PROJECT INFORMATION DOCUMENT (PID)
INITIATION/CONCEPT STAGE

Report No.: 99615

Project Name	Strengthening financial accountability of the public sector in Romania
Region	ECA
Country	Romania
Sector(s)	Governance
Theme(s)	Public Financial Management
Lending Instrument	Recipient executed trust fund
Project ID	P152568
Borrower(s)	Ministry of Public Finance
Implementing Agency	Ministry of Public Finance
Environmental Category	C
Date PID Prepared	September 11, 2015
Estimated Date of Approval	October 1, 2015
Initiation Note Review Decision	
Other Decision(s) (as needed)	

I. Introduction and Context

Country Context

1. **The Romanian economy posted a strong growth in the first half of 2015, the highest in the EU at 3.7 percent**, Economic growth was driven by private consumption on the back of advances in employment and wages and by the gradual recovery of investment. In quarterly terms, growth was 4.3 percent in the first quarter of the year, decelerating in the second quarter to 3.3 percent. Domestic demand is projected to remain the driver of growth in 2015, when we expect the economy to expand by around 3.6 percent. In spite of a weak performance of the public investment in the first months of 2015, a rebound in investment is expected for the year driven by the private sector. This includes a better absorption of the EU funds, which is targeted by the authorities to reach around 80 percent by end-2015, from around 49 percent at end-March. In spite of slow progress with structural reforms in the public sector, in energy and in transport, the macroeconomic framework remains solid, with inflation in negative territory, a low current account deficit and a consolidated budget in surplus in the first half of the year. As the precautionary programs with the IMF and the EC [expired] at the end of September, the government has pledged to continue to consolidate the macroeconomic framework in spite of the approaching local and general elections in 2016. Economic uncertainties at global and European levels and the ongoing regional tensions continue to remain factors of vulnerability for Romania.

2. **The economy decelerated in the second quarter of 2015 to 3.3 percent; however business surveys project a pick-up in economic activity in the coming months.** On the production side, important contributions to growth come from the ITC sector (up 15.0 percent) and financial intermediation, while manufacturing recorded a slowdown (up 0.8 percent). On the uses side, growth was driven mainly by private consumption (5.9 percent up, resulting in a 3.8 ppt contribution to overall growth) and gross fixed capital formation (7.9 percent up and a 1.6 ppt contribution). Net exports of goods and services had a negative contribution of -1.6 ppt on the back of slower growth of exports, up 4.2 percent, and an acceleration of imports growth, 7.8 percent up, driven by the increase in disposable incomes. The August Monthly Business Survey of the Statistical Office shows that managers expect increases in output in all sectors surveyed, apart from construction, in the period until the end of October.

Sectoral and Institutional Context

3. Improving the quality of the public sector remains a priority for Romania. Given that the public sector spends about one-third of GDP, or around €45 billion every year, the efficiency and efficacy of this spending have a major impact on economic growth, job creation, and the quality of public services. Romania has had the highest public investment spending in GDP in the EU in the past 15 years, but it scores lowest in infrastructure development rankings. Improving the quality of policy making can therefore lead to large welfare gains and accelerate the sustainable convergence of Romania with the EU.

4. **Romania has made substantial progress in improving governance over the past decade, but weaknesses in government effectiveness put it at a competitive disadvantage compared to its EU neighbors.** Effective institutions are essential for growth. The Worldwide Governance Indicators show that Romania has made substantial progress since 2000 on all six indicators. Most progress has been made on regulatory quality (69th percentile), while government effectiveness remains at around the 52nd percentile of countries worldwide.

5. **Romania continues to strengthen the center of government.** A delivery unit focused on key national priorities such as public procurement, tax administration, energy and youth employment has been successfully established. Future initiatives include establishing a strategy unit that would coordinate priority policy making by linking sectoral strategies to national and EU-wide priorities. The Bank is also supporting efforts to link strategy formulation to the budgeting process and putting in place a system for coherent regulatory impact assessments. These efforts will need to be supported by a strong monitoring and evaluation framework to track progress and ensure mid-course corrections where necessary.

Relationship to CAS/CPS/CPF

6. **The proposed activity is fully in line with the proposed 2014-2017 Country Partnership Strategy** (CPS). The FEG-DPL, whose implementation is supported by the proposed activity, is one of the core pieces under the forthcoming CPS. The proposed activity thus directly addresses one of the three CPS pillars – further modernization of the public sector (Creating a 21st century Government). In this context, the RIB is an important step for

linking the budget allocation with the program performance and thus, focusing the policy-makers on the delivery of the results; and the improvements in the financial governance of the SOEs as well as the wage bill policies allow for increasing the quality of spending policies.

II. Proposed Development Objective(s)

Proposed Development Objective(s) (From CN)

7. The overarching objective of this activity is to provide direct support for the implementation of the measures under the FEG-DPL series to strengthen the fiscal management by improving the quality of public spending and financial performance of the SOEs.

Key Results (From CN)

(a) Component 1: Policy-based budgeting: will help the MoPF and line ministries allocate funding more efficiently based on prior performance and showcase (or take the accountability for) the results achieved with the budgetary expenditure. This budgeting method is not used on Romania at the moment, which results in low quality and prioritization of public expenditure.

(b) Component 2: Accounting and reporting will allow the MoPF to strengthen the oversight of the financial management of the SOEs with the aim to improve their corporate governance, and decrease the fiscal losses and arrears. The SOEs have been operating at a loss in aggregate since 2009 and estimated SOE payment arrears amount to 2.5 % of GDP (as of end-2013).

(c) Component 3: Public Sector Wage Bill will support the introduction and monitoring of the Unified Public Wage Law.

III. Preliminary Description

Concept Description [and Implementation Arrangements]

8. Component 1: Introduction of the results-informed budgeting (RIB).

The rationale is for the government to be able to allocate resources more efficiently by formulating the budget based on performance from previous year. This gives the MoPF an efficient tool to respond to budget requests from the line ministries and at the same time for the latter to defend the spending needs by the results achieved by their programs. The activity includes the pilots of RIB in 2 line ministries; where the process is managed and methodologically guided by the MoPF and the ministries themselves prepare the program structure with support of MoPF and international consultants procured under the grant. The capacity building workshops and awareness raising activities with all relevant counterparts; technical changes to the budget classification and chart of accounts, and related IT configuration are part of the activities under this component.

9. Given the present situation, where no line ministries submit their budget requests based on the results on indicators from the previous year and the ministries use the line budget structure; the team discussed with the MoPF counterparts the international examples of the approaches the countries have taken to introduce RIB. The experiences of France, Sweden, Russia and South Korea show various models of budget program structure and the size of the programs; starting positions for the reform; and motivations.

10. Some of the lessons that could be drawn for piloting the RIB in Romania are that it takes time to legitimize the programs and their performance measures; the responsible ministry must implement measures to also ensure compliance with the program structure; real value is in the use of performance information for internal steering and sparking a conversation that may require further investigation (evaluation); the RIB changes the relations between the budget authority and line ministries in regards to the budget negotiations and management discussions; one should avoid any organizational restructuring at the start when introducing the RIB; and finally, the mistake that countries make is it to use the existing indicators (many of which are focused on the activities) and too little program outcomes and outputs.

11. Component 2: Improving the quality of financial reporting (FR) of SOEs (preparation for harmonization with IFRS)

12. The rationale for this activity is to decrease the fiscal losses by tightening the financial oversight of the SOEs. The promotion of good practices in financial reporting of the SOEs (including the move towards IRFS) is part of the comprehensive reform program of the SOEs under the FEG-DPL. According to the Memorandum on state ownership and oversight approved by the government in April 2014, the oversight function is placed within the MoPF. While the full harmonization with IFRS for all SOEs is beyond the timeframe of this component, the technical advice includes a) stocktaking of the present FR standards compared to the IFRS, strategic and technical guidance on bringing this gap, piloting the new methodology in up to 5 SOEs, with support of the related capacity building both in these as well as the MoPF to perform the financial monitoring function.

13. Component 3: Improving the wage bill management

14. The rationale for this activity is to implement the 2011 Unitary Pay Law by making an evidence-based decision on the wage bill changes. This is to rectify effectively the present situation, where the government increased the minimum wage, but kept the wage bill at the same level. The advisory and analytical work includes the a) policy note exploring the options on decompressing the central government wage bill; b) devising a simulation model to estimate the impact of these proposed options; and c) making a policy proposal to improve the wage bill management based on this evidence.

IV. Safeguard Policies that Might Apply

Safeguard Policies Triggered by the Project	**Yes**	**No**	**TBD**
Environmental Assessment OP/BP 4.01		N	
Natural Habitats OP/BP 4.04		N	
Forests OP/BP 4.36		N	
Pest Management OP 4.09		N	
Physical Cultural Resources OP/BP 4.11		N	
Indigenous Peoples OP/BP 4.10		N	
Involuntary Resettlement OP/BP 4.12		N	
Safety of Dams OP/BP 4.37		N	
Projects on International Waterways OP/BP 7.50		N	
Projects in Disputed Areas OP/BP 7.60		N	

V. Financing (in USD Million)

Total Project Cost:	752,100	Total Bank Financing:	488,100
Total Co-financing:		Financing Gap:	0

Financing Source	**Amount**
BORROWER/RECIPIENT	264,000
Total	752,100

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