maintain reform momentum. However, given the emergency nature of some of the policy measures supported by this operation, those measures were promoted through emergency ordinances.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

29. **The proposed operation is structured under two pillars.** The first pillar aims to strengthen inclusion and fiscal management. In DPL1, the first pillar includes actions taken for the temporary protection of FDPs, provision of education and health services, housing, social assistance and access to the labor market. It also includes measures to support host communities by increasing the capacity of the Government by enabling hiring of additional staff at national and local levels. The first pillar also addresses structural inefficiencies in fiscal management that have contributed to Romania's fiscal imbalances, including measures to improve the tax and spending efficiency of the Government and sustainability of the pension system. Relevant measures include program-based budgeting and increased use of electronic platforms. The second pillar supports decarbonization and climate resilience. Under the first operation, supported measures include renovation of buildings to increase energy efficiency, amendments to the energy law to support greater private sector participation in renewables, and increased afforestation and reforestation.

30. **Technical assistance by development partners, including the World Bank Group, will be crucial for the reform implementation and sustainability.** Implementation capacity of the Government of Romania is limited. In addition to the World Bank, which provides technical and analytical assistance in most of the areas supported by the DPL series, the Government also works closely with the European Commission and other IFIs. The World Bank has several RAS agreements with the Government on many of the areas supported by the DPL series, such as wages, pensions, social assistance and labor, tax and budget reforms and the energy sector. In addition, the IMF provides technical assistance on modernizing tax administration. The Government of Romania also works with the European Bank for Reconstruction and Development and the European Investment Bank, especially on

infrastructure and projects supporting the green transition, whereas the World Bank provides complementary technical assistance in these areas.

31. **The first operation in the series incorporates emergency support to the Government of Romania given the influx of FDPs from Ukraine.** The humanitarian crisis unfolding as a result of the Russian invasion of Ukraine has resulted in a quarter of Ukraine's population fleeing their homes, making this the fastest growing refugee crisis since World War II. In response, the European Council announced (on March 4)[16] the establishment of Temporary Protection in EU member states (MS) in accordance with Directive 2001/55/EC, which provides minimum standards for giving temporary protection in the event of mass inflows of displaced persons for a period of up to 12 months, with automatic extension by six monthly periods for a maximum of one year. MS are required to transpose the European Council directive at the country level to support implementation. EU financing to support countries with FDPs remains to be articulated. The idea is to advance disbursement of EU cohesion funds to support additional financing needs.

Pillar I: Strengthening Inclusion and Fiscal Management

32. **In response to the influx of FDPs, the Romanian Government acted swiftly, passing a series of government decisions and emergency ordinances to host the FDPs.** Over 1,040,000 FDPs have entered Romania, of which about 115,000 have remained in the country (as of end-May 2022). The FDPs are, overwhelmingly, young, educated mothers with children. Currently, it is unclear what fraction of FDPs are of Roma origin. The Government Ordinances, inter alia, waived the requirement for COVID-19 tests/vaccines to enter Romania and removed the requirement for biometric or traditional passports (as many FDPs did not have passports, especially minors). In addition, the authorities mobilized their emergency response (led by the Ministry of Internal Affairs, Department of Emergency Situations and Inspectorate of Emergency Situations) and partnered with civil society organizations to provide services at the border, organize transport, and provide temporary and short-term accommodation across public and private providers. The Government also took measures to protect the most vulnerable, especially unaccompanied minors, elderly, and persons with disabilities. The FDP-related measures supported by the DPL series follow the building blocks of the Global Principles of Refugee Response[17], aiming to put forward durable but transitional solutions to enhance refugee self-reliance and ease pressures on host countries. For those FDPs who plan to stay for the longer term, the DPL series supports their long-term integration. At the institutional level, the Chancellery of the Prime Minister is coordinating the activities of the agencies involved in the management of the FDPs along with three task forces, which coordinate various functions.

Measures to grant legal status to FDPs and access to social services

DPL1, PA1: The Borrower has: (i) provided temporary protection to forcibly displaced persons from Ukraine ("FDPs from Ukraine") as evidenced by the Government Decision no. 367/2022; and (ii) enabled FDPs from Ukraine access to public services like health, education, housing and social assistance, particularly to vulnerable groups such as persons with disabilities, elderly and minors, as evidenced by the Emergency	**DPL2, Trigger 1:** The Borrower has established (i) an identity registry of FDPs from Ukraine and issued government recognized IDs; (ii) systems for access to the database of FDPs from Ukraine for relevant national and sub-national authorities; and (iii) consolidated service centers (One-Stop Shops) for

[16] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32022D0382
[17] United Nations Refugee Agency 2018. Global Compact on Refugees. https://www.unhcr.org/5c658aed4.pdf

Ordinance no. 15/2022, as amended by Emergency Ordinance no. 20/2022 and Emergency Ordinance no. 28/2022.	FDPs from Ukraine for registration and information dissemination. **DPL2, Trigger 2:** The Borrower has (i) adjusted the Social Reference Indicator (SRI), to incorporate indexation and an adequate SRI update; and (ii) adopted the regulations to implement the VMI (Minimum Inclusion Income Program –or Venitul Minim de Incluziune) law that provides protection to all low-income families in Romania that are in relative monetary poverty.

33. **Temporary protection and registration represent the first step in the process towards the access of FDPs to public services and labor markets.** Immediate access to public services is critical for FDPs, because of the trauma, harassment and impediments they have faced in their journey from Ukraine to Romania. Urgent access to health care is critical as FDPs have often travelled for many days and arrive cold and dehydrated with potential exposure to infectious diseases. The overcrowded conditions endured during their journey and in reception centers make them susceptible to infectious diseases. Care is also required for people with ongoing chronic health conditions, such as diabetes. Women escaping Ukraine need access to sexual and reproductive healthcare, including emergency obstetric care and they are also at risk of sexual and gender-based violence (GBV) and trafficking. Displaced children need access to intensive language learning, remedial support in foundational mathematics, literacy, accelerated education to enroll in the corresponding age grade, and psychosocial support to ensure smooth integration into formal schooling. Unaccompanied minors are immediately transferred into the care of the relevant child protection authorities, and suitable placement is identified for the disabled, elderly and people with urgent medical needs. Despite the efforts of the Government, one of the main obstacles facing FDPs is a lack of information at border crossings and in reception facilities, and language barriers. The Government is working on these aspects to make the process smoother.

34. **DPL1 supports the provision of temporary protection to FDPs in Romania.** The Government of Romania has adopted the legal provisions and measures to ensure the implementation of the EU Temporary Protection directive. In Romania, temporary protection is granted for a period of one year by the General Inspectorate for Immigrations, starting from March 3, 2022. It can be automatically extended for a period of 6 months and for a maximum of one year if the situation persists. The establishment of a Temporary Protection option for FDPs has been critical to ensure the right to reside. To date, only a small percent of FDPs have elected to apply for asylum and an alternative was required for FDPs to have the right to reside in Romania beyond the 90-day temporary visa period. Moreover, this measure enables the Government to collect basic demographic information on the FDPs. Currently, there are 15 one-stop shops (Migrant Integration Centers) that provide first point of contact and support to FDPs. Their service offer is currently limited to the provision of information on temporary protection and services and the FDP identification details that are being collected are also restricted to basic demographic data.

35. **The current operation also supports the Romanian Government's response to provide FDPs with access to public services, even prior to applying for temporary protection.** It grants FDPs access to medical care; access to the educational system for those under the age of 18; child protection and protection of people with disabilities;

housing; and other support and humanitarian assistance. In addition, a payment for food expenses in the amount of 20 lei/day/person is granted to individuals hosting foreign citizens or stateless people. National legislation was amended to grant humanitarian assistance with significant contributions and coordination among various ministries. Local authorities coordinated their efforts with the government agencies and developed their own operational plans based on local needs assessments. Essentially, the measures adopted by the Government provide free and unconditional access to public services. Many of the requirements to join educational institutions, access medical services and other support have been eased for the FDPs in the emergency response phase.

36. An accessible and detailed database on FDPs is needed for planning and hosting them for the longer term and will be supported by DPL2. Basic demographic information on FDPs, such as age, gender, address, contact numbers are collected at the time of registration of temporary protection or at the initiation of asylum.[18] However, the data required to plan for expanded social and municipal services is currently missing. There is therefore a need to promote solutions for integrated service delivery and digital solutions to facilitate access to services. The second operation in this DPL series will support the Government in the development of these systems to establish a detailed database of FDPs which will be accessible to relevant government ministries/agencies to enable them to plan for the provision of services in the longer term. It will also support the ramping up of the existing one-stop shops to enable provision of additional services/information. The user-centric focus of these centers would provide FDPs with the incentive to access them and therefore aid the Government in addressing gaps in the registration of FDPs.

37. DPL2 will also support the Government in the adoption of regulations to implement the VMI Law (Minimum Inclusion Income Program –or Venitul Minim de Incluziune (VMI)). On the more structural issues impeding inclusion in Romania, the social protection system is administratively burdensome and inefficient. Fragmentation of Romania's three means-tested benefits has limited their effectiveness in reducing poverty and strengthening shared prosperity, while limited incentives for employment, skills strengthening and links to job opportunities have negatively impacted the labor market participation of social assistance beneficiaries. The three programs have different eligibility thresholds, different social assistance units, different equivalence scales, and different implementation procedures. Parallel but unconnected delivery of these benefits without a shared database increases the system's administrative costs and beneficiaries' private costs (to apply, recertify and receive the benefit). As a result, the impact of social transfers in reducing poverty and inequality in Romania is among the lowest in EU countries: social assistance contributed a 16 percent decrease in the share of the population at risk of poverty, and a 7 percent decrease in the Gini coefficient of equivalized disposable income, compared to the EU average of 33 and 14 percent, respectively in 2020. Besides, the impact of the COVID-19 pandemic on the poor and vulnerable and the influx of FDPs from Ukraine could increase the share of households at risk of poverty. To resolve these inefficiencies, DPL2 will support the consolidation of two of the three means-tested programs into a single anti-poverty program (VMI) with a single eligibility criteria and administration procedure; increase the adequacy of the benefits and the coverage of the poor; and deliver on the targets of the approved Romania Poverty Reduction Strategy. The implementation of the VMI is expected to significantly improve the targeting efficiency and poverty impact of the social protection system in Romania. The simplification of the program for both beneficiaries and social workers is expected to improve the effectiveness and efficiency

[18] The EU data privacy laws govern the information collected.

of social assistance directed at households. The vast majority of the VMI beneficiaries are expected to be Roma and other vulnerable groups. Furthermore, a key element of the VMI program is the activation of adults by connecting them to the labor market and the activation of children by ensuring their school attendance. As a result, the VMI is expected to boost human capital and empower people to pursue their education and seek opportunities to lift themselves and their families out of poverty.

38. In addition, DPL2 supports the indexation of social benefits to maintain them at adequate levels. Launched in 2008, the Social Reference Indicator (SRI) was supposed to serve as a benchmark for indexing the values of different social protection benefits in a systematic manner. However, subsequent Governments did not follow the systematic SRI indexation. Some benefits were indexed in an ad-hoc manner based on the separate laws. Subsequently, some benefits shrank in value while others were disproportionally increased. The second operation supports the adoption of an adjusted SRI to maintain social benefits at an adequate level, which is expected to substantially advance the shared prosperity and poverty impacts of the social protection system in Romania.

39. Results: These reforms will help FDPs to reside legally in Romania with a government issued ID and also have a registry of all FDPs to enable various levels of Government to plan for the longer-term integration of FDPs. The reforms will also enable FDPs to access social services. The actions on social programs will support inclusion, in general, with increased access of low-income families in relative poverty to the Minimum Inclusion Income program.

Access to employment for FDPs

DPL1, PA2: The Borrower has established the procedures for the employment of FDPs from Ukraine by: (i) reducing barriers such as the requirement to hold work permits and work visa; (ii) eliminating skill recognition barriers; and (iii) enabling access to the unemployment insurance system, as evidenced by the Emergency Ordinance no. 20/2022.	**DPL2, Trigger 3**: The Borrower has (i) approved guidelines and information packages to support the access to public employment services for FDPs from Ukraine; and (ii) adopted measures to provide Romanian language classes to adult FDPs from Ukraine to foster their integration into the Romanian labor market.

40. To ensure full integration of FDPs in Romania, they will also need to be integrated into the labor market. Many of the FDPs do not have the required documentation on skills or work experience to get employed in Romania. Given that the majority of the FDPs are women, the gender dimension of employment will be crucial. The Gender Dimensions of Forced Displacement Research Report[19] recognizes that forced displacement, geographic location, race, ethnicity, and other characteristics interact to affect women's safety, experiences, and opportunities. In the context of Romania, despite having a robust legal framework to support gender equality, women's labor force participation is the third lowest among EU member states[20]. Care responsibilities and other family responsibilities are ranked the highest among the reasons why women are missing from the labor force in

[19] Klugman, Jeni. The Gender Dimensions of Forced Displacement: A Synthesis of New Research (English). Gender Dimensions of Forced Displacement Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/895601643214591612/The-Gender-Dimensions-of-Forced-Displacement-A-Synthesis-of-New-Research

[20] Eurostat, Datasource: LSFT_r_ergau for 2018-2020

Romania. Unfortunately, Romania has not reached either of the Barcelona targets[21] to have at least 33 percent of children below the age of three and 90 percent of children between the age of three and school age in childcare. Additionally, the labor market in Romania displays employment segregation, resulting in women resorting to typically unpaid, informal, and low return jobs, a demonstration of gender norms and stereotypes.[22] These underlying challenges of female labor force participation in Romania need to be acknowledged and addressed.[23]

41. **The current operation supports the Government's efforts to integrate FDPs from Ukraine into the Romanian labor market.** Several measures were adopted in March 2022 to reduce entry barriers to the labor market for FDPs. FDPs from Ukraine can now work in Romania without the need for a work permit and without observing the nine-month period in a year limit for an employment agreement, as under the normal rules. In addition, the right of residence for work purposes is extended without the need to obtain a long stay working visa. FDPs that do not have documents attesting to their professional qualifications or work experience can apply to Government employment agencies for support and registration. Also, they can work in Romania based on an affidavit in which they declare that they possess the appropriate professional training and experience in the field of activity in question and that they have no criminal record. FDPs will also have access to the unemployment insurance system in Romania.

42. **To enable longer-term integration of FDPs into the labor market, DPL2 supports their access to public employment services and language training.** Access to labor markets is critical for successful hosting of FDPs in protracted crises. In the longer term, labor market integration can include skills assessment to facilitate access to the labor market, training needs assessment, including language training, and the establishment of matching platforms to facilitate the connection between employers and FDPs. To support longer term access of FDPs to the Romanian labor market, DPL2 will support access of FDPs to public employment services (like active labor market programs, job matching services and others) and Romanian language training for adults.

43. **Results**: The actions supported by the DPL series in this area will help FDPs access and be integrated into the Romanian labor market with many of them in employment.

Support to host communities and FDPs

DPL1, PA3: The Borrower has enabled hiring of government staff without competition for a period of up to three (3) years (or till ninety (90) days after the end of the situation that generates a massive influx of FDPs from Ukraine) to support scaled up services in migration and crisis management and the provision of social services at the central and local levels, as evidenced by the Emergency Ordinance no. 15/2022, as amended, and the Emergency Ordinance no. 20/2022.	**DPL2, Trigger 4**: The Borrower has approved integrated measures in the hosting schools for (i) FDPs from Ukraine and host community students to benefit equally from funding and other amenities; and (ii) FDPs from Ukraine and host community teachers to benefit equally from teacher training facilities.

[21] Targets agreed by the Council of Europe on the development of childcare facilities for young children with a view to increase female labour participation, strike a work-life balance for working parents and bring about sustainable and inclusive growth in Europe
[22] Friedrich Ebert Stiftung Report (2021), Economic Gender Inequalities in Romania.
[23] In addition, LGBTI people in Romania also face discrimination and exclusion in the labor market (Fundamental Rights Agency (2020), A long way to go for LGBTI equality).

44. **In a global context of protracted crises and protracted forcible displacement, early actions to support FDPs and host communities are critical.** Recognition of the immediate humanitarian needs created by forced displacement is well understood and largely managed by receiving countries with support from relevant United Nations (UN) and international actors. However, increasingly it is recognized that there is an urgency to focus on the long-term development impacts in refugee hosting communities, given the protracted nature of most crises.[24] Significant refugee inflows can strain service delivery in host communities and increase tensions due to potential food insecurity, additional strains on service delivery and competition for limited housing and economic opportunities. Appropriately designed policies and investments directed to both FDPs and host communities that address these stresses can generate positive development outcomes. Failure to consider the needs of both FDPs as well as the hosting communities can reduce social cohesion and result in negative outcomes for both groups.

45. **The current operation supports the Government's efforts to enable hiring of additional staff to maintain adequate levels of public service delivery to host communities and FDPs.** The provision of social assistance to FDPs (supported by the DPL) reduces tension between FDPs and host groups.[25] In addition, the Government has passed an emergency ordinance that enables them to hire staff without competition for a specified period of time which may not exceed 90 days after the cessation of armed conflict in Ukraine (but not exceeding three years from the entry into force of Emergency Ordinance no. 20/2022). This would enable the Government to support scaled up service delivery needs and crisis management services, including additional border and immigration staff, social support at local levels and emergency management support. This will help the Government address the immediate needs arising from the influx of FDPs while maintaining adequate service delivery to host communities.

46. **DPL2 supports integrated measures in FDP-hosting schools that ensure that benefits accrue to both hosts and FDPs.** In the longer term, it will be important to ensure that additional benefits accruing to FDPs also aid host communities. In line with global principles of refugee response, it is important to integrate FDPs into host communities from the beginning of their arrival, especially, given that most forced displacements tend to be protracted. It is important to help FDPs access economic opportunities so that they do not remain dependent on unpredictable relief and aid. It is also critical to invest in host communities, to address long-standing development issues, and strengthen service delivery. It is important to avoid the creation or reinforcement of parallel systems. In line with these principles, the Government of Romania is planning for long term integration of FDPs from Ukraine. The second operation in this programmatic series supports integrated measures in FDP hosting schools to ensure that FDPs and hosts benefit equally from increased funding and other amenities such as accelerated education programs, remedial programs, and teacher training opportunities.

47. **Results**: The actions supported in this area will enable the government to scale up its service delivery to cater to the needs of increased number of people. It will also help host communities to benefit from the support measures put in place in schools for FDPs, thereby strengthening FDP integration and inclusion. One of the areas will be schools wherein both host and FDP teachers will benefit from additional training being provided.

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[24] Globally, three-quarters of refugees are displaced for more than 5 years, which underscores the importance of planning for medium to long-term actions to address potential issues associated with forced displacement.
[25] Coniglio, Nicola Daniele, Vitorocco Peragine, and Davide Vurchio. 2022. "The Geography of Displacement, FDPs' Camps and Social Conflicts."

Tax and spending efficiency

DPL1, PA4: The Borrower has adopted regulations to: (i) implement program-based budgeting, as evidenced by the Government Decision no. 467/2022; (ii) make it compulsory for Romanian companies to register in the electronic platform of the Borrower's Ministry of Finance and the National Agency for Fiscal Administration, as evidenced by Ordinance no. 11/2021; and (iii) implement the national system for electronic invoicing, as evidenced by the Emergency Ordinance no. 120/2021.	**DPL2, Trigger 5**: The Borrower has: (i) published in the Official Gazette the amendments to the Unitary Pay Law ensuring that further wage increases and existing inequities are addressed in a fiscally sustainable manner; and (ii) taken appropriate measures to reduce preferential tax regimes and exemptions for various taxpayer categories thereby reducing tax expenditures and improving tax coverage.

48. The current operation supports the introduction of program-based budgeting in the central administration. While the current framework for the annual budget is clear, the policy content and the results orientation of the budget need to be considerably strengthened. Despite improvements, planning/ policy prioritization and budgeting remain largely disconnected. To strengthen the results orientation of the budget, the Government has embarked on a bold set of reforms. The objectives of the reform are to improve the planning and budgeting of government policies. In the first stage, in early 2022 a series of institutional strategic planning and budgeting methodologies and mechanisms have been adopted linking policies to budget programming[26] and procedural and institutional adjustments were made to strengthen the system of ex-ante and ex-post regulatory impact analysis. As a result, a new policy planning and budgeting system will be gradually put in place in all ministries. All line ministries are expected to have planned their budgets based on programs and at least three ministries should also have executed/implemented budgets on programs by June 2025 and all ministries by end-2026.

49. DPL1 also supports the Government's efforts to mandate companies to register through the electronic platform and implement the system for electronic invoicing, thereby supporting the digital transition. The tax authorities have established the Virtual Private Space, an electronic platform of the Ministry of Finance and Tax Agency for all communication and transactions related to taxes. Although this platform has been in existence since 2014, it was primarily used by households for the communication and payment of taxes with the Tax Agency. The current operation supports the Government's efforts in making it mandatory for all firms to communicate on all tax related matters only through the electronic platform.[27] This includes submission of forms as well as payments and all forms of communication.[28] This effort is likely to reduce the administrative burden of paying taxes for companies while supporting increased use of digital platforms as well as reduced use of paper. In addition, this operation also supports the mandatory use of the national system for electronic invoicing by all companies offering goods and services to the public sector (business-to-government).[29]Electronic invoicing is likely to lead to improvements in the transparency of the government procurement processes and will allow the monitoring of

[26] Government Decision no. 427 of March 29, 2022, approving the methodological framework for the design, monitoring, reporting and review of the Institutional Strategic Plans of ministries and Government Decision no. 467 of April 6, 2022, approving the methodology for program-based budget preparation and execution.
[27] Implemented through Government Decision no. 11 of August 30, 2021, amending Law no. 207 of 2015 on the Fiscal Procedure Code.
[28] The use of this electronic platform for individuals remains voluntary.
[29] Implemented through Government Emergency Ordinance no. 120 of October 4, 2021, regarding the management, operation, and implementation of the national system for electronic invoicing.

public acquisitions and the execution of budgets in real time. Starting in 2023, the Government intends to extend the application of electronic invoicing also to business-to-business transactions. The Government expects a reduction in tax fraud and evasion from the implementation of these measures.

50. **DPL2 supports the adoption of a wage law that will be critical to manage the wage bill and increase transparency.** The compensation of public sector employees constitutes the largest spending category in the budget, accounting for 11.3 percent of GDP in 2021. It has increased from 7.8 percent in 2015 and is well above the EU average of 10.1 percent of GDP. In 2021, it accounted for more than a third of the Government's revenues. The public sector pay system also lacks horizontal equity. Although, the Pay Law no. 153 of 2017 increased gross pay and made it more competitive, some sectors and institutions benefited more than the others. Pay transparency also remains a challenge due to ad-hoc decisions and exemptions. The expansion of the wage bill was to a large extent driven by the dynamics of variable pay, following the introduction of new bonuses and allowances through the Pay Law in 2017 and other decisions afterwards. Due to the numerous amendments to and exemptions from the Pay Law, pay procedures are less transparent than before 2017. In the Central Government, the share of variable pay varies and is growing in most sectors, approaching 40 percent of the base pay overall. The share of the variable pay is unusually high in some sectors. Meanwhile, public employment has been on an upward trend but is not large relative to the EU average. DPL2 supports a comprehensive pay reform through the amendment of the Unitary Pay Law which will address many of the issues with the existing system. Complementary technical assistance is being provided through a RAS on public sector wages.

51. **DPL2 will also support the Government in reducing tax exemptions.** The extensive preferential tax regimes and exemptions for various labor categories (IT, construction, self-employed) and microenterprises, reduced VAT rates, and relatively low tax rates which were further cut in recent years, have diminished the tax base considerably and led to significant revenue losses. The second operation in this programmatic series will also support the Government's efforts in reducing tax expenditures.

52. **Results**: The measures supported in this area will result in better management of public sector wages and increase in government tax and spending efficiency. The introduction of program budgeting will improve spending efficiency, leading to better public investment projects, with higher economic returns.

Pensions

DPL1, PA5: The Borrower has increased the employee contributions under Pillar II of pensions to support sustainability of the pension system, as evidenced by the Emergency Ordinance no. 23/2022.	**DPL2, Trigger 6:** The Borrower has approved the new Public Pension Law to ensure the sustainability of the public pensions system and address existing inequities.

53. **Public pensions accounted for 6.3 percent of GDP in 2021 and are another significant source of spending for the Government.** The pension system runs a deficit of 2 percent of GDP and this deficit is likely to increase to over 5 percent if Law no. 127 of 2019 is implemented as envisaged. The current pension benefit formula is complex, non-transparent and it leads to significant inequities among different cohorts of pensioners. The new benefit formula envisaged by Law no. 127 of 2019 simplifies the benefit formula and resolves some of the inequities in the current system but is likely unaffordable. The reform of the pension system with the objective of making it sustainable, equitable and rules-based is key for strengthening the fiscal management of the

Government. The current pension system in Romania comprises three pillars. Pillar 1 is a defined benefit system financed through social insurance contributions paid primarily by workers, and with transfers from the state budget. The system is financed on a pay-as-you-go basis. Pillar 2 is a fully funded mandatory private defined contribution system with a minimum investment return guarantee and based on the principle of individual accounts. Pillar 3 is a fully funded voluntary private defined contribution system based on the principle of individual accounts.

54. The current operation supports the Government's efforts to increase employee contributions under Pillar 2 of the pension system. An increase in employee contributions under Pillar 2 of the pension system from 3.75 to 4.75 percent (effective January 1, 2023) will reduce the points system contribution rate in Pillar 1 because eligible workers pay a total of 25 percent of their wage for the two pillars combined. The increase in employee contributions is mandatory only for workers under 35 years of age or new entrants to the labor market. As the population ages, it will be important to increase the stability, role and contribution of Pillar 2 to ensure adequacy of pension benefits. The goal should be to keep the target replacement ratio from Pillars 1 and 2 combined the same. This means that younger cohorts of workers will need to save more through Pillar 2 than current elderly workers. Over the past years, the Government's policy towards Pillar 2 has been erratic and the target contribution rate for Pillar 2 of 6 percent has not been reached so far. In fact, in 2018, the contribution rate was reduced to 3.75 percent from 5.1 percent in 2017. The current Government is committed to substantive pension reforms, including Pillar 2, and the operation supports these reforms. In addition, the Government has also undertaken regulatory reforms to allow for greater diversification of pension system assets, which is likely to both improve rates of return on participant Pillar 2 accounts and reduce overall investment risk.

55. DPL2 will support the adoption of a new Public Pension Law to strengthen the management of the pension system and to address existing inequities. The current benefit formula is inequitable and non-transparent and complicates the introduction of a new benefit formula through Law no. 127 of 2019. This is because the benefit formula for new pensioners is not a function of the point value as it is for existing pensioners. No adjustment to the benefit formula was made to account for the sharp increase in 2018 in the gross average wage. In addition, the impact of the new benefit formula proposed in the 2019 law is unaffordable. This is because it tops up benefits for all to the highest level achieved by any recent retirees; for purposes of calculating benefits, it effectively decreases the definition of the "full contribution period" for everyone to 25 years from the current 35-year target; it increases pensions by up to 40 percent for many old-age and disability pensioners and may freeze benefits for some period of time for more recent retirees. There are also incentives for early retirement for many types of workers, affecting the sustainability and equity of the pension system. Finally, there is no clearly articulated pension system strategy for the whole system and each of its three pillars. The new pension law supported by DPL2 will help address these deficiencies in the public pension system. Complementary technical assistance is also being provided through a RAS on pensions.

56. Results: The reforms in this area will improve the equity of the pension system and strengthen pension management. The results indicator will capture the benefits from the adoption of a rules-based indexation of pensions. Also, the increase in the employee contributions to the second pension pillar will support the sustainability of the pension system.

Pillar II: Fostering Decarbonization and Climate Resilience

57. **In line with the European Green Deal, the Government of Romania is taking steps to achieve climate neutrality by 2050 and increase energy independence.** The second pillar fosters decarbonization and climate resilience by tackling key gaps in the legislative framework with respect to renewables, the strengthening of energy efficiency in buildings and deepening of carbon sinks. The support to increased investments in renewables and other fuels like green hydrogen and optimizing energy consumption through energy efficiency measures will contribute to the Government's efforts to achieve its international commitments on climate change and increase resilience and adaptation to climate change. It will support preparedness of the energy sector to reduced and more extreme rainfall patterns by diversification of the energy matrix with renewables and less dependence on hydro power. It will also support adaptation through increased energy efficiency in buildings. These measures will also reduce energy imports, a key part of the current energy crisis context.

58. **Achieving climate neutrality by 2050 will also require a transition towards a green economy.** Climate neutrality can only be achieved through a structural transformation facilitating the creation of new green markets and businesses founded on low-carbon productive processes. Renewable energy will play a key role in the process. The policy actions supported by Pillar II will enable the shift to a green economy and boost green growth, by (i) increasing the availability of green electricity and low carbon fuels, to fuel productive processes; (ii) improving energy efficiency, with spillovers on the country's competitiveness and energy prices through a reduction in the use of expensive generation units and imports; (iii) attracting private sector investment; and (iv) facilitating the use of EU funds, mainly the RRF and the Modernization Fund.

<u>Renewable energy and private capital mobilization</u>

DPL1, PA6: The Borrower has approved amendments to the Law on Electricity and Natural Gas to support renewables and private sector participation in the sector by: (i) enabling hedging and bilateral contracts that protect renewable energy developers from market price volatility; (ii) incorporating balancing and market flexibility measures (such as allowing the participation of active consumers in flexibility mechanisms) to increase the capacity of the energy sector to manage larger shares of renewable energy; and (iii) incentivizing the deployment of smart metering, as evidenced by the Emergency Ordinance no. 143/2021.	**DPL2, Trigger 7:** The Borrower has approved measures to scale-up green hydrogen and other low carbon fuels. **DPL2, Trigger 8:** The Borrower has approved an offshore wind framework for the development and operation of offshore wind farms.

59. **Romania has set the objective of adding over 7,000 MW of renewable energy capacity to offset the committed decommissioning of coal-fired plants and to increase the share of renewables in overall electricity generation.** The decommissioning of 4,590 MW of coal-fired power plants will require additional generation capacity to offset the capacity lost. The 2021-2030 Integrated National Energy and Climate Plan (INECP) sets the objective to add 2,302 MW of onshore wind, 3,692 of solar and 1,088 MW of hydro power capacity to the electricity generation mix. To achieve these goals, Romania needs to attract private investment to the sector, allow further flexibility in the operation of the power system and ensure increased participation of demand-side solutions in the stability of the network. The INECP estimates the country's investment needs in the energy sector

at EUR22.6 billion by 2030. Therefore, private sector investment in renewables will be needed, given the large financing needs. While renewables attracted private investments in the past, the pace has stagnated over the last seven years, as a result of regulatory setbacks. Moreover, the incremental share of variable renewable energy in the system and the energy challenges stemming from the energy crisis will require a more flexible and efficient management of the energy system, incorporating new technologies for system balancing and increased participation of demand-side management (DSM) solutions. Adequate DSM tools will also reduce the need for additional electricity supply and infrastructure, improve the management of the power system and reduce the overall system's operational costs. In addition, renewable energy will contribute to the climate change adaptation of the power sector, in the context of declining and more extreme rainfall patterns, limiting the dependence on hydro power generation (currently at about 25 percent of the total electricity generation) both from the demand and supply sides.

60. DPL1 supports reforms to the Electricity and Natural Gas Law to improve the investment environment for the private sector and demand-side participation in the electricity sector. One of the main barriers for private sector participation in capital-intensive renewables is the need to have long-term stability of cash-flows to make the projects bankable. The electricity market is volatile and specific mechanisms like supplier/end-user bilateral agreements or hedging instruments are needed to stabilize prices for power generators, making renewable projects bankable. The Ministry of Energy has approved and submitted to parliament the amendments to the Energy Law to encourage private sector participation in renewables and sector efficiency by, inter alia (i) allowing hedging and bilateral contracts which will reduce the exposure of private investment to market price volatility; (ii) incorporating demand-side capacities to balance the market and to add flexibility to the system, to ensure greater transparency in market participation and to increase the system's capacity to manage larger shares of variable renewable energy; (iii) empowering consumers' participation in the sector by defining the role of active consumers, energy communities, prosumers, aggregators and energy storage providers, and recognizing them as market participants; (iv) introducing dynamic price contracts (hourly tariffs) for end-consumers to enhance their response to market price signals; and (v) incentivizing the deployment of smart metering infrastructure, as an enabling technology for demand participation in the system. In addition, the Government along with partners such as the EC and the WBG is working on optimizing the overall public-private-partnership (PPP) framework to further support private sector participation in infrastructure sectors.

61. The second DPL in the series will support measures for the scale-up of green hydrogen and other low carbon fuels. Accelerating the decarbonization of the economy will require actions beyond the electricity sector. Hard-to-abate and energy-intensive sectors require technological solutions to transition to green alternatives, when electrification is not viable. Low-carbon fuels like hydrogen are expected to become the alternative to conventional fuels in sectors like industry, heating and freight transport, and may potentially become an economic booster for regions impacted by the energy transition. The second operation will support regulatory changes to enable a hydrogen industry and hydrogen ready infrastructure in Romania.

62. DPL2 will also support the adoption of measures to develop offshore wind farms. Offshore wind is a promising technology to tap into the wind resource in the Black Sea. However, it requires specific regulations to develop, including the management of concessions in the seabed, compatibility with other sea uses and rights, and specific infrastructure. The second operation will support the adoption of a framework that will support the development of offshore wind investments in the Black Sea.

63. **Results:** The reforms supported in this area will enable the contracting of additional renewable capacity. The contracting of renewable energy will translate into the installation of additional renewable energy capacity and increased private sector participation in renewables, enabling the mobilization of private capital.

Energy efficiency and renovation of the building stock

DPL1, PA 7: The Borrower, through its Ministry of Development, Public Works and Administration, has approved: (i) an increase in the ambition of energy renovation measures to reduce heating energy consumption by at least fifty (50) percent in multi-family apartment buildings (MABs); and (ii) the rules and conditions for enabling energy efficiency and resilience renovations in MABs and in public buildings, as evidenced by Orders nos. 440, 441, 442, 443, and 444/2022.	**DPL2, Trigger 9:** The Borrower has adopted national energy efficiency regulations setting energy efficiency requirements and actions to be incorporated in key energy-intensive sectors of the economy.

64. **Romania has set ambitious targets to reduce primary energy consumption and the renovation of buildings has been identified as a critical initiative to meet these targets.** Energy intensity in Romania is above the European average and the energy efficiency potential is still untapped. Only modest progress has been achieved in the past decade on energy efficiency (56 percent of its 2020 energy savings target so far), but Romania has now committed to reducing primary energy consumption by 37.5 percent[30] by 2030, above the EU target of 32.5 percent. The building sector accounts for 42 percent of final energy consumption, with residential buildings accounting for more than 90 percent of the built-up area, followed by educational buildings and commercial buildings.[31] The Government has put special focus on renovating Multi-family Apartment Buildings (MABs), which represent approximately 40 percent of the building stock. Romania prepared the Long-Term Renovation Strategy (LTRS) to lay out a realistic and implementable strategy to meet the objectives of achieving energy efficiency in buildings. The LTRS aims at decarbonizing the whole building stock by 2050 and estimates the aggregate investment needs in building renovation by 2030 at EUR12.8 billion. The European Commission will provide sizeable resources to enable investments in the sector. But it will also be important for the Government to attract the private sector by undertaking regulatory reforms to address existing barriers.

65. **The current operation supports the adoption of the regulations for the renovation of MABs and public buildings to improve energy efficiency and for streamlining access to relevant EU funds.** The operation supports an update to the regulations for increasing the energy performance of apartment buildings, expanding the list of expenditures that shall be eligible to support moderate or deep renovation and the eligibility requirements to participate in public energy renovation programs that aim to achieve a minimum of 50 percent reduction in the final energy consumption, for space heating of MABs built before 31 December 2005. The operation also supports the approval of eligibility conditions for accessing European funds related to the NRRP, thus accelerating the absorption of EU funds. In addition, the operation supports the renovation of the building stock, related to (i)

[30] 2021-2030 Integrated National Energy and Climate Plan
[31] World Bank. 2021. *Reimbursable Advisory Services Agreement on Consolidation of the Strategic Planning Capacity of the Ministry of Development, Public Works and Administration for Renovation of the National Building Stock for Energy Efficiency and Seismic Risk in Romania (P169420)*

Integrated renovation (Seismic Consolidation and Moderate Energy Renovation) of MABs, (ii) Moderate energy renovation of MABs for communities at risk of poverty and social exclusion, (iii) Moderate or deep energy renovation of MABs, (iv) Integrated renovation (seismic consolidation and moderate energy renovation) of public buildings and (v) Moderate or deep energy renovation of public buildings. Better insulation of buildings as part of the Renovation Wave will better adapt the building stock to expected temperature increases as result of climate change.

66. **DPL2 will support the adoption of energy efficiency regulations to reduce energy consumption beyond the renovation of the building stock.** Coordinated action in different sectors is required to achieve energy-consumption-reduction goals and reduce aggregate energy intensity of the country. While the first DPL in the series focuses on interventions in buildings, the second DPL will support the approval of energy efficiency regulations, which will raise the level of ambition of Romania in energy efficiency and prioritize it to achieve overarching climate targets focusing on energy efficiency measures in hard-to-abate sectors like transport, ICT (like data centers), industry, heating and cooling, residential sector (i.e., incentivize behavioral change) and the public sector.

67. **Results**: The actions supported in this area will accelerate the renovation of the building stock with energy efficiency measures. These measures will reduce energy consumption and improve the adaptation of the building stock to the increase in temperatures resulting from climate change.

Forests

DPL1, PA8: The Borrower has adopted a legal framework providing incentives to accelerate afforestation and reforestation on certain categories of land, as evidenced by the Emergency Ordinance no. 35/2022.	**DPL2, Trigger 10**: The Borrower has adopted measures laying down binding rules for afforestation and reforestation.

68. **In the past few years, Romania has seen increasing levels of deforestation**. The area under forested degraded agricultural land has steadily decreased from 2,355 ha in 2014 to less than 200 ha in 2020. This has resulted in severe surface and wind erosion in these areas. Romania needs to increase the area under forest vegetation to enable the rehabilitation of these tracts of land. In addition, forested areas also act as carbon sinks and support emissions reduction. Given their critical role in climate mitigation and adaptation, the Government is committed to increasing afforestation activities.

69. **The current operation supports the Government's efforts on afforestation and reforestation.** It provides a legal framework for providing incentives to accelerate afforestation and reforestation efforts on different categories of land. These include the following: agricultural lands in the categories of use of arable land, permanent meadows and permanent crops; lands in the national forest fund, which were affected by forest fires, natural calamity, pest infestations and catastrophic events; and for the installation of forest curtains for the protection and maintenance of the plantations. The financial incentives will be provided to landowners who could be individuals or legal entities or administrative-territorial units, will be approved by the Ministry of Environment, Waters and Forests and will be monitored by the Central Public Authority for Environmental Protection. Under the assumption that 10,000 hectares will be afforested and reforested in 2022 and another 15,000 hectares in 2023, the incentives will cost Euro 4.56 million in 2022 and Euro 6.84 million in 2023 (the costs are marginal). The

Government plans to reforest and afforest another 31,000 hectares between 2024-2026 under similar terms. The PA will support climate change mitigation through sustainable forest management activities that increase carbon stocks and reduces the impact of forestry activities, enabling also reduction of emissions from the deforestation or degradation of ecosystems. Furthermore, the afforestation programs would also support adaptation, with treed slopes reducing rainfall run-off (and flood risks) as well as landslide risk and integrating wildfire risk management (depending on the types of trees, inclusion of fire breaks).

70. DPL2 will support the adoption of implementation guidelines to lay down binding rules for afforestation and reforestation. These rules will enable more concerted efforts at afforestation and reforestation through the amendment of forest management plans, provisions for the use of forest land, and the methodology for the approval of the annual windthrow harvesting quota. It will also include details on the composition, schemes and technologies for forest regeneration and afforestation of degraded land together with the norms for overall forest management.

71. Results: The reforms supported in this area will increase the land surface to be afforested or reforested, Increasing the forestry coverage will support climate adaptation and mitigation efforts.

72. This operation is underpinned by extensive analytical work. The prior actions of this operation are supported by analytical work prepared by the WBG and are complemented by additional work undertaken by the Government and other development partners. The Government proactively draws upon the WBG's analytical work and technical assistance to formulate the key reform programs (Table 4).

Table 4: DPF Prior Actions and Analytical Underpinnings

Prior Actions	**Analytical Underpinnings**
Pillar I: Strengthen Inclusion and Fiscal Management	
Prior action #1, #2, and #3 (collectively focused on FDPs and Host Communities)	• **Refugee Policy Review Framework Technical Note (2021) World Bank** *link*. The review and framework build on experience on forced displacement and development and highlights the criticality of support towards host communities to manage the shock of refugee inflows as well as actions to reduce the vulnerabilities of FDPs. The technical note highlights five critical policy dimensions: i) Support to host communities, including ensuring adequate public resources, promoting social cohesion and preparedness for hosting; ii) Regulatory and governance measures ensuring legal status of FDPs, access to civil registration and documentation, justice and security; iii) Economic opportunities through freedom of movement, right to work, and access to housing and financial services; iv) access to national services for education, health, social protection, and protection of vulnerable groups; and v) cross-sectorial actions to reduce gender based barriers to access services and economic activity and social inclusion. • **Forcibly Displaced (2017), World Bank Group.** *link.* This report highlights the context of forced displacement with more than 50 percent of FDPs, displaced for more than four years. The report examines how to support host communities to manage the sudden inflows of large numbers of FDPs, and the pressures to expand services, create jobs and address intractable development issues. It also

	underscores the importance of collaboration between humanitarian and development actors, and the need to prepare early for long lasting solutions. • **The Impact of Forced Displacement on Host Communities: A Review of the Empirical Literature in Economics. (2019) World Bank**. *link.* The report reviews 49 empirical studies across 17 forced displacement crises to understand the impact on household wellbeing, prices, employment and wages, and concludes that in most cases positive outcomes for host communities can be expected. • **The Economic and Fiscal Effects of Granting Refugees Formal Labor Market Access (2018) Center for Global Development Working Paper 496.** *link* The report argues that granting formal access to the labor market has the potential to create substantial benefits for FDPs and their host communities. *The key recommendation is to ensure planning beyond the emergency response to prepare early for long lasting solutions, for both FDPs and host communities, and the importance of collaboration between humanitarian and development actors.*
Prior action #4 (Tax and spending efficiency)	• The RAS on **Strengthening Planning and Budgeting Capacity** I (*P156889*) and II (P168605) have provided technical assistance to the General Secretariat of the Government, Ministry of Finance and line ministries to strengthen the linkages between policy planning and budgeting and gradually introduce elements of program-based budgeting. The RAS on the **Development of the Capacity of the Central Public Administration to Carry Out Impact Studies** (*P156807* and subsequent extensions) has helped selected public sector institutions to conduct ex-ante impact assessments for policy changes. The **Support to the Establishment of a Strategy Unit** (*P154787*) RAS has helped the Government to strengthen the strategic planning function in the Center of Government. *The key recommendation is to align the allocation of public resources with results by moving from an input-based budgeting process to a performance-based one.*
Prior action #5 (Pensions)	• The RAS on **Support for the Operationalization of Social Protection Reforms in the National Recovery and Resilience Plan** (P178551) with the Ministry of Labor and Social Solidarity and the RAS on **Pensions Capacity Building** (P177723) with the Ministry of Finance, provide technical assistance to the two ministries to assess the challenges of the public pension system, conduct simulations for the impact of various policy reform options and provide input for the overhauling of the legal framework for the public pensions in Romania. • *The key recommendations are to address the inequity aspects of the current pension system, where otherwise similar cohorts of pensioners receive different pensions function of the retirement date and introduce rules-based indexation formulas.*
Pillar II: Foster Decarbonization and Climate Resilience	
Prior action #6 (Renewable energy and private capital mobilization)	• The EU trust funded activity **Internal Energy Market and Energy Transition in Romania - (P175774)**, supports the Ministry of Energy, the Competition Council and the Energy Regulatory Authority ANRE in implementing measures to improve the competition in energy markets and the energy transition, in areas like offshore wind, green hydrogen or demand-side management.
Prior action #7 (Energy Efficiency)	• The EU trust funded activity **Technical Assistance Facility to Support Renovation Wave under Cohesion Policy in Select EU Member States (P177061)**, currently under implementation, supports the design of financial mechanisms and provision of technical assistance to overcome key capacity gaps and bottlenecks to accelerate the renovation of the building stock with energy efficiency measures.

	• The RAS **Consolidation of the Strategic Planning Capacity of the Ministry of Development, Public Works and Administration for Renovation of the National Building Stock for Energy Efficiency and Seismic Risk in Romania (P169420)**, supported the MRDPWA to design the Long-Term Renovation Strategy of the building stock which establishes the analytical foundation and draws the actions to renovate the building stock with energy efficiency measures. *The key recommendations include the development of specific financial mechanisms and renovation schemes, to facilitate access to financial resources to end beneficiaries.*
Prior action #8 (Forests)	• World Bank, **Forest Sector Rapid Assessment, Romania** Climate Change and Low Carbon Green Growth Program, 2014 • **Annual report on the state of the environment in Romania in 2020**, Ministry of Environment, Waters and Forests, National Agency for Environmental Protection • **Forest Status Report for 2019**, Ministry of Environment, Waters and Forests • United Nations Economic Commission for Europe (UNECE) **- Romania Environmental Performance Third Review**, 2021 *Key recommendations to reverse the effects of climate change are sustainable forest management, including the fight against illegal logging, and afforestation of abandoned agricultural areas, which require effective national and EU funding.*

4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

73. **This DPL series underpins the overarching objective of the Country Partnership Framework (FY19-23) on strengthening institutions as well as the three focus areas.**[32] These three areas include: (i) ensuring equal opportunities for all; (ii) catalyzing private sector growth and competitiveness; and (iii) building resilience to shocks. The selectivity of financing of IBRD in Romania as above GDI is aligned with selectivity filters referenced above. The first pillar of the DPL series seeks to ensure inclusive access to public services for FDPs and host communities, in light of the influx of displaced people as a result of the Russian invasion of Ukraine. The pillar also supports structural reforms to improve the Government's fiscal position. This operation supports the Government's efforts in providing FDPs from Ukraine with the right to reside in the country, access public services and the labor market and receive other assistance from the Government of Romania, while also supporting host communities. In addition, improvements in the pension system, tax and spending efficiency and increased use of digital platforms will increase the fiscal space to enable further redistribution while maintaining fiscal sustainability. The second pillar supports decarbonization and private sector growth. Reforms in the current operation will support increased energy efficiency in buildings, higher private sector participation in renewables, and a larger area under forest cover. These activities will enable Romania to build resilience to climate related shocks.

74. **This operation supports Romania's progress towards the WBG's Twin Goals of ending extreme poverty and promoting shared prosperity.** Increased support to and integration of FDPs from Ukraine into the Romanian society will help them become self-reliant and enable them to get employed. This will help them sustain

[32] Report No. 126154-RO, discussed by Board of Executive Directors on May 21, 2018.

themselves and provide for their families. Pension, tax and spending reforms will enable efficient use of fiscal resources and increased fiscal space. This will help the Government increase fiscal buffers and improve public spending which will be beneficial for the poor and those in the bottom 40 percent of the population. Efforts aimed at decarbonization and increased forest cover will support a reduction in extreme weather events which typically impact the poor and vulnerable to a larger extent. Finally, increased private sector participation in renewables and building renovations will provide jobs while also supporting the transition to net zero emissions.

75. Other WBG operations/activities complementing the proposed DPL series include: (a) the RAS on Improving the Tax Framework in Romania in the context of the National Recovery and Resilience Plan (P178899), in advanced preparation, which will support the tax reform of the Government with analysis of policy options, costing and impact; (b) the ongoing analytical work on the Government's Support for Fossil Fuels in Romania (P178096) assesses the level and distribution of the subsidies to fossil fuels in the country with the purpose of guiding future decarbonization policy dialogue; (c) the Trust Fund Romania: Modernizing the Intergovernmental Transfers System (P176830), financed by the EU under the Technical Support Instrument (TSI) program, supports the Government's effort to modernize the intergovernmental fiscal transfer system in order to improve its efficiency, predictability and transparency; and (d) IFC's technical, legal and financial pre-assessment study for developing a new hospital in the Municipality of Ploiesti through a PPP. In addition, the Country Climate and Development Report (CCDR) for Romania will be prepared over the next few months and the DPL team will work closely with the CCDR team.

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

76. Romania's policy making process is broadly consultative and inclusive. The Government generally follows a consultative policymaking process with policies going through public scrutiny. Policies are screened for compliance by relevant public bodies, such as the Legislative Council or the Constitutional Court, by regulatory agencies or by consultative bodies, such as the Economic and Social unit of the Fiscal Council, and extensive public consultations with relevant stakeholders are carried out in general prior to their adoption. The European Commission holds regular exchanges with the Government on the status of the implementation of the NRRP. All draft policies are uploaded on the Government website and the initiating ministry holds stakeholder consultations through workshops. Stakeholders can provide comments during workshops and/or send their comments through digital platforms which are then taken into account, to the extent possible, by the authorities. With the exception of the emergency measures to support FDPs, the reforms supported by this operation have gone through prior consultations with relevant stakeholders. On the fiscal reforms being supported by the Government, consultations were held with the business community, academia, and the European Commission. Measures supporting energy efficiency, and renewables were also extensively discussed with the EC and the communities impacted. On forests, consultations took place with the civil society and local governments.

77. On the measures related to the FDPs, the Government works closely with the UN agencies and the NGO community, thereby benefiting from their feedback, guidance, and support. The current forms of communication essentially include websites and dedicated call centers that support FDPs and help address their issues. In addition, the World Bank is conducting weekly qualitative interviews (user journey mapping tool) to understand the challenges and obstacles FDPs face when accessing services, and to identify evolving needs and service gaps. The findings from these interviews are used to inform the Government's counterparts and other stakeholders to improve service effectiveness. Given the dynamic nature of the crisis, these approaches were established to allow for rapid feedback. This approach will be further enhanced through the establishment of one-stop shops under DPL2.

78. Coordination with development partners. Collaboration between the IMF and the World Bank staff is effective with regular consultations on macroeconomic, debt management, financial sector, and structural issues. Another development partner closely engaged in the policy areas supported by this DPL series is the European Commission. The World Bank and the EC coordinate in the areas of fiscal reforms and the green and digital transition. As part of the preparation of this programmatic series, the task team also consulted extensively with the NGO sector, academia, and the business community.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

79. Overall, the policy reforms supported by this operation are expected to have positive effects on Romanian households' welfare in the long run with some short-term costs associated with some of the actions under both Pillar I and Pillar II. Under Pillar I, the provision of basic services and access to the labor market for FDPs from Ukraine can have positive impacts on their welfare. However, such measures might crowd out services and increase job competition for Romanians in host communities, especially those in rural and lagging regions where existing services and job opportunities are limited. PA#4 on improving the fiscal position of the Government under Pillar I can potentially open up additional fiscal space for social spending. The actions supported by Pillar II are likely to improve the quality of life for all segments of the population, especially communities living in polluted areas, and in energy-inefficient buildings in the long run. However, some sections of the community (like renters in MABs) could be negatively impacted.

80. Under Pillar I, the actions taken by the Government are expected to have positive effects on the wellbeing of FDPs, while potentially mitigating the negative effects on host communities. According to a recent survey in Romania,[33] 68 percent of respondents have a serious health condition, 79 percent are with at least one child, almost every respondent has at least one elderly person and 60 percent want to work. Therefore, PAs #1 and #2, providing them with healthcare, education, housing, social assistance and opportunities in the labor market, will have positive effects. Access to the labor market will also reduce women's risk to sexual harassment, exploitation and human trafficking that arises from lack of income.[34] However, childcare facilities will be needed to support female FDPs' participation in the labor market. The support measures can be more impactful when accounting for the diverse needs between transiting FDPs who need transportation assistance, urgent healthcare, and temporary lodging while staying FDPs might need more support on school enrolment, longer-term housing, healthcare, and social assistance. Meanwhile, research confirms that provision of social assistance to both FDPs and hosts reduces tensions between them. The Government's support to host communities in PA#3 is also through hiring of additional temporary government staff so that service delivery to host communities can be maintained. This is especially important in communities hosting refugees where the existing level of service provision is low or

[33] International Organization for Migration (IOM) Displacement Tracking Matrix survey.

[34] The Government is also in the process of developing an abuse and exploitation risk prevention package including information material, public training, information campaigns and the establishment of a working group to prevent sexual exploitation, abuse and the risks associated with human trafficking.

under pressure from increased demand. The influx of FDPs can put additional pressure on local service delivery as well as increase job competition. Findings from the March 2022 World Bank Rapid Assessment Survey show that 22 percent of Romanians are concerned about the crowding out of public services as a results of FDP arrivals while about 10 percent expressed concerns about increased job competition. It will be important for the Government to also increase investment and support job creation in host communities.[35] In addition, it is equally important that the Government undertake extensive communication and outreach activities and consultations with FDPs and host communities, first and foremost to identify the needs, and also to evaluate the satisfaction with services delivered. The Government has established a task force to oversee the integration of the FDPs and representatives of the local communities are a part of the task force and they have provided inputs into the integration plan. The integration plan contains a set of short- and long-term measures regarding information on the rights, obligations and facilities available to the FDPs from Ukraine; prevention of the risks of abuse and exploitation; identification of the needs and facilitation of access to services (health, education, social assistance) and the labor market, including information and training of Romanian employers on how to hire FDPs from Ukraine; an inventory of FDP's competences and qualifications; provision of housing in existing buildings owned by the central and local government; the rehabilitation and/or renovation of unused buildings in which FDPs can be accommodated; and the construction of new housing facilities, among others.

81. The pension reform envisioned under PA#5 is not likely to affect poverty in Romania. An increase in employee contribution under Pillar 2 of the pension system will reduce the points system contribution in Pillar 1 because eligible workers pay a total of 25 percent of their wage for Pillars 1 and 2 combined. An analysis conducted under the RAS on Romania Pension Capacity Building shows that the expected net effects on the overall pension benefits is minimal. The increase in employee contribution under Pillar 2 is mandatory only for workers under 35 years of age, so it does not affect older cohorts.

82. The transition to renewables and improved energy efficiency is likely to improve the welfare of Romanians in the long run. As documented in the literature, climate change and environmental degradation disproportionately affect the poor and vulnerable.[36] Hence, these measures are likely to improve their wellbeing in the long run. Also, the transition to renewables and energy efficiency renovation can help create jobs, spur technological innovation, and increase climate resilience.

83. The short-term price effects of renewables on Romanian energy consumers are expected to be negligible while the energy efficiency and afforestation measures will have a positive effect. Renewables are one of the cheapest sources of energy, and upfront investment costs have declined because of technological improvements. As a result, the move to renewables can lower energy costs for consumers. Also, the introduction of dynamic pricing (hourly pricing) to consumers supported by PA#6 provides varied prices at different hours of the day to incentivize consumers to vary energy consumption accordingly to reduce their energy bills. Energy renovation of MABs in PA#7 can bring benefits to owners and renters through multiple channels: monetary channels (lower monthly energy bill) and non-monetary channels (thermal comfort and possibly health). Energy renovation may also increase property prices and bring positive wealth impacts for owners (majority of the units are owned). However, this can potentially increase rental prices with adverse effects on MAB renters.

[35] It will be important to ensure non-discrimination in accordance with national and EU law.

[36] See, for example, Hallegatte et al. (2016). *Shock Waves – Managing the Impacts of Climate Changes on Poverty*; Skoufias et al. (2011). "The Poverty Impacts of Climate Changes: A Review of the Evidence". World Bank Policy Research Working Paper No. 5622.

Nevertheless, it is important to note that, according to Eurostat in 2020, Romania has the highest rate of home ownership in the EU, and only 3.9 percent of the population are renters. Moreover, only a subset of renters is subject to a potential increase in rental prices. In Romania, rental prices are often fixed or indexed to inflation. Thus, only renters with new contracts or short-term contracts are affected while renters with long-term contracts are unlikely to see a significant change in rental prices. Incentives to accelerate afforestation and reforestation in PA#8 can have small positive financial effects for forest landowners (through the incentives) and improve air quality for the overall population in the long term.

84. Several prior actions provide direct strong support to women and marginalized groups. PA#1 and #2 provide temporary protection and access to social services and employment to FDPs from Ukraine, majority of which are women and who will be the sole provider for their families. Measures supported by this operation provide them with access to medical care, schooling, child protection, housing, and other humanitarian assistance. With 48 percent of FDP respondents reported to be with at least one disabled person, this operation also supports protection to people with disabilities. While providing these services, it will be important to ensure adherence to non-discrimination in accordance with EU and national laws.

5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

85. The Pillar I prior actions of this operation are expected to have neutral or positive effects on the environment, forests, and other natural resources. The first three prior actions under Pillar I will ensure the right for FDPs to reside in Romania and access social services and the labor market. Such actions help mitigate the potential adverse environmental effects associated with FDP-affected areas like subsistence use of the environment to meet basic needs (firewood collection) and unregulated waste disposal or water use. The access of FDPs to services and assistance reduces the risk of establishment of unregulated FDP camps. PA#4 encourages switching to e-invoicing, reducing the overall environmental implications of processing invoices, reducing paper and ink use (as most ink is toxic, when the paper biodegrades, if left behind it can be damaging to the environment). In addition, companies that send and receive electronic documents also help cut down on fossil fuel pollution from mailing and shipping. Nevertheless, electronic waste (IT equipment) would have to be properly managed and discarded to avoid any potential negative environmental effects.

86. The Pillar II policy and institutional reforms have significant positive effects while the implementation related potential negative environmental effects in the medium- to long-term can be dealt with by Romania given its existing legal framework.

- PA #6 will help generate low-carbon energy and will also reduce some types of air pollution. These measures will not only have environmental benefits but will also have positive effects on health and human capital. There are concerns that the implementation of these policies (investments in the installation and operation of the renewable energy systems) could potentially result in negative environmental effects associated with land use, solid waste and e-waste, and bird and bat death due to collisions with wind turbines. On balance, the Romanian legislation is well placed to effectively mitigate this. To this end, Romania's Environmental Impact Assessment (EIA) regulatory system mandates appropriate mitigation measures such as seasonal/hourly halting of selected wind turbines when representing a risk to birds (migration season), landscape impact assessment, implementation of adequate waste management protocols and supervision, ex-ante identification of indigenous protected fauna and flora and impact mitigation plans during construction and operation. Regarding the potential impact on agricultural land, land competition mainly concerns large solar installations in rural land. Rooftop solar installation in residential and industrial areas may not compete with agricultural land. According to WB data, Romania counts with over 134.000 sq Km of agricultural land. The Government aims at installing 5,054 MW by 2030, which would require about 50-150 sq km of land. At this point, the land competition for agricultural uses may not be of concern. Moreover, the need for establishing public consultations and ESIAs for new projects, and lease/buy land agreements, mitigate potential risks in this regard.

- PA #7 will result in energy efficient buildings, thereby reducing energy use and associated GHG emissions due to the reduced reliance on fossil fuels. The waste generated from the renovation works could imply negative environmental effects, which can be managed through existing legislation. Romania has adequate waste management legislation in place and is implementing regional integrated municipal waste management systems that mitigate potential issues raised by improper activities related to the construction, demolition, and renovation works. The inspections by local authorities of construction and demolition waste could be strengthened, and actions are being taken to fill the current legal gaps.
- PA #8 on incentives to accelerate afforestation and reforestation will contribute to both climate change mitigation and adaptation. It will increase long-term carbon storage within forests and will help balance the overall national GHG emissions. It will further help to restore ecosystem integrity and enhance forest cover in Romania. To mitigate any implementation-related potential negative effects of afforestation and reforestation on biodiversity, interventions in these areas will need to be sustainable regarding the selection of trees and related pest management to preserve the habitat-specific type and species and minimize implications on the environment. Romania's current regulations on forest regeneration and afforestation, coupled with the secondary legislation to be adopted under DPL2, could effectively support the mitigation of the above-mentioned negative effects.

87. **Over the last decade, Romania has made significant progress in revising its regulatory and compliance assurance mechanisms and institutions, including integrated environmental permitting and the EIA legal framework.** Changes have been introduced to permitting and licensing to align the national system with EU legislation. The relevant authorities have been reorganized and new legislation was introduced for integrated environmental permits. Currently, the existing regulatory framework covers all necessary aspects of conducting Strategic Environmental Assessment (SEA) and EIA in an integrated manner, including the preparation of environmental management plans along with the requirements on information dissemination and public participation in decision making. With the publication in December 2018 of the Law no. 292 on the assessment of the impact of certain public and private projects on the environment, which represents the transposition of EU Directive 2014/52, the mainstreaming of an EA process into projects is fully harmonized with the EU directives on EA.

88. **The waste management and chemicals sector have an advanced environmental policy and legal framework, smoothing the path towards sustainable development, but further strengthening of enforcement and monitoring are still needed.** Romania has introduced many of the principles of modern waste management systems, despite the challenging additional tasks for the Government, municipalities, companies and individuals linked to the evolving nature of the EU environmental legislation and policy. Principles of prioritization of waste

generation prevention and its reuse or recovery from disposal are anchored in the legal system but implementation needs to be strengthened. Also, weak enforcement and monitoring due to improper allocation of resources, absence of a long-term vision, shared responsibilities across government institutions, and low technical capacity of central and local governments, undermines effectiveness. However, there are multiple ongoing efforts within the Government to accelerate the transition to a circular economy. Furthermore, Romania plans to use NRRP funds to further improve its waste management governance and accelerate the expansion and modernization of its waste management systems through investments on separate collection, prevention, reduction, re-use and recovery to comply with the applicable EU legislation and transition to the circular economy.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

89. The country's Public Financial Management (PFM) system has been strengthened in the past few years. Romania has modernized its PFM system over the last 20 years and initiatives are envisaged in areas such as strengthening strategic planning and budgeting, revenue administration and public investment management. The most recent IMF Fiscal Transparency Evaluation[37] report found that Romania performs well in the Fiscal Transparency Code benchmarking and recommended strengthening budget planning and policy orientation. Romania's general Government budget is made publicly available in printed form and on the external website of the MoF[38]. Budget execution is generally well-organized, with clear guidelines, regulations, and timelines, but there is potential for streamlining and further automating procedures supported by more effective preventive controls. Reporting and accounting functions are based on well-developed policies, including a unified budget classification and Chart of Accounts; however, despite the recent implementation of a national reporting system, manual intervention for collection, verification, and validation of financial information is still practiced, which limits timely operational outputs and analysis. While well-regulated, the effectiveness of the internal public auditing is affected by systemic capacity constraints, particularly at the local level. External public auditing is being reformed to fully observe the international standards and contribute to strengthening the public financial management. Its main areas of focus remain updating its legislative and methodological framework, strengthening performance audits, digitalization of audit processes and enhanced communication of findings to stakeholders.

90. Public procurement (PP) in Romania is governed by four laws which transpose the 2014 EU Directives. These include Law no. 98 on public procurement, Law no. 99 on utilities, Law no. 100 on concessions and Law no. 101 on the remedies system adopted in 2016. The legislative package was adopted in 2016 and is supplemented by implementing rules adopted by Government decision. Instructions are issued by the National Agency for Public Procurement (ANAP), which holds the regulatory function, whenever there is need to clarify the applicability of the legislative provisions and a web-based guide was developed as a primary source of guidance and in-depth practical information for the contracting authorities with a clear focus on the procurement planning. An improved e-Procurement system (SEAP) administered by the Authority for Digitalization (ADR) is in place since April 2018 with 99 percent of the procurement volume being managed through the system. The National Office for

[37] *Romania: Fiscal Transparency Evaluation*, IMF, March 2015 *http://www.imf.org/en/Publications/CR/Issues/2016/12/31/Romania-Fiscal-Transparency-Evaluation-42775*
[38] *Buget 2022 - Acasa - MFP (gov.ro)*

Centralized Procurement (ONAC) was set up in 2018 with the scope to run centralized procurement for selected categories of products and services on behalf of other public authorities. Three regional centralized procurement bodies have also been recently set up and started their activity.

91. **In 2020, the Bank assessed Romania's public procurement system and the impact of the national PP strategy adopted in 2015.** The goal of the assessment was to analyze the effectiveness of the public procurement framework in Romania after the introduction of the new public procurement legislation and to formulate recommendations for improvement that would help with the creation of an action plan. The assessment included four key areas: procurement cycle and market practices; capacity development; monitoring, oversight and control; and integrity and transparency of the public procurement system. The key recommendations referred to i) the need to ensure the strategic oversight of the public procurement system and the adoption of decisions informed by the latest analysis of performance of the entire system at country, regional and local level; ii) the need to ensure a stable and predictable legislative framework and proper public consultations whenever changes are needed; iii) the opportunities to expand the scope and scale of centralized procurement by creating sectoral and/or regional centralized procurement units; iv) the opportunities to expand the understanding of environmentally and socially responsible procurement across all contracting authorities; v) the implementation of the competency framework for public procurement and continuation of the capacity development program. A new public procurement strategy and action plan are currently being prepared by ANAP with Bank's support.

92. **The control and oversight framework of the National Bank of Romania (NBR) can be relied upon to account for the World Bank`s financing proceeds.** The latest 2014 update of the 2011 IMF Safeguards Assessment, found that the safeguards framework at the NBR remains robust. The NBR continues to publish its audited financial statements as part of the annual reports and maintains strong controls over management of foreign reserves, government banking, and vault operations, particularly relevant in the context of the post-pandemic fiscal consolidation. The latest publicly available audit reports had an unmodified (clean) opinion on the preparation and presentation of the NBR`s financial statements for 2016–2020.[39]

93. **Disbursement.** The proposed loan and grant will follow the World Bank`s standard disbursement procedures for development policy operations. Loan and grant proceeds will be disbursed in a single tranche, pro-rated in the event of partial withdrawals of the single tranche, to the foreign currency national budget account at the NBR, which forms part of the country's foreign currency reserves and budget management system and channels other financing as well. Disbursements will not be linked to specific purchases, and no evidence will be needed to support disbursement, nor will procurement requirements be necessary. The loan proceeds will be used in accordance with the public debt legislation, while the grant proceeds will be used in line with the public finance legislation. If loan and grant proceeds are used for purposes defined as ineligible in the Financing Agreements, the World Bank, upon notice, will require the Borrower to refund such amount promptly, and such amount shall be cancelled.

94. **Reporting and auditing.** Considering the World Bank's knowledge of the PFM systems, the ongoing improvements of these systems and the latest IMF assessment of the NBR, the World Bank will not require an

[39] *https://bnr.ro/PublicationDocuments.aspx?icid=3043*

audit for the proposed operation. The Borrower will provide confirmation to the World Bank on the amounts deposited in the foreign currency account within 30 days of receiving the funds. The front-end fee for the loan will be covered from the Borrower's own sources.

95. **Closing date.** The closing date of the proposed operation will be September 30, 2023.

96. **This assessment concludes that the fiduciary risk for the operation is moderate.** This rating appreciates the robustness of the PFM system and ongoing reforms, and the reliability of the NBR control framework.

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

97. **The MoF leads the effort in coordinating the overall implementation of the DPL.** The MoF has experience and is conversant with World Bank policies and procedures through lending, RAS and TA operations. Given the history of budget lending operations in Romania, some institutional capacity has been built up on data requirements and overall monitoring arrangements. Romania is a subscriber to the Fund's Special Data Dissemination Standard Plus (SDDS Plus) since November 2019. In addition, data is generally available through the MoF and the central bank's website. The World Bank team will continue to provide support to the Government in monitoring the reform progress and results. The monitoring of the results will be coordinated by the MoF which has a dedicated team for overseeing project implementation. The team works in coordination with the relevant ministries and agencies participating in the program (see below). The MoF team has extensive experience in working on DPLs and has played a similar monitoring role in the past.

98. **The World Bank team works closely with relevant ministries and agencies to monitor progress.** This includes the MoF, the NBR, the Chancellery of the Prime Minister, Ministry of Labor and Social Solidarity, Ministry of Education, Ministry of Energy, Ministry of Environment, Water and Forests, Ministry of Internal Affairs, Ministry of Development, Public Works and Administration and other relevant ministries.

99. **Grievance Redress.** Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

6. SUMMARY OF RISKS AND MITIGATION

100. **The overall risk rating for this operation is moderate.** Among the risk categories, political and governance risk is deemed to be substantial, technical design risk is low, while all other risk categories are rated as moderate, including 'other risks' related to the spillovers from the war in Ukraine (Table 5).

101. **Political and governance risk is substantial.** In recent years there have been frequent changes in political leadership because of unstable ruling coalitions. These political challenges have reduced the reform momentum and continuity. Some of the reforms, especially those related to public sector wages and pensions, could be politically difficult. However, the Government remains committed to the policies being supported by the current DPL series, and reform continuity is also ensured by the fact that the current Government is a coalition of traditionally opposing parties, all in agreement of a common agenda and mode of governing. Also, there is a strong backing from the European Commission for these reforms. In addition, the World Bank has a strong policy dialogue with the Government of Romania on all the areas of the DPL series. All these factors mitigate, in part, the political risks.

102. **Institutional capacity for implementation and sustainability risk is assessed to be moderate.** While the legislative and regulatory framework of the country is fairly strong, the relatively weaker implementation capacity risks reducing the impact of reforms. This risk is mitigated by the fact that Romania receives significant assistance from the World Bank, the EC and other development partners for institutional capacity strengthening. On the reforms supported by this DPL, the World Bank will continue to provide technical assistance; and capacity building efforts will also be undertaken for many of the reforms. Close supervision of this operation will help address the challenges related to institutional capacity. The World Bank's existing and planned engagements will support reform implementation.

103. **Macroeconomic risk is rated as moderate.** Romania was already in the Excessive Deficit Procedure of the EC prior to the COVID-19 pandemic. The fiscal deficit increased substantially as a result of the COVID-19 pandemic in 2020 but the Government was able to rein in spending, partly, in 2021. Now, with the influx of FDPs from Ukraine and the elevated food and energy prices, spending is likely to rise again. However, the Government remains committed to fiscal consolidation with efforts aimed at reaching a deficit of 3 percent of GDP in the medium term, in accordance with the Stability and Growth Pact. Also, given the economic implications of the war, growth has been revised downwards and is subject to a degree of uncertainty due to the geopolitical situation in the region and the uncertainty surrounding its impacts. Increased absorption of EU funds (that have historically been low), provide an upside to growth while the improvements in budgeting, supported by this DPL series, will help strengthen the funds' absorption rates. In addition, the reforms supported by this DPL series, especially those that improve tax and spending efficiency, and those that will help contain the wage bill and the pension system deficit, will support the Government's fiscal consolidation efforts. These efforts will support the achievement of the PDO to strengthen inclusion and fiscal management and the residual risks are moderate.

104. **Risks related to sector strategies and policies, fiduciary, environment and social aspects, and stakeholders are moderate.** Some of the reforms that are being supported by this DPL are technically complex in nature, especially those related to renewables and energy efficiency. In addition, there are also social and environmental risks related to some of the actions on FDPs and measures supported under Pillar II. Stakeholder

risks are largely related to FDPs and pension reforms. These risks are mitigated, in part, by technical assistance provided by the World Bank, EC and other development partners, the strong existing environmental and social safeguards in EU countries, as well as communication and citizen engagement on the key aspects of the reforms.

105. Other risks (related to the war in Ukraine) are rated as moderate: There is considerable uncertainty related to the ongoing war in Ukraine which could potentially get prolonged or spread to other countries. These events will have substantial implications on FDP arrivals, energy costs and supply, the green transition and other broader repercussions, including impacts on growth, fiscal needs, and security concerns. The government is taking measures to shield consumers and firms from excessive price hikes, including support from the EU.

Table 5: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	Substantial
2. Macroeconomic	Moderate
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Low
5. Institutional Capacity for Implementation and Sustainability	Moderate
6. Fiduciary	Moderate
7. Environment and Social	Moderate
8. Stakeholders	Moderate
9. Other	Moderate
Overall	Moderate

ANNEX 1: POLICY AND RESULTS MATRIX

Prior Actions and Triggers		Results		
Prior Actions under DPF 1	**Triggers for DPF 2**	**Indicator Name**	**Baseline: 2021**	**Target 2024**
Pillar I: Strengthen Inclusion and Fiscal Management				
Prior Action #1. The Borrower has: (i) provided temporary protection to forcibly displaced persons from Ukraine ("FDPs from Ukraine") as evidenced by the Government Decision no. 367/2022; and (ii) enabled FDPs from Ukraine access to public services like health, education, housing and social assistance, particularly to vulnerable groups such as persons with disabilities, elderly and minors, as evidenced by the Emergency Ordinance no. 15/2022, as amended by Emergency Ordinance no. 20/2022 and Emergency Ordinance no. 28/2022.	**Trigger #1.** The Borrower has established (i) an identity registry of FDPs from Ukraine and issued government recognized IDs; (ii) systems for access to the database of FDPs from Ukraine for relevant national and sub-national authorities; and (iii) consolidated service centers (One-Stop Shops) for FDPs from Ukraine for registration and information dissemination **Trigger #2.** The Borrower has (i) adjusted the Social Reference Indicator (SRI), to incorporate indexation and an adequate SRI update; and (ii) adopted the regulations to implement the VMI (Minimum Inclusion Income Program –or Venitul Minim de Incluziune) Law that provides protection to all low-income families in Romania that are in relative monetary poverty	**Results Indicator #1**: Share of FDPs from Ukraine with government recognized IDs **Results Indicator #2**: Cumulative share of women FDPs from Ukraine that use healthcare services as a share of those registered **Results Indicator #3**: Access to Minimum Inclusion Income Program (component of VMI – or Venitul Minim de Incluziune)	0 0 165,205 families	90% of FDPs 40% of registered FDP women Increase by at least 40%

Prior Actions and Triggers		Results		
Prior Action #2. The Borrower has established the procedures for the employment of FDPs from Ukraine by: (i) reducing barriers such as the requirement to hold work permits and work visa; (ii) eliminating skill recognition barriers; and (iii) enabling access to the unemployment insurance system, as evidenced by the Emergency Ordinance no. 20/2022.	**Trigger #3.** The Borrower has (i) approved guidelines and information packages to support the access to public employment services for FDPs from Ukraine; and (ii) adopted measures to provide Romanian language classes to adult FDPs from Ukraine to foster their integration into the Romanian labor market	**Results Indicator #4:** Share of FDPs from Ukraine aged 15-64 in employment as a share of FDPs from Ukraine registered with the National Agency for Employment	0	40% of FDPs aged 15-64 of which: 50% are women aged 15-64
Prior Action #3. The Borrower has enabled hiring of government staff without competition for a period of up to three (3) years (or till ninety (90) days after the end of the situation that generates a massive influx of FDPs from Ukraine) to support scaled up services in migration and crisis management and the provision of social services at the central and local levels, as evidenced by the Emergency Ordinance no. 15/2022, as amended, and the Emergency Ordinance no. 20/2022.	**Trigger #4.** The Borrower has approved integrated measures in the hosting schools for (i) FDPs from Ukraine and host community students to benefit equally from funding and other amenities; and (ii) FDPs from Ukraine and host community teachers to benefit equally from teacher training facilities	**Results Indicator #5:** Share of hosting schools in total schools hosting FDPs from Ukraine implementing integrated measures for students and inclusive training for teachers	0	75%
Prior Action #4. The Borrower has adopted regulations to: (i) implement program-based budgeting, as evidenced by the Government Decision no. 467/2022; (ii) make it compulsory for Romanian	**Trigger #5.** The Borrower has: (i) published in the Official Gazette the amendments to the Unitary Pay Law ensuring that further wage increases and existing inequities are addressed in a fiscally sustainable manner; and (ii) taken appropriate	**Results Indicator #6:** Unitary pay scale for local governments **Results Indicator #7:** Number of ministries	NA 0	Established At least 2

Prior Actions and Triggers		Results		
companies to register in the electronic platform of the Borrower's Ministry of Finance and the National Agency for Fiscal Administration, as evidenced by Ordinance no. 11/2021; and (iii) implement the national system for electronic invoicing, as evidenced by the Emergency Ordinance no. 120/2021	measures to reduce preferential tax regimes and exemptions for various taxpayer categories thereby reducing tax expenditures and improving tax coverage	adopting program- based budgeting		
Prior Action #5. The Borrower has increased the employee contributions under Pillar II of pensions to support sustainability of the pension system, as evidenced by the Emergency Ordinance no. 23/2022	**Trigger #6.** The Borrower has approved a new Public Pension Law to ensure the sustainability of the public pensions system and address existing inequities	**Results Indicator #8:** Value of the pension point[40]	1,442 Ron	Increase by up to 100% of inflation and 50% of real wage growth annually
Pillar II: Foster Decarbonization and Climate Resilience				
Prior Action #6. The Borrower has approved amendments to the Law on Electricity and Natural Gas to support renewables and private sector participation in the sector by: (i) enabling hedging and bilateral contracts that protect renewable energy developers from market price volatility; (ii) incorporating balancing and	**Trigger #7.** The Borrower has approved measures to scale-up green hydrogen and other low carbon fuels **Trigger #8.** The Borrower has approved an offshore wind framework for the development and operation of offshore wind farms	**Results Indicator #9:** New renewable capacity contracted, of which Electricity generation capacity Green hydrogen generation capacity (electrolyzers)	0 MW 0 MW 0 MW	1,050 MW 950 MW 100 MW

[40] The pension point is a monetary indicator (expressed in Ron) which, multiplied by the number of pension points, gives the value of the pension for an individual pensioner. The number of points is a function of the years of contribution and the amount contributed to the public pension fund. Currently, the value of the pension point is 1,442 Ron.

Prior Actions and Triggers		Results		
market flexibility measures (such as allowing the participation of active consumers in flexibility mechanisms) to increase the capacity of the energy sector to manage larger shares of renewable energy; and (iii) incentivizing the deployment of smart metering, as evidenced by the Emergency Ordinance no. 143/2021.				
Prior Action #7. The Borrower, through its Ministry of Development, Public Works and Administration, has approved: (i) an increase in the ambition of energy renovation measures to reduce heating energy consumption by at least fifty (50) percent in multi-family apartment buildings (MABs); and (ii) the rules and conditions for enabling energy efficiency and resilience renovations in MABs and in public buildings, as evidenced by Orders nos. 440, 441, 442, 443, and 444/2022.	**Trigger #9.** The Borrower has adopted national energy efficiency regulations setting energy efficiency requirements and actions to be incorporated in key energy-intensive sectors of the economy	**Results Indicator #10:** Surface area of buildings to undergo energy efficiency renovation for which financing is secured	0 m^2	2,170,000 m^2
Prior Action #8. The Borrower has adopted a legal framework providing incentives to accelerate afforestation and reforestation on certain categories of land, as evidenced by the Emergency Ordinance no. 35/2022	**Trigger #10.** The Borrower has adopted measures laying down binding rules for afforestation and reforestation	**Results Indicator #11:** New area under afforestation or reforestation works	13,912 ha	Increase by at least 11,000 ha

ANNEX 2: IMF ASSESSMENT LETTER

Romania—Assessment Letter for the World Bank

May 5, 2022

This letter updates IMF staff's assessment of Romania's economic conditions and policies since the last Article IV Consultation, which was concluded on August 27, 2021.

Recent Development, Outlook, and Risks

- **War spillovers:** Romania's vulnerability to spillovers from the war in Ukraine is largely indirect, including through lower growth in Europe and higher energy and food prices. Tighter financial conditions and high uncertainty will weigh on confidence and activity. Sovereign risk premiums have increased, and military operations in the Black Sea add to risks for seaborne trade. Also, more than 700,000 Ukrainian refugees have fled across the border, but the majority have moved on to third countries. At the same time, Romania is a grain producer, and largely self-sufficient in energy (with limited imports from Russia). Other direct trade and financial links with Russia and Ukraine are limited.
- **Growth:** Even before the war in Ukraine, the initially strong recovery from the COVID-induced recession had lost steam. After real GDP reached pre-crisis levels in H1 2021, growth slowed to 2.4 percent y/y in Q4 2021 due to surging energy prices, supply chain disruptions, and slowing investment. In 2022, growth is projected to slow to 2¼ percent on account of lower demand from EU trading partners, lower private investment, and the adverse impact on consumption of higher inflation. Over the medium term, growth is set to recover as consumption and private investment rebound, more than offsetting the withdrawal of fiscal stimulus as temporary support measures expire. Public investment is expected to rise, supported by EU funds, including new resources under the Recovery and Resilience Facility (RRF).
- **Inflation:** Inflation has risen sharply, driven by the energy price shock, to 10.2 percent y/y by March 2022, despite schemes to limit energy price increases. Core inflation rose more moderately, but also picked up toward end-2021 as higher fuel and transport costs were passed through. Two-year ahead inflation expectations have increased more moderately, but reached the upper edge of the target band (1.5–3.5 percent). Inflation is projected to remain elevated through most of 2022, before trending down as base effects fade, a small negative output gap remains, and wage growth stays moderate.

- **External:** The current account deficit widened further in 2021 to 7.1 percent of GDP, led by a deterioration in the merchandise trade as imports rebounded while automotive exports were disrupted by supply-chain issues. Net FDI inflows recovered strongly, and net sovereign bond issuance declined as prefinancing under the RRF was disbursed. As a result, international reserves rose and reserve coverage remains adequate. EU funds are also projected to finance a large share of current account deficits going forward.
- **Fiscal:** The fiscal deficit shrank to 6.8 percent of GDP in 2021, below the authorities' target of 7.2 percent of GDP, but is set to widen again in 2022. In 2021, higher-than-expected nominal revenues were offset by higher expenditures, largely on COVID-related spending as the pandemic continued. In addition to structural spending increases--including an increase in general and minimum pensions, wages, and other social assistance--the authorities in 2022 introduced temporary measures to alleviate the impact of rising fuel prices on the economy (about 2 percent of GDP, of which they expect the EU to cover about 0.7 percent). Reaching the authorities' deficit target of 5.8 percent of GDP will be challenging. Staff project a deficit slightly over 8 percent of GDP.

Risks are tilted to the downside. The main risk stems from protracted spillovers from Russia's invasion of Ukraine leading to an escalation of sanctions and deglobalization. New outbreaks of lethal and contagious COVID variants may also disrupt growth, given Romania's low vaccination rate. A concerted sharp tightening by global central banks in response to de-anchoring inflation expectations may create strains in financing the twin deficits, albeit mitigated by the fiscal liquidity buffer, foreign exchange reserves, and the ECB repo line, which has been extended to January 2023.

Policy Framework and Settings

Fiscal policy needs to lay the groundwork for consolidation in the medium term. For 2022, the measures to alleviate the impact of sharply higher energy and food prices are broadly appropriate but could be better targeted. The structural increases in spending need to be financed sustainably. In this regard, relying on strengthening the tax administration alone is risky. Absent tax policy measures, staff project deficits well in excess of 3 percent of GDP over the medium term and rising public debt.

Monetary policy is broadly appropriate. To anchor expectations in response to rising inflation, the National Bank of Romania (NBR) raised policy rates and tightened liquidity management. Since October 2021, the NBR has raised the policy rate by a total of 175 bps, and tighter liquidity management has effectively added another 100 bps to money market rates. With the outbreak of the war, the NBR resumed moderate purchases of government bonds to help calm spiking yields and stabilized the exchange rate. To absorb external shocks and reduce overvaluation over time, exchange rate flexibility should be gradually increased, with intervention limited to addressing disorderly market conditions.

In the financial sector, the unwinding of the pandemic-era relaxations should continue, and buffers should be raised further, alongside the normalization of credit support schemes. Emerging from the pandemic, the Romanian banking system has maintained its strong capital, liquidity, and profitability position.

The structural reform agenda needs to be urgently reinvigorated. To improve medium-term growth prospects in an equitable way, absorb the large available EU funds, and meet commitments under the Recovery and Resilience Plan, including investments in the green energy transition to achieve a phase-out of coal by 2032, a number of structural issues need to be tackled. Utilizing EU funds in a productive way implies a significant strain on the public administration. In this context, the authorities need to expeditiously follow up on the recommendations made in the recent Public Investment Management Assessment (PIMA). Also, SOE reforms to free up fiscal resources and boost economic efficiency, expanding digitalization and strengthening the anti-corruption framework, and improving the health system are critical. Also, the recently enhanced AML/CFT framework needs to be robustly implemented.

IMF Relations

Romania currently does not have an IMF-supported program. A virtual staff visit took place during December 6-14, 2021. The next Article IV mission is scheduled for May 30-June 10, 2022. The mission team plans to travel to Bucharest.

Table 1. Romania: Selected Economic and Social Indicators, 2016–23

	2016	2017	2018	2019	2020	2021 Est.	2022 Proj.	2023 Proj.
Output and prices				(Annual percentage change)				
Real GDP	4.7	7.3	4.5	4.2	-3.7	5.9	2.2	3.4
Domestic demand 1/	4.9	8.9	5.9	5.7	-2.1	7.2	3.1	3.2
Contributions to GDP growth								
Domestic demand 1/	4.9	9.1	6.2	6.0	-2.1	8.1	2.4	3.5
Private consumption	4.9	6.8	5.0	2.7	-3.4	5.2	2.1	2.4
Government consumption	0.0	0.6	0.4	0.9	0.2	-0.2	0.3	0.2
Net exports	-0.2	-1.8	-1.8	-1.8	-1.7	-2.2	-0.2	-0.2
Consumer price index (CPI, average)	-1.6	1.3	4.6	3.8	2.6	5.0	9.3	4.0
Consumer price index (CPI, end of period)	-0.5	3.3	3.3	4.0	2.1	8.2	7.6	3.4
Core price index (CPI, end of period)	0.3	2.4	2.5	3.7	3.3	5.8	5.3	3.4
Producer price index (average)	-1.8	3.5	5.0	4.0	0.0	14.9	...	...
Unemployment rate (average)	7.2	6.1	5.2	4.9	6.0	5.3	5.6	5.5
Nominal wages, gross 2/	12.8	14.8	35.4	13.0	6.4	7.1	8.0	8.0
Saving and Investment				(In percent of GDP)				
Gross domestic investment 1/	23.4	23.4	22.8	23.6	24.4	26.2	24.2	24.8
Gross national savings	21.8	20.3	18.1	18.7	19.4	19.2	17.3	18.4
General government finances 3/								
Revenue	28.9	28.0	29.2	28.9	28.8	30.7	32.0	30.8
Expenditure	31.3	30.8	32.0	33.5	38.5	37.4	40.1	37.0
Fiscal balance	-2.4	-2.8	-2.8	-4.6	-9.6	-6.8	-8.1	-6.1
External financing (net)	0.7	0.8	0.6	0.9	4.6	4.6	5.6	3.1
Domestic financing (net)	2.2	2.4	2.5	3.2	5.4	2.2	2.5	3.0
Primary balance	-1.2	-1.7	-1.5	-3.4	-8.3	-5.3	-6.5	-4.3
Structural fiscal balance 4/	-1.7	-3.5	-3.7	-5.1	-5.1	-6.7	-6.5	-6.2
Gross public debt (including guarantees)	39.0	36.8	36.5	36.8	49.6	51.4	56.3	58.4
Money and credit				(Annual percentage change)				
Broad money (M3)	9.7	11.5	8.8	10.9	15.3	15.8	12.1	10.5
Credit to private sector	1.2	5.7	8.0	6.6	5.5	14.8	12.0	9.1
Interest rates, eop				(In percent)				
NBR policy rate	1.75	1.75	2.50	2.50	1.50	1.75	...	...
NBR lending rate (Lombard)	3.25	2.75	3.50	3.50	2.00	2.50	...	...
Interbank offer rate (1 week)	0.6	1.5	2.4	2.9	1.8	2.4	...	...
Balance of payments				(In percent of GDP)				
Current account balance	-1.6	-3.1	-4.6	-4.9	-5.0	-7.1	-6.9	-6.4
Merchandise trade balance	-1.0	-2.5	-3.4	-4.1	-4.3	-5.8	-5.2	-4.9
Exports (goods)	30.7	30.5	30.2	28.3	26.3	29.2	33.7	33.3
Imports (goods)	36.4	37.3	37.7	36.3	34.9	38.9	43.1	42.8
Capital account balance	2.5	1.2	1.2	1.3	1.9	2.4	2.4	2.0
Financial account balance	4.1	-0.5	-1.3	-1.0	-1.8	-3.3	-3.0	-4.0
Foreign direct investment balance	-2.7	-2.6	-2.4	-2.2	-1.4	-3.0	-2.5	-2.7
International investment position	-48.7	-46.6	-43.7	-43.3	-47.8	-45.7	-47.9	-49.3
Gross official reserves	22.3	19.8	18.0	16.8	19.4	19.1	17.2	15.7
Gross external debt	55.4	51.9	48.8	49.2	57.9	56.0	54.9	54.1
Exchange rates								
Lei per euro (end of period)	4.54	4.66	4.66	4.78	4.87	4.95	…	…
Lei per euro (average)	4.49	4.57	4.65	4.75	4.84	4.92	…	…
Real effective exchange rate								
CPI based (percentage change)	-1.8	-1.5	2.8	-0.4	1.5	0.9	…	…
GDP deflator based (percentage change)	2.1	1.7	4.3	2.4	2.7	1.0	…	…
Memorandum Items:								
Nominal GDP (in bn RON)	763.7	857.9	951.7	1059.0	1058.9	1179.4	1257.7	1355.2
Potential output growth	3.5	3.7	3.7	3.7	1.5	4.1	2.1	3.1

Social and Other Indicators

GDP per capita: US$14,667 (2021); **GDP per capita, PPP:** current international $32,116 (2020)

People at risk of poverty or social exclusion: 31.2% (2019)

Sources: Romanian authorities; World Development Indicators database; Eurostat; and IMF staff estimates and projections.
1/ Including potential statistical uncertainty related to large inventory contribution in 2018 and 2021.
2/ Year 2018 reflects the upward adjustment of gross wages due to the implementation of the shift in social security contributions from employers to employees, which kept net wages and costs to employers unaffected (see Box 1 in the 2018 Article IV staff report).
3/ General government finances refer to cash data.
4/ Fiscal balance (cash basis) adjusted for the automatic effects of the business cycle and one-off effects.

ANNEX 3: LETTER OF DEVELOPMENT POLICY

MINISTRY OF FINANCE
MINISTER'S OFFICE

Letter of Development Policy

June 10., 2022

Mr. David Malpass, President
The World Bank
1818 H Street N.W., Washington D.C., 20433

RE: Romania: First Programmatic Inclusive and Green Growth Development Policy Financing

Dear Mr. Malpass:

The Government of Romania appreciates the excellent cooperation with the World Bank and the support received from your institution over the years for key reforms and investments which have accelerated the convergence in living standards with the European Union, reduced poverty and strengthen the confidence of the investors in our economy. The Government is determined to further promote a prudent macroeconomic management and vigorously pursue structural reforms and investments in the economy in order to boost productivity, create high value-added jobs and enhance the growth potential of our country for the benefit of all Romanians.

Thanks to an effective support provided by the Government to households and companies through targeted programs and disciplined macroeconomic management, Romania has successfully overcome the effects of the COVID-19 crisis. Despite strong external headwinds, the Romanian economy expanded by 5.9 percent in 2021, one of the highest growth rates in the European Union, successfully rebounding from a contraction of 3.7 percent in 2020. An important element of this rebound was the fact that the Government has maintained a high level of public investment, as key priority, while increases in wages and pensions have preserved the purchasing power of households.

Unfortunately, the Russian invasion of Ukraine at the end of February this year has come as a major shock for the global and European economy and has triggered a humanitarian crisis of large proportions. This has come on top of the high global energy and food prices and the disruptions in the international supply chains. Sharing a border of around 650 km with Ukraine, Romania has received over 1,040,000 refugees from the war, of which around 115,000 stayed in our country as of end of May. More refugees are expected to come function of the escalation of the conflict. Showing a tremendous solidarity, the Romanian society and the Government have quickly mobilized themselves to provide support, including by offering full access to social services, such as social assistance, health and education, or psychological help, and integrate them into the labor market. Looking forward, the Government will continue to provide the needed assistance to the refugees, including by customizing the support to best respond to the profile of each person through the establishment of a registry of forcibly displaced persons, issuing them a personal identification document and working with the Romanian host communities to ensure that they have the needed resources for an effective integration.

In spite of these adverse global and regional conditions, the Government continues to work with determination to advance structural reforms and promote investment needed to grow our economy and increase living standards. We have prepared a solid National Resilience and Recovery Plan (NRRP), which promotes priority reforms and investments for the period 2021–2026, allowing Romania to access important resources under the EU Resilience and Recovery Facility. The quality of the Romanian NRRP was assessed as very good by the EU. Through the NRRP and the national budget we focus on key investments in Romania's infrastructure, both at central and local levels, to reduce the infrastructure gap with the EU, enhance the competitiveness of the economy and improve the quality of public services offered to citizens.

A key priority for our Government is to put in place mechanisms and allocate resources to accelerate the greening of the economy and promote digitalization. Thus, we aim to decarbonize the energy sector by 2032 and target to install more than 7,000 MW of renewable energy and improve the energy efficiency of millions of square meters of private and public buildings. In parallel, we are working to increase the surface of our forests and have just promoted a decision which encourages reforestation and afforestation, targeting this way to plant more than 50,000 hectares of new forests by 2026. We have set aside in the NRRP important resources for planting new forests. We are also cognizant of the fact that in order to meet Romania's investment needs we need to mobilize important levels of private investment. Thus, we have simplified and clarified the legal framework for renewable energy, we are working on guidelines to facilitate public-private partnerships and we will promote a decarbonization law as a roadmap for greening our economy. We are confident that these measures will help to mobilize significant private investment for the Romanian economy to create green high value-added jobs.

As the same time, the Government continues to promote macroeconomic stability. Together with the National Bank of Romania we promote a mix of macroeconomic policies to contain inflation. A key reform area for our Government is to strengthen public finances. Cognizant of the need to boost budget revenues by improving tax compliance, we have launched a comprehensive reform of the National Agency for Fiscal Administration (NAFA), including by redefining business processes, upgrading its IT system and the skills of staff. In order to reduce fraud and error and improve communication with taxpayers, we have passed measures to request all companies to register in the platform of NAFA and have implemented the electronic invoicing national system (RO e-factura), operationalized in November 2021, a first phase in making it compulsory for companies. This year we will be working on measures to reduce tax expenditures and broaden taxation base.

In parallel with reforming the revenue side of the budget, we are putting significant effort into enhancing the efficiency and efficacy of public spending. We have passed measures to strengthen the linkages between policymaking and budgeting and to gradually introduce performance-based budgeting, with the goal of moving towards program-based budgeting in the central administration by 2026. We have also been working on strengthening the center of the government to improve policy oversight and ensure improved policy coordination and harmonization. We have launched the processes of reforming our pension and public wage systems and strengthen the corporate governance framework of SOEs.

In order to protect households and companies from the effects of the high energy and food prices we have temporarily capped the prices of electricity and gas until March 2023 in a fiscally sustainable manner. Further, in order to protect the living standards of the most vulnerable of our citizens, we have adjusted upwards the Social Reference Indicator (SRI), to incorporate indexation and an adequate SRI update are working on procedures to implement the social protection legislation for vulnerable consumers, in a manner aligned to the Minimum Inclusion Income Program.

We are confident that the measures we have put in place or are under preparation and planning will place the Romanian economy on a firmer footing and enhance its competitiveness in an inclusive and sustainable manner. We will continue to work the World Bank to advance our reform program and boost investment.

Yours sincerely,

Adrian Câciu

Minister of Finance
Government of Romania

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Operation Pillar 1: Strengthen Inclusion and Fiscal Management		
Prior action #1: The Borrower has: (i) provided temporary protection to forcibly displaced persons from Ukraine ("FDPs from Ukraine") as evidenced by the Government Decision no. 367/2022; and (ii) enabled FDPs from Ukraine access to public services like health, education, housing and social assistance, particularly to vulnerable groups such as persons with disabilities, elderly and minors, as evidenced by the Emergency Ordinance no. 15/2022, as amended by Emergency Ordinance no. 20/2022 and Emergency Ordinance no. 28/2022.	Yes - positive	Yes - positive to FDPs, but potentially negative to host communities (crowd out services), especially in rural and lagging regions with existing low level of provision of quality public services
Prior action #2: The Borrower has established the procedures for the employment of FDPs from Ukraine by: (i) reducing barriers such as the requirement to hold work permits and work visa; (ii) eliminating skill recognition barriers; and (iii) enabling access to the unemployment insurance system, as evidenced by the Emergency Ordinance no. 20/2022.	Yes - positive	Yes – positive to FDPs and could be potentially negative to host communities (job competition) especially in rural and lagging regions with limited employment opportunities
Prior action #3: The Borrower has enabled hiring of government staff without competition for a period of up to three (3) years (or till ninety (90) days after the end of the situation that generates a massive influx of FDPs from Ukraine) to support scaled up services in migration and crisis management and the provision of social services at the central and local levels, as evidenced by the Emergency Ordinance no. 15/2022, as amended, and the Emergency Ordinance no. 20/2022.	Neutral	Yes – positive to FDPs and hosts through provision of scaled up public services
Prior action #4: The Borrower has adopted regulations to: (i) implement program-based budgeting, as evidenced by the Government Decision no. 467/2022; (ii) make it compulsory for Romanian companies to register in the electronic platform of the Borrower's Ministry of Finance and the National Agency for Fiscal Administration, as evidenced by Ordinance no. 11/2021; and	Yes – positive if electronic waste is taken care of properly	Yes – positive in the long term

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
(iii) implement the national system for electronic invoicing, as evidenced by the Emergency Ordinance no. 120/2021.		
Prior action #5: The Borrower has increased the employee contributions under Pillar II of pensions to support sustainability of the pension system, as evidenced by the Emergency Ordinance no. 23/2022.	Neutral	Neutral
Operation Pillar 2: Foster Decarbonization and Climate Resilience		
Prior action #6: The Borrower has approved amendments to the Law on Electricity and Natural Gas to support renewables and private sector participation in the sector by: (i) enabling hedging and bilateral contracts that protect renewable energy developers from market price volatility; (ii) incorporating balancing and market flexibility measures (such as allowing the participation of active consumers in flexibility mechanisms) to increase the capacity of the energy sector to manage larger shares of renewable energy; and (iii) incentivizing the deployment of smart metering, as evidenced by the Emergency Ordinance no. 143/2021.	Yes – positive, with the potential implementation-related negative effects addressed through EIA and other mitigation measures	Yes – positive in the long term
Prior action #7: The Borrower, through its Ministry of Development, Public Works and Administration, has approved: (i) an increase in the ambition of energy renovation measures to reduce heating energy consumption by at least fifty (50) percent in multi-family apartment buildings (MABs); and (ii) the rules and conditions for enabling energy efficiency and resilience renovations in MABs and in public buildings, as evidenced by Orders nos. 440, 441, 442, 443, and 444/2022.	Yes – positive, with potential implementation-related negative effects being managed through the existing legislation	Yes - positive in the long term, but potentially negative to renters of MABs
Prior action #8: The Borrower has adopted a legal framework providing incentives to accelerate afforestation and reforestation on certain categories of land, as evidenced by the Emergency Ordinance no. 35/2022.	Yes – positive with potential implementation-related negative effects managed through existing legislation	Yes – positive in the long term