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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A PROPOSED LOAN

IN THE AMOUNT OF EQUIVALENT TO €500 MILLION

(US$558.27 MILLION EQUIVALENT)

TO

ROMANIA

FOR THE

SECOND FISCAL EFFECTIVENESS AND GROWTH DEVELOPMENT POLICY LOAN

November 16, 2016

Macroeconomics and Fiscal Management Global Practice
Europe and Central Asia Region

ROMANIA – GOVERNMENT FISCAL YEAR
January 1 – December 31

CURRENCY EQUIVALENTS
(Exchange Rate Effective as of September 30, 2016)

Currency Unit	New Romanian Lei (RON)
US$1.00	RON 3.98
€1.00	RON 4.45

ABBREVIATIONS AND ACRONYMS

ABP	Annual Borrowing Plan
ANCPI	National Agency for Cadaster and Land Registration (Agentia Nationala de Cadastru si Publicitate Imobiliara)
ANAF	Tax Administration (Agentia Nationala de Administrare Fiscala)
ANRE	National Energy Regulatory Authority (Autoritatea Nationala de Reglementare in domeniul Energiei)
AROPE	At Risk of Poverty or Social Exclusion
ASF	Financial Supervisory Authority (Autoritatea de Supraveghere Financiara)
CEM	Country Economic Memorandum
CFAA	Country Fiduciary Accountability Assessment
CIT	Corporate Income Tax
COFOG	Classification of the Functions of Government
CPI	Consumer Price Index
CPS	Country Partnership Strategy
CSR	Country Specific Recommendations
DAM	Day-Ahead Market
DMS	Debt Management Strategy
DPL	Development Policy Loan
DSA	Debt Sustainability Analysis
EC	European Commission
ECA	Europe and Central Asia
ECB	European Central Bank
EDP	Excessive Deficit Procedure
ESA	European System of Accounts
EU	European Union
FBS	Fiscal Budgetary Strategy
FDI	Foreign Direct Investment
FEG-DPL	Fiscal Effectiveness and Growth Development Policy Loan
FRL	Fiscal Responsibility Law
FSA	Family Support Allowance
FTSE	Financial Times Stock Exchange
GDP	Gross Domestic Product

GEO	Government Emergency Ordinance
GHG	Greenhouse Gas
GMI	Guaranteed Minimum Income
GOR	Government of Romania
GRS	Grievance Redress Service
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
INDC	Intended Nationally Determined Contribution
IPO	Initial Public Offering
LDP	Letter of Development Policy
MIIP	Minimum Inclusion Income Program
MOH	Ministry of Health
MOPF	Ministry of Public Finance
MSCI	Morgan Stanley Capital International
MSIP	Minimum Social Inclusion Program
MTBF	Medium Term Budget Framework
MTO	Medium-term Objective
NBR	National Bank of Romania
NCC	National Climate Change and Low Carbon Growth Strategy
NEET	Neither in Employment nor in Education or Training
NEETD	Not in Employment, Education, Training, or Disabled
NPL	Nonperforming Loan
NRP	National Reform Program
NUTS	Nomenclature of Territorial Units for Statistics
OECD	Organization for Economic Cooperation and Development
OPCOM	Romanian Power Market Operator (Operatorul Pietei de Energie Electrica si de Gaze Naturale din Romania)
PFM	Public Financial Management
PIT	Personal Income Tax
PPP	Purchasing Power Parity
PSIA	Poverty and Social Impact Assessment
RAMP	Revenue Administration Modernization Project
RAS	Reimbursable Advisory Service
RSE	Roma Sensitivity Enhancer
SASMP	Social Assistance System Modernization Project
SDR	Standardized Death Rate
SOE	State-owned Enterprise
SPO	Secondary Public Offering
SRU	Spending Review Unit
TA	Technical Assistance
UEIP	Unit for the Evaluation and Monitoring of Investment Projects

US	United States
VAT	Value Added Tax
WB	World Bank

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ROMANIA

SECOND FISCAL EFFECTIVENESS AND GROWTH DEVELOPMENT POLICY LOAN

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SUMMARY OF PROPOSED LOAN AND PROGRAM
ROMANIA
SECOND FISCAL EFFECTIVENESS AND GROWTH DEVELOPMENT POLICY LOAN

Borrower	ROMANIA
Implementation Agency	MINISTRY OF PUBLIC FINANCE
Financing Data	IBRD Loan Terms: 19.5 years grace period, 20 years of repayment, fixed spread. Front-end fee: 0.25 percent of loan amount to be financed from own resources. Amount: €500 million (US$558.27 million equivalent)
Operation Type	Programmatic (second of two), single-tranche
Pillars of the Operation and Program Development Objective	The proposed Development Policy Loan (DPL) series supports government reforms to: (a) strengthen fiscal management and the performance of state-owned enterprises (SOEs) (b) improve the functioning of energy, property, and capital markets
Results Indicators	• The number of the MOPF's liability management operations increases from 0 in 2013 to 3 in 2017. • Average unit price for centrally procured drugs and devices declines from RON 22.2 in 2015 to RON 20.0 in 2017. • The budget allocated to the portfolio of significant[1] public investment projects monitored by the MOPF increases from RON 5.7 billion[2] in 2014 to RON 6.1 billion in 2017. • The budget allocated to means-tested social assistance programs increases from RON 1.2 billion in the 2014 budget to RON 1.8 billion in the 2018 budget. • The number of SOEs with professional Board and management appointed increases from 25 in 2013 to 80 in 2017. • The amount of natural gas traded at centralized platforms increases from 0 billion cubic meters in 2013 to 2 billion cubic meters in 2017. • International trade in electricity (exports plus imports) increases from 2.6 TWh at end-2012 to 4.0 TWh at end-2017. • Energy sector greenhouse gas (GHG) emissions declines from 86.5 million tons in 2012 to 80 million tons in 2017. • Registered urban real estate as a share of total urban real estate increases from 39 percent at end-2013 to 57 percent by end-2017.

[1] A significant project is one with a total cost of over RON 100 million, according to the Romanian legislation. The implementation of the portfolio of significant projects is monitored by MOPF.
[2] Around €1.8 billion at the exchange rate of RON 4.45 per Euro.

	• The number of benchmarks of the secondary emerging market index met has increased from 4 at end-2013 to 8 by end-2017.
Overall Risk Rating	Substantial
Operation ID	P149776

IBRD PROGRAM DOCUMENT
FOR A PROPOSED
SECOND FISCAL EFFECTIVENESS AND GROWTH DEVELOPMENT POLICY LOAN TO ROMANIA

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed Second Fiscal Effectiveness and Growth Development Policy Loan (FEG-DPL2) of €500 million (US$558.27 million equivalent) is the second in a programmatic series of two Development Policy Loans (DPLs) to Romania.** This FEG-DPL series was designed in close collaboration with the government, the European Commission (EC), and the International Monetary Fund (IMF) to complement the 2013–2015 precautionary programs of the European Union (EU) and the IMF.[3] It supports key structural reforms to strengthen fiscal management and performance of state-owned enterprises (SOEs), and to improve the functioning of the energy, property, and capital markets. It builds upon previous World Bank (WB) policy lending operations in Romania and is aligned with Romania's Country Partnership Strategy (CPS) for 2014–2017. Its implementation received broad-based political support under different administrations and was closely coordinated with the EC and the IMF. Implementation also involved significant WB technical assistance (TA[4]) in the areas of social assistance; SOE corporate governance; climate change mitigation; cadaster; health; debt management; capital markets and public investment management; and was supported by WB projects in social assistance and health.

2. **Romania has achieved the highest growth in the EU over the last fifteen years, but further progress with structural reforms is needed to sustain it.** Between 2000 and 2015, growth averaged 8 percent per capita in Purchasing Power Parity (PPP) terms, raising Romania's income relative to the EU average from 26 percent to 57 percent over the same period. Yet, pro-cyclical fiscal policies and sizeable capital inflows in the run-up to the 2008 crisis led to important macroeconomic imbalances that required a sharp correction. The Romanian government acted decisively, implementing one of the largest post-crisis fiscal consolidation efforts in the EU. Relying heavily on spending cuts, Romania reduced its fiscal deficit in cash terms from 7.2 percent of GDP in 2009 to 1.4 percent in 2015. The consolidation helped to rapidly restore market confidence and reignite economic growth. Romania is now in a better macroeconomic position than many other EU member states, with a public debt-to-GDP ratio of 39.3 percent in 2015, a small current account deficit, and solid GDP growth. Yet, it is likely to be difficult for Romania to sustain high growth and converge towards the average EU income within a generation as a result of demographic pressures; poor health and education outcomes; adverse climate change impacts; a large infrastructure gap; and inefficient public investment, unless Romania decisively tackles its unfinished structural reform agenda.

3. **Poverty in Romania remains the highest in the EU and progress in poverty reduction has been limited.** Romania had the highest share of poor people in the EU with 40.2 percent of the population at-risk-of poverty and social exclusion (AROPE) in 2014. The Roma population, in particular, faces poverty, deprivation, and systemic challenges in accessing basic services. The Roma employment rate is estimated at 30 percent.[5] The share of Romanians at-risk-of poverty before social transfers slightly increased in

[3] Both programs expired in September 2015.
[4] Including RAS.
[5] World Bank. 2014. Diagnostics and policy advice for supporting Roma inclusion in Romania.

recent years from 28.0 percent in 2012 to 28.5 percent in 2014[6]. The share of at-risk-of-poverty after social transfers recorded an even steeper increase from 22.6 percent in 2012 to 25.4 in 2014. A comprehensive reform of Romania's social assistance system, necessary to make further progress in poverty reduction, was launched in 2009, but implementation has been slow[7]. During the last four years the government increased social transfers, many of which were not well targeted.[8] Social assistance reforms have been re-launched by the current government and an anti-poverty package has been promoted in January 2016, aimed at increasing school attendance and employment, and leveraging EU funds to reach the poor.[9] The gender gap is below the EU average. At 53.3 percent, the employment rate among women aged 15–64 was low in 2014, compared to 68.7 percent among men and lower than the EU28 average (59.6 percent). Women's salaries were 89.1 percent of men's in 2014, placing the gender pay gap below the EU average.[10]

4. **This DPL contributes significantly to poverty reduction in Romania.** The reform of the social assistance programs and the introduction of the Minimum Social Inclusion Program (MSIP)[11], which this DPL series supports, will increase both the number of beneficiaries of means-tested programs and the benefit levels that they receive. The coverage of households in the poorest quintile can be expected to increase from the current level of 60 percent to about 80 percent, with progressive coverage and larger benefit levels for the poorest. The changes in the cadaster legislation will help streamline the registration process and reduce the cost of first registration, which is currently prohibitive for many of the poor, including the Roma population. Currently, 36 percent of households in Roma settlements have no property documentation. In addition, reforms of SOE governance, public investment management, energy and capital markets, which are supported by this DPL will boost Romania's economic growth potential benefiting Romania's bottom 40 percent. Improvements in SOE performance and public investment management will also free up fiscal resources that could be re-allocated to social spending.

5. **At the same time, this DPL supports key structural reforms that help boost Romania's growth potential and accelerate convergence with the EU.** This operation supports a new corporate governance framework for public enterprises; one IPO[12]; and the restructuring of a large SOE. These measures are expected to help improve the performance of the large and inefficient SOE sector[13] and its contribution to sustained economic growth. The coupling of the electricity market with Central Europe is boosting energy trade and will help support energy price convergence. The adoption of the climate change strategy and action plan will help Romania to reduce energy sector emissions, while keeping the energy sector competitive. The adoption of the new capital markets framework will increase financial intermediation,

[6] At-risk-of poverty rate, defined as people with less than 60 percent of the median equivalized income after social transfers.

[7] A waiver to BP 8.60 has been granted to extend beyond 24 months the presentation of this second operation of the programmatic FEG DPL series to the Board. The first FEG DPL was approved by the Board on May 22, 2014.

[8] Parliament introduced in June last year measures to raise the state child allowance with a cost of around 0.24 percent of GDP in 2016, but only 30 percent of the budget reaches poor children and poor families.

[9] The package combined existing and new measures, many of which are aimed at increasing school attendance and employment. Romania has the highest share of young people neither in employment nor in education and training (NEET) in the EU.

[10] The gender pay gap represents the difference between average gross hourly earnings of male paid employees and female paid employees as a percentage of average gross hourly earnings of male paid employees.

[11] The law is called Minimum Inclusion Income Program (MIIP) in the Romanian legislation.

[12] The largest IPO for the Romanian stock market, also listed in London.

[13] Currently the number of SOEs exceeds 1,200, the largest in the EU.

which remains shallow in Romania relative to regional peers,[14] and has paved the way for Romania to be included in the FTSE-Russell indices.

6. **This DPL helps improve the efficiency of public spending.** Romania's public sector outcomes lag behind other EU member states in key areas. It has the lowest life expectancy, the highest infant mortality and the highest incidence of mortality from cardiovascular diseases and cervical cancer in the EU according to Eurostat. Romania's infrastructure gap relative to the rest of the EU is widening due to weak project selection and prioritization, low execution rates, a backlog of long-overdue, unfinished investments and relatively weak absorption of EU funds. Social protection spending is fragmented and not well targeted. The prevalence of large and usually inefficiently managed SOEs discourages investment, distorts competition and strains the budget. This DPL improves public sector outcomes through the following prior actions: (i) extending the use of centralized procurement in health will lead to important price reductions for medicines and generate savings which can be channeled to underfunded programs in the health sector; (ii) the prioritization of public investments will lead to a better allocation of the scarce public money towards priority projects and accelerate the implementation of infrastructure projects; (iii) the law on the MSIP will consolidate social assistance programs, reduce administrative costs and channel more resources to the poor; and (iv) the new law on corporate governance of SOEs is an important milestone in strengthening the performance of Romania's large SOE sector.

7. **The government has made progress in recent years in overcoming important structural constraints.** In the aftermath of the crisis, several governments have promoted important structural reforms in public finance, corporate governance of SOEs, competition, energy, and labor markets. These reforms were supported by the EU, the IMF and the WB and have helped revive growth and facilitate fiscal adjustment. Key fiscal reforms included the implementation of the Fiscal Responsibility Law (FRL), which established fiscal rules and an independent fiscal council, as well as a Fiscal Budgetary Strategy, which is anchored in the EU Fiscal Compact. While national and sub-national fiscal rules are sound, their enforcement has been weak.[15] During the last year, the authorities have implemented several important reforms: they have improved the transparency of decision-making and exposed corruption; introduced fiscal transparency measures; adopted a new public procurement law; advanced a series of pro-poor policies; and made progress with addressing high-level corruption, including by approving an anti-corruption strategy in August 2016.[16] They also advanced several important structural reforms, supported under this DPL, such as cadaster reforms; and new laws on corporate governance of SOEs and social assistance.

8. **There are substantial domestic and external risks to this operation.** First, political uncertainty is high, prior to the upcoming general elections, scheduled for December 2016. Ad-hoc parliamentary decisions, including amendments to the fiscal code, have increased fiscal pressures and heightened the risk that Romania may enter the EC's Excessive Deficit Procedure (EDP) in the coming years[17]. Yet, public debt is sustainable and among the lowest in the EU. The lack of strategic decision-making entail risks for fiscal and growth sustainability. Yet, the DPL reform agenda has enjoyed bi-partisan political support from

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[14] At €16.9 billion in 2015 (10.8 percent of GDP), Romania's stock market capitalization is below that of other EU peers, such as Hungary (14.3 percent of GDP) and the Czech Republic (14.0 percent of GDP). Its daily turnover, at €7.3 million in 2015, is substantially below regional peers.

[15] For example, the budget law 2016 waived the provision of the Fiscal Responsibility Law and of the fiscal rule.

[16] In the course of 2015, the National Anti-Corruption Department (DNA) indicted over 1250 defendants, including current and former ministers, members of Parliament, mayors, judges, prosecutors and other senior officials.

[17] European Commission. 2016. "Spring 2016 Economic Forecast: Staying the course amid high risks". http://ec.europa.eu/economy_finance/eu/forecasts/2016_spring_forecast_en.htm

several governments and in Parliament. The reforms supported under this DPL were implemented despite frequent changes of governments, ministers and a high turnover at decision-making levels. Second, low capacity and vested interests, especially with respect to SOEs, public investment and in the health sector, could adversely affect the sustainability of several of the reforms supported under this DPL. The authorities have made significant progress in advancing key reforms supported under this operation: the secondary legislation of the law on corporate governance of public enterprises (Law 111/2016) has been approved by government; the procurement of centrally procured antibiotics and oncology drugs has started; and the MSIP Law has been approved by Parliament. Moreover, the government has improved transparency of decision-making and made progress with addressing high-level corruption. Third, a surge in global interest rates, a slow Euro area recovery, or over worsening market sentiments toward emerging economies in Europe would adversely affect Romania's growth. However, Romania is now better prepared to absorb shocks than it was before the 2008 crisis and its macroeconomic position and growth are solid compared to some other EU member states and other regional peers.

2. MACROECONOMIC POLICY FRAMEWORK

2.1 RECENT ECONOMIC DEVELOPMENTS

9. **Romania has experienced a solid recovery since 2013 supported by strong growth, which has gradually become more broad-based.** Initially driven by strong export performance, growth has benefited increasingly from a pickup in domestic demand. Against the back-drop of weak external demand, Romania's exports grew by an average of 14.6 percent per year between 2013 and 2015 driven by a steep increase in international sales of machinery and transport equipment produced by foreign-invested factories. Private consumption recovered strongly in 2014 on the back of robust wage growth; declining unemployment; low interest rates; and low commodity prices, pushing real GDP growth to 3.0 percent in 2014 (Table 1). Economic growth accelerated further to 3.8 percent in 2015, led by the pick-up in private consumption[18] and supported by a rebound in investment, which returned to near pre-crisis growth rates. In 2015, Romania's investment was at 24.7 percent of GDP the highest investment in the EU.[19] Investment is broad-based: in 2015, 42.4 percent of investment went into services and trade, 37.9 percent to industry, and 12.0 percent to construction. Investment recovery was also aided by improvements in the absorption of EU funds.[20]

10. **Romania's economic growth has been the highest in the EU in the first half of 2016 and the fastest since 2008, supported by the impacts of earlier structural reforms, improvements in the labor market, and tax cuts.** Economic growth accelerated to 5.2 percent in the first half of 2016, led by private consumption (up 9.4 percent), which was boosted by the reduction in the standard VAT rate from 24 percent to 20 percent in January 2016, and by labor market improvements. Investment growth remained solid at 7.3 percent due to strong private sector activity. Exports have continued to expand, but have been outpaced by imports, leading to a widening of the current account deficit to 1.5 percent of the projected GDP by June 2016, from 1.1 percent in 2015.

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[18] The cut in VAT on food and food-related products from 24 percent to 9 percent from June 2015 significantly contributed to consumption growth.

[19] Eurostat, preliminary figure.

[20] Despite its pick up since 2014, Romania's absorption of EU funds remains the lowest in the EU at 75.7 percent at the end of September 2016.

Table 1. Key Macroeconomic Indicators

	Actuals						*Est.*	*Projected*		
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Real economy										
GDP (nominal, billion RON)	533.9	565.1	595.4	637.5	667.6	712.8	764.2	813.0	865.1	917.7
Real GDP growth	-0.8	1.1	0.6	3.5	3.0	3.8	5.1	3.8	3.4	3.3
Contributions, of which:										
Consumption	-0.3	0.6	0.8	-0.2	2.3	3.9	5.7	4.0	3.7	3.6
Investment	-0.4	0.5	-1.3	0.1	0.8	1.3	1.3	0.9	0.8	0.8
Net exports	-0.1	-0.1	1.1	3.6	-0.2	-1.5	-1.9	-1.2	-1.1	-1.1
Unemployment rate (ILO definition)	6.9	7.2	6.8	7.1	6.8	6.8	6.4	6.2	6.3	6.5
GDP deflator (2010 = 100)	100.0	104.7	109.6	113.4	115.3	118.7	121.1	124.1	127.7	131.2
Fiscal accounts										
Revenues	33.0	33.2	33.0	32.0	32.1	32.8	31.3	30.7	30.5	30.5
Expenditures	39.5	37.6	35.5	34.6	33.8	34.1	34.1	33.5	33.3	33.3
General government balance (cash)	-6.6	-4.4	-2.5	-2.5	-1.7	-1.4	-2.8	-2.8	-2.8	-2.8
General government balance (ESA2010)	-6.9	-5.4	-3.7	-2.1	-0.9	-0.7	-2.8	-3.4	…	…
Gross general government debt 2/	30.5	33.9	37.7	38.9	40.6	39.3	39.5	40.0	40.4	41.0
Selected monetary accounts										
Base money (% change) 3/	2.8	5.2	3.7	12.7	18.2	26.1	…	…	…	…
Credit to nongovernment (% change)	5.2	6.2	1.6	-3.4	-3.7	2.5	…	…	…	…
Interest (key policy rate, in percent) 4/	6.25	6.00	5.25	4.00	2.75	1.75	…	…	…	…
Balance of payments										
Current account balance	-5.1	-4.9	-4.8	-1.1	-0.5	-1.1	-2.4	-3.6	-4.1	-4.1
Exports	32.3	36.8	37.5	39.7	41.2	41.1	41.4	41.2	41.2	…
Imports	38.4	42.4	42.4	40.5	41.5	41.6	43.1	43.6	43.9	…
FDI	1.8	1.4	1.6	1.9	1.6	1.9	1.9	1.9	1.8	…
Gross Reserves (in € billions) 4/	36.0	37.3	35.4	35.4	35.5	35.5	36.9	38.6	40.8	…
in months of next year's imports	8.8	7.9	7.5	7.3	6.8	6.4	6.1	5.7	5.5	…
in percent of short-term external debt	183.9	163.4	169.3	184.5	187.7	183.6	180.9	183.8	193.6	…
External debt (% of GDP)	73.8	74.9	75.5	68.0	63.1	56.1	53.6	52.5	50.7	48.3
Terms of trade (merchandise, % change)	1.3	1.8	-3.4	0.4	0.9	1.2	0.0	-0.1	0.6	-0.3
Exchange rate (RON/€, average)	4.2	4.2	4.5	4.4	4.4	4.4	4.5	4.5	4.5	…
Memorandum items										
GDP nominal in US$, millions	168.0	186.1	171.7	191.6	199.4	177.3	181.9	194.3	206.3	219.0
Potential GDP (2010, billion RON)	555.4	560.9	570.7	580.1	591.3	607.0	625.8	647.0	…	…
Output gap	-3.9	-3.8	-4.9	-3.1	-2.1	-1.1	0.0	0.3	…	…

Source: The Ministry of Public Finance (MOPF); the National Bank of Romania (NBR); Eurostat; IMF; Bank staff estimates and projections. As of September 2016. 1/In percent of GDP, unless indicated otherwise; 2/World Bank Assessment; End of Period, 3/Comprises currency in circulation plus overnight deposits; 4/End of Period

11. **Romania's external position has significantly improved, but vulnerabilities remain.** The current account deficit fell from 13.4 percent of GDP in 2007 to 0.5 percent in 2014 and widened slightly to 1.1 percent in 2015. While strong import compression as a result of weak domestic demand initially helped

the current account, improvements in the current account have been increasingly supported by strong growth in exports of goods and services. Net foreign direct investment (FDI) inflows averaged 1.7 percent of GDP per year between 2010 and 2015 and have more than covered Romania's current account deficits since 2013. Total external debt has declined rapidly from a peak of 75.5 percent of GDP in 2012 to 56.1 percent in 2015. Still, external vulnerabilities persist. External financing needs remain high at around 20 percent of GDP in 2015 (down from 34 percent in 2012) and Romania's negative net international investment position is sizeable, at around 51 percent of GDP in 2015. External short-term debt remains relatively high at about 54.5 percent of foreign reserves in 2015, but rollover risks are mitigated by the fact that 61.3 percent of external short-term debt consists of intra-company loans. Reserves remain adequate at € 36.9 billion at end-August 2016, covering more than six months of imports.

12. **The exchange rate is in line with fundamentals and inflation is low.** Romania's real exchange rate has depreciated by more than 3 percent since 2014. Episodes of volatility have been limited and driven mainly by fluctuations in portfolio flows. The IMF assesses the exchange rate to be broadly in line with its equilibrium level.[21] Wages have grown strongly and in excess of productivity growth in 2015, as a result of public wage hikes and increases in the minimum wage, raising unit labor costs by 1.7 percent between 2013 and 2015. Annual average inflation has been trending downward since 2013 and turned into deflation because of the VAT cuts (2015, 2016), falling oil prices, and strong harvests (2013 and 2014). Prices fell 0.2 percent in the 12 months through August 2016, prompting the NBR to lower its end-2016 inflation forecast to -0.4 percent. Cuts in policy interest rates, from 6 percent in 2012 to 1.75 percent in May 2015, have supported the economic recovery.

13. **Romania has undergone substantial fiscal adjustment and has one of the lowest public debt levels in the EU.** It reached its medium-term objective of a structural deficit of 1 percent of GDP in 2014 and maintained it in 2015 (Table 2), as improved tax collection[22] compensated for ad-hoc spending increases on child allowances and public sector wages, and also for a decline in the VAT rate on food and food-related items from 24 percent to 9 percent since June 2015. Revenues fell by 2 percent, as improvement in the collection of PIT, CIT and social contributions could not offset the VAT cuts. Expenditures increased 5.5 percent, driven by a larger public wage bill, pension hikes and the doubling of the child allowance. Public debt amounts to 39.3 percent of GDP in 2015 and is among the lowest in the EU,[23] but has been gradually increasing since 2008.[24] Sovereign credit default swap spreads (five years) fell to 112 basis points by September 27, 2016, from a peak of 557 basis points in January 2012 and have been declining relative to September 2015 by around 20 basis points. All major rating agencies place Romania in the investment category with a stable or positive outlook.

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[21] IMF. 2016. *Romania – Staff Report for the 2016 Article IV Consultation*.

[22] Recent tax administration reforms have helped to improve revenue collection by 0.7 percent of GDP in 2015, relative to 2014. With support from the WB Revenue Administration Modernization Project (RAMP) we expect further improvements in tax collection through better compliance in the medium term.

[23] As of end 2015, public debt amounted to 37.9 percent of GDP according to the EU methodology.

[24] Net public debt has slightly increased as a share of GDP since 2013 from 30.2 percent of GDP to 31.8.

Table 2. Romania - Fiscal Developments and Prospects, 2010–2019 1/

	Actuals						*Est.*	*Projected*		
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Revenue, % of GDP	**33.0**	**33.2**	**33.0**	**32.0**	**32.1**	**32.8**	**31.3**	**30.7**	**30.5**	**30.5**
Taxes, of which:	27.1	28.4	28.3	27.7	27.3	27.5	26.4	25.9	25.7	25.6
VAT	7.7	8.7	8.6	8.3	7.6	8.0	7.0	6.7	6.7	6.7
Social security contributions	8.9	9.2	8.8	8.7	8.6	8.1	8.1	8.1	8.1	8.0
Nontax revenue	3.9	3.4	3.1	2.8	2.6	2.7	2.7	2.7	2.7	2.7
Capital revenue	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1
Grants 1/	1.9	1.3	1.4	1.4	2.0	2.4	2.0	2.0	2.0	2.0
Expenditure, % of GDP	**39.5**	**37.6**	**35.5**	**34.6**	**33.8**	**34.1**	**34.1**	**33.5**	**33.3**	**33.3**
Current expenditure, of which:	35.8	33.5	32.3	31.8	31.4	31.8	31.6	31.0	30.9	30.9
Compensation of employees	8.4	7.0	7.0	7.4	7.5	7.3	7.9	7.9	7.9	7.9
Goods and services	5.8	5.8	5.9	6.2	5.9	5.7	5.7	5.7	5.7	5.7
Interest	1.4	1.6	1.8	1.7	1.5	1.3	1.5	1.5	1.5	1.6
Subsidies	1.3	1.2	1.0	0.8	0.9	0.9	0.9	0.9	0.9	0.8
Transfers, of which:	18.6	17.5	16.3	15.6	15.4	16.5	15.6	15.0	14.9	14.9
Pensions	8.4	8.1	7.6	7.3	7.2	7.2	7.2	7.2	7.2	7.2
Projects with external credits	0.4	0.4	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Capital expenditure 2/	3.8	4.1	3.3	2.9	2.6	2.5	2.5	2.5	2.4	2.3
Net lending and expense refunds	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0
Fiscal balance , % of GDP	**-6.6**	**-4.4**	**-2.5**	**-2.5**	**-1.7**	**-1.4**	**-2.8**	**-2.8**	**-2.8**	**-2.8**
Memorandum items:										
Primary balance	-5.1	-2.7	-0.7	-0.8	-0.2	0.0	-1.3	-1.3	-1.3	-1.2
Structural deficit	-6.1	-3.4	-1.7	-1.7	-0.5	-0.7	-3.2	-2.9	-2.9	-2.8
Total capital spending	6.6	6.6	6.1	5.1	4.8	5.9	5.6	5.2	5.1	5.0
Health spending	3.6	3.7	3.8	4.3	4.0	4.1	…	…	…	…
Education spending	3.5	3.2	3.0	3.0	3.1	3.2	…	…	…	…

Source: MOPF; IMF; Bank staff estimates and projections. As of end-September 2016. 1/ In percent of GDP, unless indicated otherwise; 2/ Includes EU-financed capital projects; 3/ Does not include all capital spending.

14. **The banking sector is well capitalized, but credit remains subdued.** The banking sector is well capitalized and the tier-one average capital adequacy ratio was 19.1 percent in June 2016. Nonperforming loans (NPLs) declined from a peak of 21.9 percent of total loans at end-2013 to 11.3 percent in June 2016 aided by measures to facilitate their resolution, such as NPL sales and write-offs. Despite the decline in NPLs, historically low interest rates, and strong liquidity in the banking sector, credit growth remains subdued. Contributing to weak bank lending are a lack of bankable projects and continued deleveraging as banks remain exposed to a high, though declining, share of foreign currency loans, of around 50 percent in June 2016. Credit to corporations continued to contract in year-on-year terms by 5.6 percent in August 2016, while credit to households modestly declined relative to the month before to 5.8 percent year-on-year in nominal terms. The Parliament approved the law on the discharge of debt obligations ('Giving in payment' law) in April 2016, intended to help households in financial distress with their mortgages. However, this has led to tightening conditions for mortgage lending and is likely to have an adverse effect

on credit growth.[25] After the insolvency of the largest insurance company in 2014, the Financial Supervisory Authority (ASF) completed a comprehensive balance sheet review of the insurance sector in 2015. In this exercise, several insurance companies were found to be underserved, indicating sector-side trends which should be addressed through targeted regulatory measures. However, ASF does not expect any macroeconomic impact or spillover effects for the broader financial sector.

2.2 MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

15. **Parliament adopted several measures in the run-up to the 2016 parliamentary election with broad political support. These could lead to an elevated fiscal deficit over the medium term in the absence of compensatory measures**. In 2015, Parliament approved a wide range of tax policy measures that are likely to lead to a decline in the budget revenue-to-GDP ratio of up to 1.5 percent of GDP in 2016 and 2.1 percent in 2017 in cumulative net terms. Hikes in public wages, which are the lowest in Europe in purchasing power standards, and measures to move towards a unitary pay law are expected to raise the total wage bill to 7.9 percent of GDP in 2016. Our baseline projection assumes that the fiscal deficit is expected to widen significantly to 2.8 percent in cash terms in 2016 and remain at this level.[26] The current Government has expressed a strong commitment to avoiding the Excessive Deficit Procedure. The Convergence Program submitted to the EC in May projects a budget deficit of less than 3 percent of GDP throughout its projection horizon[27] (see also Annex 2). This could be achieved in 2017 and 2018 if the government were to postpone certain measures[28] approved under the fiscal code in 2016, and contain public wage spending pressures. However, the structural deficit will remain above Romania's medium-term budgetary objective (MTO) of a deficit of 1 percent of GDP.

16. **Growth is expected to remain solid due to pro-cyclical fiscal policies and structural reforms**. Real GDP growth is expected to increase to 5.1 percent in 2016 before moderating to 3.8 percent in 2017, as the effects of the fiscal stimulus dissipate. The output gap is projected to close in 2016 and inflation is expected to reach -0.4 percent at end-2016 and 2.0 percent at end-2017.[29] Structural reforms promoted under this DPL are expected to support potential growth over the medium-term. The implementation of the corporate governance law and the recruitment of professional management for SOEs are expected to lead to an improved performance among state-owned enterprises. The adoption of the new cadaster framework should lead to increased registration of property and should improve the functioning of the land and real estate markets. Energy sector reforms have already contributed to lower wholesale electricity and gas prices and will strengthen the competition in the energy market. Capital market reforms

[25] The law discharges households with loans collateralized by residential real property from credit or nonbank financial institutions of less than €250,000 at origination to discharge their loans if they transfer their mortgaged property to the financial institution. It retroactively applies to existing loans, undermining property rights and creating significant legal uncertainty. The NBR estimates that banking sector losses could reach up to 0.4 percent of GDP should the law be fully implemented. However, so far the implementation of the new law has encountered several technical and legal difficulties. Several banks have challenged the law in Romania's constitutional court. A decision is expected by the end of 2016.

[26] This is a conservative fiscal scenario. A government deficit in excess of 3 percent of GDP at market prices could trigger an EDP by the EU, requiring fiscal adjustment in subsequent years.

[27] See http://discutii.mfinante.ro/static/10/Mfp/pdc/programconvergenta2016-2019.pdf.

[28] For example, the government could postpone the reduction of excise duties for fuels (0.33 percent of GDP) and the reduction of VAT from 20 to 19 percent (0.26 percent of GDP) until tax efficiency has significantly improved to compensate for these additional tax rate reductions. The government could also raise dividends from SOEs and accelerate the implementation of IPOs (0.22 percent of GDP).

[29] Banca Nationala a Romaniei, Raportul asupra Inflatiei, August 2016.

will bring Romania close to obtaining secondary emerging market status.[30] The DPL also supports improvements in public investment prioritization which, combined with improvements in the absorption of EU funds, will be important to mitigate the growth impact of declining national financed capital spending.

Table 3: Government Financing Needs 1/

	Actual		*Est.*	*Projections*				
	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
GROSS FINANCING NEEDS	9.0	8.8	9.2	7.7	8.1	7.7	6.6	5.6
Primary Deficit (- is surplus)	0.2	0.0	1.3	1.3	1.3	1.2	1.2	1.2
Interest Expenses	1.5	1.3	1.5	1.5	1.5	1.6	1.6	1.6
Debt Amortization	7.3	7.4	6.4	4.9	5.3	4.9	3.8	2.8
Domestic	6.1	5.0	5.1	4.0	3.5	3.4	2.8	1.8
External	1.2	2.5	1.2	0.9	1.8	1.5	1.0	1.0
Private Creditors	0.0	1.0	0.9	0.0	0.8	0.8	0.9	0.8
Official Creditors	1.2	1.5	0.3	0.9	1.0	0.8	0.2	0.2
GROSS FINANCING SOURCES	9.0	8.8	9.2	7.7	8.1	7.7	6.6	5.6
Privatization Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Decrease in Buffers (- is increase)	-0.2	0.8	0.0	0.0	0.0	0.0	0.0	0.0
Domestic Market Access	6.3	6.0	7.2	5.9	5.8	5.7	5.1	4.4
External Financing	2.9	2.0	2.0	1.8	2.3	2.1	1.6	1.3
Private Creditors	2.6	1.3	1.9	1.3	1.7	1.4	1.0	0.8
Official Creditors	0.3	0.7	0.1	0.6	0.6	0.6	0.5	0.5
Memo Items:								
Overall Fiscal Balance (Cash)	-1.7	-1.4	-2.8	-2.8	-2.8	-2.8	-2.8	-2.8
Gross general government debt	40.6	39.3	39.5	40.0	40.4	41.0	41.4	41.8

Source: Ministry of Public Finance; World Bank staff estimates and projections as of September 2016. 1/ In percent of GDP unless otherwise indicated.

17. **Public debt remains sustainable.** Under the Bank's baseline scenario, public debt is projected to increase modestly from 39.3 of GDP percent in 2015 to 41.8 percent by 2021. Net public debt is expected to remain below 40 percent of GDP throughout the projection horizon. Financing needs remain manageable at around 7.5 percent of GDP between 2016 and 2021 (see Table 3). The government intends to rely primarily on the domestic market for financing during the projection period, with around 70 percent of financing coming from domestic sources, including from banks and pension and investment funds. The risk structure of the debt portfolio has significantly improved as the average time-to-maturity increased to 5.3 years at end-2015 from 3.6 years in 2011 and the share of variable interest rate debt declined. If real GDP growth were to be 1.2 percentage points (a quarter of its 10-year standard deviation) lower than projected in 2017 and 2018, Romania's public debt-to-GDP ratio would reach 54.6 percent by 2021. A depreciation in 2017 and 2018 of 1 percent and 1.3 percent respectively, would push public debt to 52.3 by 2021. Combining the growth shock with a real exchange rate depreciation of about 11 percent in 2017, and an interest rate hike of 200 basis points could raise public debt to 57 percent of GDP (see the Public Debt Sustainability Analysis (DSA) in Annex 4). An "overshooting" scenario[31] assumes that the government will implement the fiscal code as approved, further increase public wages and preserve public investment spending. Under this scenario, the fiscal deficit will increase to 3.6 percent of GDP in 2017[32].

[30] Romania is currently considered a frontier market under the FTSE Global Equity Index.

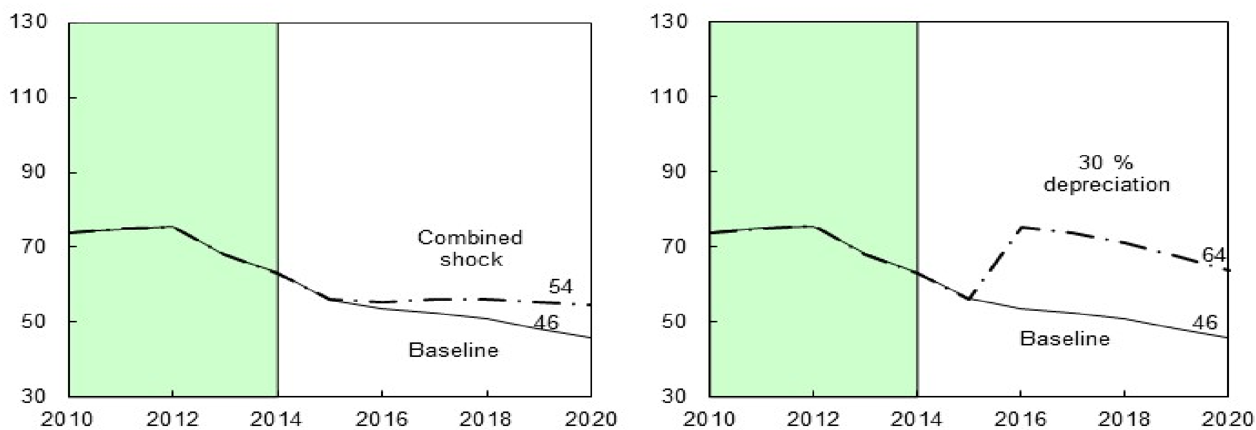
[31] See the DSA in Annex 4.

[32] The European Commission projects a fiscal deficit of 3.4 percent of GDP (ESA terms) in 2017 under their no policy change scenario. See http://ec.europa.eu/economy_finance/eu/forecasts/2016_spring_forecast_en.htm.

This would imply that Romania will enter into the EDP of the EU and be forced to reduce its structural fiscal deficit by 0.5 percent of GDP per year starting in 2018, as stipulated under the procedure. Under this scenario, public debt-to-GDP ratio will peak in 2019.

18. **Romania's external debt is also sustainable.** External debt has been rapidly declining since 2012. Looking forward, domestic demand pressures are expected to lead to a widening of the current account deficit towards 4.1 percent of GDP in 2018, which will be partly financed through higher FDI inflows. Still, gross external financing needs and external debt are projected to continue to decline between 2016 and 2021 under the baseline but at a lower pace (Figure 1). Romania remains vulnerable to changes in the global market sentiment. Permanent 1/4 standard deviation shocks applied to the real interest rate, the growth rate, and the current account balance would push the external debt towards 54 percent of GDP in 2020. A one-time real depreciation of 30 percent will increase external debt to 64 percent of GDP in 2020.

Figure 1. External Debt Sustainability 1/



Source: IMF and Bank staff estimates as of May 2016. 1/External debt in percent of GDP.

19. **Political and macroeconomic risks to this outlook are substantial.** Further ad-hoc decisions cannot be discounted in the run-up to the 2016 elections. These could have adverse implications for budget and growth. However, they are partly mitigated by the support to structural reforms from reformist politicians within all political parties, as expressed during extensive consultations with the Bank team. The European Semester and Romania's EU membership commitments provide a strong anchor for the DPL reform agenda. Externally, a loss of confidence in emerging market economies in Europe, because of either global emerging market developments or heightened uncertainty within the EU, could lead to capital outflows and trigger a currency depreciation. As around 50 percent of bank lending is in foreign currency, an important depreciation of the exchange rate, as experienced in the case of the Swiss franc, could cause deterioration in bank and company balance sheets. It would also increase public debt. Hikes in U.S. interest rates could trigger capital outflows and increase domestic rollover costs. Further ad-hoc increases in the minimum wage could harm competitiveness.

20. **The macroeconomic policy framework is adequate for this operation.** The authorities implemented a coherent mix of macroeconomic policies: fiscal, monetary, and income, during and after the global crisis, which helped to correct the large pre-crisis external and internal imbalances. Although the fiscal policy stance weakened in 2015, Romania remains among the EU member states with no macro-

economic imbalances in the 2016 European Semester cycle.[33] Risks arise from Romania's relatively large negative net international investment position and a weak medium-term export capacity. The banking system is well capitalized and able to withstand adverse shocks, as asset quality gradually improved and NPLs declined. The Government has also taken steps to strengthen debt management, reducing rollover risks and locking in currently low interest rates.

2.3 RELATIONS WITH IMF AND EUROPEAN COMMISSION

21. **Currently, Romania does not receive financing support from the IMF.** The IMF's precautionary standby arrangement with Romania expired in September 2015. The first and second reviews were completed in March 2014; no subsequent reviews were completed. The IMF program supported fiscal consolidation and reforms in health, capital expenditure, government and SOE arrears, and tax administration. It also supported structural reforms in energy and transport. The IMF concluded its Article IV consultations in May 2016, noting the pro-cyclical character of the recent fiscal relaxation measures and the need to accelerate structural reforms, especially in the areas of corporate governance of the SOEs, tax administration, prioritization of public investment and quality of the business environment (see Annex 3).

22. **Since September 2015, Romania is under the EU post-program surveillance.** Romania's most recent precautionary EU balance-of-payments program (2013–2015) ended in September 2015. The program sought to address macro-economic and financial vulnerabilities and to promote structural reforms. The key measures focused on: consolidating macroeconomic, fiscal and financial stability; enhancing administrative capacity and the business environment; reforming SOEs and the tax administration; improving public financial management; and enhancing the functioning of the energy and transport sectors.[34] Post-program surveillance will continue until at least 70 percent of the outstanding debt to the EU has been repaid, which is expected to happen by spring 2018. The European Commission (EC) works closely with the Romanian authorities in the context of the European Semester. This DPL is consistent with the most recent Country-Specific Recommendations (CSR) issued by the EU for Romania[35], especially the need to strengthen the corporate governance of SOEs; improve public investment prioritization; improve access to integrated public services; and curb informal payments in the healthcare system.

23. **The IMF and the EU programs were complementary to the reform program supported under this DPL programmatic series.** Regular consultations have been conducted with the IMF and the EU throughout the implementation of the DPL-supported reform agenda, and both institutions provided valuable guidance and input into the program.

3. GOVERNMENT'S PROGRAM

24. **The National Reform Program 2016[36] (NRP), which covers the period 2016 to 2020, aims at boosting competitiveness, employment and social cohesion; reform priorities under this DPL are anchored in the NRP.** Romania's NRP defines reform priorities to enable Romania to achieve the Europe

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[33] During the 2016 European Semester, Romania was assessed to be experiencing no macroeconomic imbalances. http://ec.europa.eu/europe2020/pdf/csr2016/cr2016_comm_en/pdf

[34] http://ec.europa.eu/economy_finance/publications/eeip/pdf/ip012_en.pdf

[35] Recommendation for a Council recommendation on the 2016 national reform programme for Romania and delivering a Council opinion on the 2016 convergence programme of Romania, Brussels, May 18th, 2016.

[36] Published in April 2016. See http://ec.europa.eu/europe2020/pdf/csr2016/nrp2016_romania_en.pdf

2020 targets. The program also reflects the EC's Country Specific Recommendations for 2015. Key reform measures supported under the NRP include improvements in public administration, public investment management; cadaster; efficiency of the health system; social protection and the investment climate.

25. **The current Government's program focuses on economic growth and poverty reduction and is anchored in the NRP.** Following the abrupt resignation of the previous government, a technocratic government assumed office in November 2015 with a limited tenure until November 2016. The main objective of the new administration is to promote good governance, including by strengthening the corporate governance of SOEs and the accountability to the public and civil society,[37] promoting public administration reforms and anti-poverty measures.

4. PROPOSED OPERATION

4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

26. **The FEG-DPL supports key legislative initiatives and policy reform measures.** The program is structured under two pillars:

(A) Strengthening fiscal management and SOE performance; and

(B) Improving the functioning of energy, property, and capital markets.

Pillar A supports the government's efforts to manage public resources more efficiently by improving the management of public debt, widening the scope for using centralized procurement in health, improving pro-poor spending and enhancing the corporate governance of SOEs to boost their performance and reduce macroeconomic risks. Pillar B supports efforts to improve the investment climate and long-term growth by eliminating distortions in the energy markets and reducing emissions; improving the transparency and the performance of state-owned companies; and facilitating land and financial markets functioning though cadaster and capital market reforms. Several reforms supported by this operation are a priority in the NRP.

27. **The proposed operation has incorporated lessons from the Bank's experience in Romania to date:**

- **Need for government ownership at the highest level and bi-partisan support in Parliament.** Strong government ownership is critical for moving the reform agenda forward. This operation has benefitted from the direct collaboration and support of the top leadership, including the prime minister, the minister of public finance, and sector ministers from different Romanian governments, as well as from the leadership and reformist members of Parliament across the political parties.

- **A solid track record of Bank engagement.** The DPL focuses on areas in which the Bank has significant expertise and engagement through analytical work, TA, and reimbursable advisory services (RASs) or where it supports complementary measures through project lending. An

[37] http://gov.ro/ro/obiective/programul-de-guvernare

intensive country and sector dialogue and the capacity to provide numerous just-in-time TA have been particularly important in the context of frequent government changes.

- **Need for coordination among development partners.** The Bank team has worked closely with the EC, IMF, and International Finance Corporation (IFC) during the preparation and implementation of this operation. The team also reached out to other stakeholders, including the private sector, trade unions and civil society.

4.2 PRIOR ACTIONS, RESULTS, AND ANALYTICAL UNDERPINNINGS

PRIOR ACTIONS AND RESULTS

Pillar A: Strengthening Fiscal Management and SOE Performance

28. **Strengthening fiscal management and SOE performance is important for locking in fiscal consolidation gains; providing high-quality public services; and supporting Romania's growth and poverty reduction.** Romania's infrastructure gap is large relative to the rest of the EU due to weak project selection and prioritization; low execution rates; a backlog of long-overdue, unfinished investments; and relatively weak absorption of EU funds. Health outcomes are among the worst in the EU: Romania has the lowest life expectancy, the highest infant mortality and the highest incidence of mortality from cardiovascular diseases and cervical cancer according to Eurostat. Ineffective procurement in the health sector leads to unnecessary expenses and reductions in budgetary resources for preventive care and other underfunded health sector activities, which is likely to benefit especially the poor. Social protection spending is fragmented and not well targeted. In 2014, means-tested programs accounted for only 17 percent of the total social assistance budget. The prevalence of large and usually inefficiently managed, SOEs discourages investment, distorts competition and strains the budget. Financial shortfalls among SOEs have also led to under-investment in key sectors such as transport and energy and limited compliance with environmental and social governance standards. On the financial management side, Romania's capacity to manage its debt effectively is limited by a shallow domestic government securities market; and constraints to engage in buybacks raise Romania's vulnerability to external shocks and rollover risk.

DPL2 Prior Action #1: The MOPF has amended the Government Decision 1470/2007 to enable the use of buy-backs and exchanges of Government securities and has implemented an electronic trading platform for public debt secondary market operations.

29. **The MOPF has made significant progress in bringing its debt management practices in line with other EU countries to reduce funding costs, decrease rollover risks, and support the development of the financial sector.** Supported under FEG-DPL1, the MOPF approved the Debt Management Strategy (DMS) (2014–2016), which was significantly improved compared to previous strategies,[38] and linked it with the 2014 Annual Borrowing Plan (ABP). The 2014 ABP laid the foundations for building up benchmark issuances and improving predictability and transparency of government operations in the primary market. As the MOPF started to issue large-size benchmark bonds, the option of bond buybacks and exchanges became increasingly important. Bond buybacks, which is a widespread international practice in almost all advanced government securities markets, allows issuers to retire outstanding debt before maturity at some cost, thereby reducing the rollover risk.

[38] Debt management reforms were supported under a Bank RAS.

30. **The MOPF and NBR have also modernized their auction infrastructure.** A fully electronic auction system for the primary government securities market at the NBR became fully functional in March 2014 (DPL1 Prior Action #1). The system's interface with the debt management system (FTI STAR) allows the MOPF to have real-time access to primary market data and conduct necessary analysis. The new system simplified the management of the primary market auctions and led to a substantial reduction in the average time of an auction, helping the market participants to better manage their liquidity. This DPL supports the implementation of an electronic platform for the secondary market to increase price disclosure and transparency. Along with a benchmark-building strategy, a more focused DMS, and an ABP that is more transparent, this platform will help to make the secondary market more liquid. Cash and liability management will boost the General Directorate for Treasury and Public Debt's ability to manage refinancing risk and reduce carry-on cash balances.

Results: The number of the MOPF's liability management operations increases from 0 in 2013 to 3 in 2017.

DPL2 Prior Action #2: The MOH has approved a centralized procurement plan for 2016, which includes antibiotics and oncology medicines.

31. **Expanding centralized procurement in the health sector can significantly lower prices on key medicines and devices and improve transparency and oversight on related contracts.** Romania's health spending of 4.0 percent of GDP is low relative to the EU average of 7.2 percent in 2014. Health outcomes are weak compared to other EU member states. In 2015, Romania had the highest infant mortality rate in the EU at 9.7 per 1,000 live births, more than twice the EU average. Since 1970, the life expectancy gap between Romania and the EU average has almost doubled, driven largely by the rise in the incidence of non-communicable diseases. Romania has a very high standardized death rate (SDR) for cardiovascular disease for people aged 64 and younger: 108.9 per 100,000, more than twice the EU rate of 43.8; the highest SDR for smoking-related causes (428 per 100,000), and an SDR for cervical cancer of 10.4 per 100,000 women, four times the EU average and easily reducible by adopting simple and inexpensive screening tests.[39] Scaling up centralized procurement in health will help (a) lower prices;[40] (b) improve the transparency and oversight of contracts; (c) improve expertise in procurement; and (d) reduce the burden on hospital staff. This will generate savings that can be ultimately used to finance currently underfunded activities.

32. **This DPL prior action significantly increases centralized procurement in the health sector.** The Ministry of Health (MOH) approved in 2013 a list of medicines, health products, devices, and equipment that can be placed under centralized procurement (Government Emergency Ordinance [GEO] 71/2012 and Ministerial Order 658 from 2013). The capacity of the centralized procurement unit at the MOH was subsequently enhanced. In 2015, around 40 centralized tendering procedures were launched mostly for procuring pharmaceuticals required under national programs, such as vaccines, and treatment for tuberculosis and human immunodeficiency virus treatment. These procedures produced significant fiscal savings, averaging around 25 percent per year for each completed tendering procedure. Yet, most pharmaceuticals, medical devices, and surgical supplies consumed in public hospitals continued to be procured locally with significant differences in unit prices for the same items. Centralized procurement was expanded significantly in 2016, by including 31 antibiotics and 12 widely used oncology drugs, which

[39] Data from Eurostat.
[40] The action is unlikely to increase the consumption of medicines and, thus, medical waste.

constitute a significant share of hospital consumption[41] and can generate important savings. It also creates valuable experience in coordinating systematic centralized procurement on a national level; and make the decision process around the acquisition of medical supplies fully transparent. The MOH has started the procurement process for the package of antibiotics and oncology medicines. The Bank supports complementary reforms in the health sector through a Health Sector Reform Project, which focuses on improving access, quality, and efficiency of public health services in Romania.

Results: Average unit price for centrally procured drugs and devices declines from RON 22.2 in 2015 to RON 20.0 in 2017.[42]

DPL2 Prior Action #3: The MoPF has published the prioritization list of significant public sector investment projects for 2016.

33. **Romania does not have a government-wide system to manage and prioritize investments.** This is a major flaw in overall spending policy and fiscal management and has become even more pressing in the context of constrained fiscal space and declining capital spending. Romania's public investment budgets have been among the EU's largest for the past decade in terms of GDP, yet projects have in the past not been prioritized within and across sectors. In some sectors, such as transport or regional development, the public investment portfolio far exceeds available medium-term resources. In addition, the implementation of almost a quarter of investments has been underway for over 10 years. The investment portfolio needs to be rationalized and nonperforming projects need to be canceled.

34. **The government has taken steps to improve public investment prioritization.** It adopted a GEO (GEO #88/2013), which establishes the MOPF as the secretariat for prioritizing significant public investments above RON 100 million, or about €22 million. The government has also approved a methodology to operationalize investment priorities (DPL1 Prior Action #3). This methodology has been applied to all ongoing and new significant investment projects in 2016. Improving transparency around investment project financing will be important to strengthen prioritization and to monitor the performance of the infrastructure investment portfolio. The Ministry of Public Finance has published the list of prioritized projects and their ranking on its website (DPL2 Prior Action #3).[43]

Results: The budget allocated to the portfolio of significant public investment projects monitored by MOPF increases from Ron 5.7 billion in 2014 to Ron 6.1 billion in 2017.

DPL2 Prior Action #4: The Government has approved and submitted to Parliament the Law of the Minimum Social Inclusion Program (MSIP).

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[41] The value of the package is estimated at around Ron 1 billion, or around 15 percent of total spending on medicines of public institutions.

[42] The baseline for this results indicator has been set to 2015 as the National Catalogue for Medicine Prices was significantly revised in 2015. The average unit price is calculated as the weighted average of the basket of medicines included in the amended 2016 centralized procurement plan, approved in July 2016, for antibiotics and oncology drugs.

[43] http://discutii.mfinante.ro/static/10/Mfp/buget/sitebuget/Listaproiectinvestpubprioritizate25022016.pdf
This prior action aims to increase transparency of public investment financing. The World Bank Group is not endorsing particular projects on the published list.

35. **Romania's social assistance program suffers from weak targeting and fragmentation.** Romania has currently three means-tested social assistance programs.[44] In 2013, these three programs covered about 62 percent and 46 percent of the poorest quintile during the cold season (November to March) and the remaining part of the year, respectively. The reasons for the relatively low coverage were: (a) relatively high costs of applying for these benefits; (b) asset tests that excluded a large number of genuinely poor households; and (c) a lack of awareness on the part of potentially eligible people about the availability of such benefits. In recent years, the government has taken several steps to increase the coverage and generosity of these programs by: unifying means-testing criteria and streamlining asset filters to reduce inclusion errors (November 2013); increasing the generosity and expanding the coverage of means-tested programs to mitigate energy shocks (June 2014); and increasing the FSA benefit for poor families with children and for children without parents (December 2014). Yet Romania's spending on means-tested social programs remains low at about 0.5 percent of GDP in 2014.

36. **The Law on the MSIP, which has been approved by Parliament in October 2016, improves targeting, expands coverage and generosity of benefits, and reduces administrative costs.[45]** In particular the MSIP is expected to cover more of the poor in the lowest income quintile and a larger fraction of the in-work poor.[46] The introduction of a benefit formula that will disregard part of the earnings will help in-work poor to increase their income by combining earnings with social assistance transfers. Consolidation of the three programs into one is expected to facilitate the application process and reduce application and administrative costs. The conditionality of the program will be strengthened to encourage active job searches and school attendance of the beneficiary. The MSIP will also rely on a performance management system that will make it possible to monitor outcomes, delivery costs, targeting, inclusion errors, and fraud.[47] The Social Assistance System Modernization Project (SASMP) will support the implementation of the MSIP.[48]

37. **Results: The budget allocated to means-tested social assistance programs increases from RON 1.2 billion in the 2014 budget to RON 1.8 billion in the 2018 budget.[49]**

DPL2 Prior Action #5: Parliament has enacted Law 111/2016 on corporate governance of public enterprises, approving GEO 109/2011; and

DPL2 Prior Action #6: The government has completed the IPO for Electrica.

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[44] The programs include the Guaranteed Minimum Income (GMI), the Family Support Allowance (FSA), and the Heating Benefits. The GMI is targeted to the poorest 5 percent of the population, the FSA to families with children in the poorest three deciles, and the Heating Benefits to families in the poorest 60 percent of the income distribution.
[45] The submission of the law to Parliament had been delayed by four changes of the Minister of Labor and Social Policies during the last year; extensive consultations with stakeholders on the key parameters of the law, including the number of eligible beneficiaries, eligibility thresholds and filters and labor market incentives; and the approval of the fiscal code which made it more difficult to secure funding for the MSIP.
[46] Technically, the new formula will replace the provisions of the GMI program, which puts a 100 percent marginal tax rate on earnings, with a benefit formula that will have a marginal tax rate of around 50 percent.
[47] The implementation of the MSIP is also expected to lead to a higher budget allocation for social assistance from 2016 onward.
[48] The SASMP supports a program of parametric and administrative reforms to improve targeting and administrative costs of Romania's social assistance.
[49] For the baseline, this is calculated as the budget of the three programs (GMI, FSH, and heating benefits) and social assistance spending.

38. **Despite improvements in their financial performance, many SOEs remain inefficient and poorly governed, which contributes to fiscal and quasi-fiscal losses and lack of payment discipline in the economy.** SOEs play a significant role in the Romanian economy. There are more than 1,100 SOEs, of which around 300 are majority-owned or controlled by the central government. SOEs have dominant positions in a number of sectors, including in energy and transport and storage[50], and a large presence in mining and quarrying, as well as in water, sewage and forestry. Some central government-owned SOEs are de facto insolvent. Many have tax arrears and arrears to suppliers. In addition to financial shortfalls, the services they provide, especially in infrastructure, are below EU standards. The root cause of these problems has been the inadequacy of governance, monitoring, and oversight of SOEs.

39. **In 2011, the authorities launched a comprehensive SOE reform program to** (a) strengthen governance of SOEs, including through professionalization of the board and management; (b) clarify public sector obligations toward SOEs, strengthen monitoring, and improve the efficiency and effectiveness of government transfers to the sector; (c) attract private investment through a program of privatization; and (d) improve the pricing and the regulatory framework in SOE-dominated sectors, particularly, in energy and transport. De-politicization of board and management appointments began with the enactment of GEO 109/2011. On privatization, three IPOs and two secondary public offerings were completed for five large SOEs in the energy sector by end-2014. Two attempted majority privatizations failed at the same time, one for a petrochemical company, which is now in insolvency proceedings, and one for a rail freight company.[51] This led to a change in the government's strategy towards more emphasis on strengthening transparency and corporate governance of SOEs. The MOPF has started to systematically monitor SOEs' financial and performance indicators, budgets, transparency, boards and management recruitment and publishes this information in an annual report on the performance of SOEs.[52] The Government has already launched the selection of professional boards and executive management for 11 large SOEs.

40. **The energy sector is dominated by SOEs, whose performance remains mixed.** Currently, SOEs in energy account for around 44 percent of the sector turnover and 77 percent of employment, and are dominant in generation and transmission. Thus, the performance of the energy SOEs carries significant risks for fiscal stability, energy security and economic growth.

41. **Given the strategic importance of Romania's energy sector for fiscal performance, growth and security of supply, its restructuring has become a priority for the government.** The focus of the reforms has been on modernizing the corporate governance of the SOEs; improving contracting practices; liberalizing electricity and gas prices for companies; and launching a number of IPOs and SPOs, particularly in energy transmission and distribution.

42. **This DPL series supports several components of the SOE reform program**:

- **Memorandum on state ownership and oversight** (DPL1 Prior Action #6). The memorandum clarifies the responsibilities of line ministries and the MOPF for corporate governance, financial reporting, accountability, transparency, and monitoring and assessment of SOE management. It

[50] SOEs account for 24 percent of sector turnover and 28 percent of employment in transport and storage.

[51] In addition, one large energy generation company, Hidroelectrica, was reorganized through insolvency, and this has helped the company become profitable again.

[52]http://discutii.mfinante.ro/static/10/Mfp/legislatie/patrimoniupublic/RAPORT_PRIVINDACTIVITATEA_IP_2014.pdf

also promotes good practices, such as movement toward International Financial Reporting Standards (IFRS).[53]

- **New law on corporate governance of SOEs** (DPL2 Prior Action #5). Law 111/2016 on corporate governance of SOEs was approved by Parliament in May 2016. It applies to all SOEs with more than 50 employees with the exception of two SOEs in the defense sector. The new law upgraded the status of GEO 109/2011 and addressed several of its weaknesses, in particular related to the (a) appointment and dismissal of board members and managers; (b) mandate contracts and administration/management plans; (c) annual budgeting process; (d) MOPF's oversight role; and (e) treatment of public service obligations imposed on SOEs. It also introduced sanctions and other infringement provisions for not complying with the law.[54] The norms of Law 111/2016 were approved by the Government in September 2016 and published in October 2016. They require the accelerated selection of management and boards for SOEs in line with the new law.

- **IPO of Electrica** (DPL2 Prior Action #6). As part of the privatization agenda, the government completed the Electrica's IPO in July 2014. Electrica is the market leader in energy supply and distribution and one of Romania's top 10 network SOEs. In July 2014, Electrica raised over US$600 million in an IPO on the Bucharest and London stock exchanges, which diluted the state's stake to 49 percent. This was the largest IPO ever done in Romania. The prior action originally envisioned the implementation of two IPOs, Electrica and Oltenia, a lignite mining and power generation company. Oltenia's market share and the wholesale electricity market price have declined since 2012 because of the rapid increase in renewable energy by private generators who enjoy priority access to the market, an increase in Hidroelectrica's generation because of favorable hydrological conditions and contracts' restructuring; high production costs because of obsolete technology; and a modest decline in Romania's electricity consumption. As a result, the conditions for a successful IPO have dissipated.

Results: The number of SOEs with professional Board and management appointed increases from 25 in 2013 to 80 in 2017.

Pillar B: Improving the Functioning of Energy, Property, and Capital Markets

43. **The reforms supported under this pillar are intended to reinvigorate private investment, growth and poverty reduction, complementing the reforms supported under the first pillar.** Well-functioning markets are key for investor confidence and private investment. In particular, high energy costs, weak property rights, and shallow capital markets have been found to constrain investment in Romania. Completing liberalization of electricity and gas markets and integrating them more closely with pan-European markets will enhance efficiency of supply and investments in energy infrastructure. In addition, the new Strategy and Action Plan for Climate Change will enable Romania to access EU funds to invest in climate-friendly energy infrastructure. Critical and long-overdue reforms in the cadaster area can be expected to clarify and enhance trading of property rights and support greater investment and collateral-based lending to the private sector. The new legal framework on cadaster is expected to streamline the

[53] EU's International Accounting Standards regulation 1606/2002 (International Accounting Standards - IFRS) determines that member states may permit or require non-publicly traded companies to publish financial statements that comply with the IFRS. In Romania, unlisted SOEs are not required to do so.
[54] In 2013 around 25 of the 177 active SOEs in the portfolio of the central government had boards appointed according to GEO 109/2011.

registration process and eliminate the costs of initial registration, which prior to the changes have been prohibitively expensive for the poor. Reforms to build up the nonbank financial sector and more efficient capital markets will foster economic growth.

DPL2 Prior Action #7: The National Energy Regulatory Authority (ANRE) has issued the Order to liberalize the nonresidential gas market.

44. **Non-residential gas and electricity markets have been liberalized.** In 2011, the government embarked on a bold energy reform program focused on gradually liberalizing the gas and electricity markets for companies and households; improving corporate governance of energy SOEs; accelerating privatization and company restructuring; and coupling the Romanian electricity market with Central Europe. In 2012, the Parliament adopted a new electricity and gas law, which restored ANRE's operational and financial independence and empowered it to continue energy market reforms. ANRE completed the liberalization of the nonresidential electricity market in early 2014 (DPL1 Prior Action #6) and did the same for the nonresidential gas market in early 2015 (DPL2 Prior Action #7).[55] Consequently, wholesale electricity and gas prices for nonresidential consumers are now determined by market participants in the energy market; this includes centralized trading platforms run by the Romanian Power Market Operator (OPCOM) and the Romanian Commodity Exchange. With the nonresidential electricity market liberalization, trading in the energy exchange platform, OPCOM's Day-Ahead Market (DAM), and centralized auctions of bilateral contracts have grown steadily and now account for all of the nonresidential electricity supply. The liberalization of the nonresidential gas market led to improvements in energy efficiency and reduced the domestic consumption of gas. It led to a significant decline in gas imports, from 20 TWh in 2013 (around 15.3 percent of total domestic consumption) to 2.91 TWh in 2015 (2.4 percent of total domestic consumption).

45. **Results: The amount of natural gas traded at centralized platforms increased from 0 billion cubic meters in 2013 to 2 billion cubic meters in 2017.**

DPL2 Prior Action #8: OPCOM[56] has coupled the Romanian Day Ahead Market (DAM) with electricity markets in Hungary, the Czech Republic, and Slovakia.

46. **The coupling of OPCOM's Day Ahead Market (DAM) with the Hungarian, Czech, and Slovak electricity markets was completed at end-2014** (DPL2 Prior Action #9). This was an important success of OPCOM and the government achievement and has facilitated electricity price convergence in the region and stability of supply. The prior action originally also included an ownership diversification of OPCOM. The authorities and Transelectrica (the electricity transmission company, OPCOM's owner), however, did not pursue it. To comply with the EU's Third Energy Package, Transelectrica (and Transgaz, the gas transmission company) had to be separated from the Ministry of Economy, which had been in charge of all state energy companies at the time. They were moved to the MOPF and then to the Prime Minister's Office and, after the creation of a separate Ministry of Energy, back to the Ministry of Economy. The Ministry of Economy and Transelectrica could take up the diversification agenda again in the near future.

[55] Thermal energy producers are exempted, but only for the quantities of natural gas used in co-generation plans and heating plants for household consumption.
[56] The Electricity and Gas Exchange Platform. OPCOM is currently owned by the electricity grid operator, Transelectrica.

47. **Results: International trade in electricity (exports plus imports) increases from 2.6 TWh at end-2012 to 4.0 TWh at end-2017.**

DPL2 Prior Action #9: Government has approved the National Climate Change and Low Carbon Green Growth Strategy for 2016-2020 and the National Action Plan on Climate Change for 2016-2020

48. **The adoption of the National Climate Change and Low Carbon Green Growth (NCC) Strategy 2016-2020 and a National Action Plan on Climate Change for 2016-2020 is an important step in reducing the carbon print of the energy sector.** The NCC Strategy was adopted by the government in October 2016 and proposes mitigation measures for reducing GHG emissions for nine economic sectors and adaptation measures to climate change for 12 sectors, including the energy sector. The energy sector is the largest contributor to Romania's carbon footprint, accounting for 58 percent of the total GHG emissions.[57] Romania will need to reduce emissions to deliver on the country's commitments under the EU targets for 2030.[58] Reducing energy sector emissions requires significant investment, particularly in the energy generation sector and in energy efficient housing. In addition, obsolete and inefficient district heating systems generate significant fiscal losses. The investment needed to reduce energy sector GHG emissions while satisfying increasing energy demand is estimated to total €7 billion[59] until 2020.

49. **The National Action Plan on Climate Change for 2016-2020 aims to reduce carbon intensity of the energy supply.** The Plan aims to reduce GHG emissions in the energy sector by: i) reducing the carbon intensity of energy supply through continued investment in economically viable renewable and low carbon energy sources; ii) improving end-user energy efficiency, particularly in buildings and industries; and iii) by addressing energy affordability of economically vulnerable groups. A key action is the replacement of the social tariff with the provision of aid for improving energy efficiency in dwellings for low-income persons.

50. **Results: Energy sector greenhouse gas (GHG) emissions declines from 86.5 million tons in 2012 to 80 million tons in 2017.**

DPL2 Prior Action #10: Parliament has enacted Law 150/2015 and the Government has adopted Government Emergency Ordinance (GEO) 35/2016, all amending Law 7/1996 on cadaster and real estate registration.

51. **Real estate registration is important for investment; agricultural development; property tax collection; economic planning; and inclusion of poor and marginalized communities**. Romania has among the lowest levels of real estate registration in the EU: only 15 percent of real estate in rural areas and 51 percent in urban areas were registered as of August, 2016. The low level of real estate registration is likely to depress investment, especially in rural areas, and constrain the collection of property taxes, which at 0.8 percent of GDP in 2015 is significantly lower than the EU average of 1.4 percent. Moreover, lack of real estate registration deters EU-financed structural investments and causes inequalities in opportunities for farmers to absorb EU Common Agricultural Policy funds. Land and property restitution has been completed in Romania with regard to land allocation (though not compensation), and most

[57] Including production and consumption activities.

[58] The EU and its member states are committed to a binding target of an at least 40 percent domestic reduction in greenhouse gas emissions by 2030 compared to 1990, to be fulfilled jointly.

[59] According to the calculations of the World Bank modelling exercise conducted under the Climate Change and Low Carbon Green Growth RAS.

farmers and urban dwellers have titles to their land. However, registering titles was voluntary. Initial registration was prohibitively expensive for the poor under the old legislation, but it is done for free under the new legal framework supported by the DPL. The goal of the National Agency for Cadaster and Land Registration (ANCPI) is to register all properties and land titles in its electronic system, eTerra, which currently covers only 8.8 million properties (including apartments) or around 22 percent of Romania's total real estate assets.

52. **The government is pursuing a three-pronged strategy to improve real estate registration.** First, it has granted the ANCPI greater financial autonomy, most importantly allowing it to retain registration fees, which means it can carry out investments to complete real estate registration nationwide (DPL1 Prior Action #7).[60] Second, to accelerate the process of property registration, Parliament enacted Law 150/2015 and the government adopted GEO 35/2016 (DPL2 Prior Action #10) which introduces a more streamlined and improved process for the systematic registration of properties. The new process for systematic registration allows "possessors" of unregistered property to register current possessions temporarily and convert them into legal ownership after three years in the absence of disputes. Systematic registration is done for the entire administrative territory (locality) with the participation of the community, the local government and land administration professionals to define boundaries and determine the rights associated with each parcel. A 60 day public display process provides public adjudication and the additional 3 year period allows claims to be made against the possession. The two changes to the cadaster framework also include legal safeguards and waive taxes and fees on the first property registration to encourage registration by all citizens, including the poor and vulnerable groups.

53. **Third, the government is in the process of preparing a comprehensive Law on Cadaster and Real Estate Registration.** In spite of the introduction of systematic registration through Law 150/2015 and GEO 35/2016, the current legal framework remains complex. The numerous amendments to Law no. 7/1996 over the years have resulted in an extremely complex piece of legislation, which includes disparate provisions for the same regulatory objective, multiple cross-references to texts within the law, articles with no less than 25 paragraphs, and also transitional and final provisions that create difficulties in interpretation. The new Law on Cadaster and Real Estate Registration will: (a) consolidate currently dispersed regulations related to real estate registration into one comprehensive and harmonized law;[61] (b) strengthen ANCPI's independence, governance structure, and obligations; and (c) simplify registration rules. The government is planning a national program for systematic land registration, financed with EU funding for rural areas; ANCPI funds; and co-financing agreements between municipalities and the ANCPI in urban and rural areas. The objective of this program is to register over 20 million new properties in rural areas over the next eight years. In urban areas, real estate registration coverage is expected to be completed by 2023. All three areas of real estate registration reforms have benefited from World Bank TA, provided through a Reimbursable Advisory Service (RAS).

54. **Results: Registered urban real estate as a share of total urban real estate increases from 39 percent at end-2013 to 57 percent by end-2017.**

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[60] The ordinance also improves the ANCPI's financial accountability. This represents a good first step toward better ANCPI governance and accountability, but a full governance framework will need to be part of the new law to cover, among other areas, more details on board composition, tenure, and an accountability framework for more than financing aspects.

[61] Simply amending law 7/1996 on cadaster and real estate registration is no longer viable because numerous past amendments have made the law incoherent.

DPL2 Prior Action #11: The Parliament has adopted amendments to the capital markets law through Law 268/2015 to modernize the regulatory landscape, and to enhance the governance and accountability of ASF.

55. **Romania's growth depends on a financial sector that is stable, resilient, and deep enough to efficiently intermediate savings and investments.** The banking system has made considerable progress in improving capital buffers and provisioning, but balance sheets are still impaired and credit to the economy is limited. In addition, with continued parent bank deleveraging and international capital flows subdued, it is now important to accelerate development of the non-bank financial sector and the institutional infrastructure for efficient domestic capital markets. Improving the functioning of capital markets will help mobilize more domestic savings. Although supervision of capital markets has been integrated into the ASF, its credibility has been undermined by: (a) concerns about politically appointed board members interfering with the effective functioning of the institution; (b) the need to strengthen institutions and regulations; and (c) the need to improve capital market supervision.

56. **The government has taken several steps to improve financial sector performance:**

- **First, a basic framework for corporate governance was introduced by reducing ASF board size and setting qualification and conflict-of-interest criteria for both board members and staff** (DPL1 Prior Action #9). A governance review was prepared in 2014 with support from the Bank to better define ASF's board and chairman hiring procedures, independence, and accountabilities. Measures were taken to strengthen the governance of the ASF, fill director appointments; close staffing gaps; and enhance staff training and capacity building.[62]

- **Second, restructuring of the ASF is well underway:** (a) the organizational structure has been flattened; (b) the onsite and offsite units of each sector have been integrated to strengthen supervision; (c) conduct and ethics codes and policies have been implemented; and (d) an integrated strategy has been approved.

- **Third**, **ASF is enhancing capital markets' supervision by implementing of a risk-based approach and by developing of a risk scoring methodology for risk-based supervision.**

- **The capital markets law has been revised to encourage the development of the non-banking sector.** The revisions include removals of barriers to foreign investor participation, strengthening corporate governance and aligning the regulatory landscape with international best practice (DPL2 Prior Action #10). As a result of these changes and the implementation of additional secondary regulation, Romania has been able to meet 8 out of 9 benchmark indicators required to upgrade it FTSE status from frontier market to secondary emerging market. Following the revisions of the capital markets law, Romania's capital market has been put by FTSE in September 2016 on the list of countries that have "a substantial potential to be upgraded to the status of the emerging market in short or medium term perspective".

57. **Results: The number of benchmarks of the secondary emerging market index[63] met increases from 4 at end-2013 to 8 by end-2017.**

[62] Measures to separate executive powers are still pending.
[63] The index is the MSCI Emerging and Frontier Market Index.

ANALYTICAL UNDERPINNINGS

58. **The design of the FEG-DPL series benefited from extensive analytical work and ongoing TA projects,** including the Country Economic Memorandum[64]and several analytical RASs funded by the Romanian government, which are listed in detail in Table 4.

Table 4. Prior Actions and Analytical Underpinnings

Prior Actions	Analytical Underpinnings
Prior Action #1: The MOPF has amended the Government Decision 1470/2007 to enable the use of buy-backs and exchanges of Government securities and has implemented an electronic trading platform for public debt secondary market operations.	• The Functional Review of the Ministry of Finance, 2010, recommended measures for improvements in debt management. • Bank RAS on debt management specified key steps to improve liability management.
Prior Action #2: The MOH has approved a centralized procurement plan for 2016, which includes antibiotics and oncology medicines.	• The Functional Review of the Ministry of Health, 2011, recommended measures to improve the efficiency of health spending.
Prior Action #3: The MoPF has published the prioritization list of significant public sector investment projects for 2016.	• The CEM 2013 stressed the need to improve public investment management. • The Bank TA report on public investment management in 2012 contrasted the significant gap between country systems and EU procedures. • The Public Investment Management RAS provides TA to the MOPF to improve investment management, strengthen capacity, and strengthen the monitoring systems for project implementation.
Prior Action #4: The Government has approved and submitted to Parliament the law on the MSIP.	• The Romania Social Assistance System Modernization Project has been supporting improvements in safety nets. • The RAS on Poverty Alleviation and Social Inclusion analyzed in detail the poverty impact of different MSIP parameters.
Prior Action #5: Parliament has enacted Law 111/2016 on corporate governance of public enterprises, approving GEO 109/2011. **Prior Action #6**: The Government has completed the IPO for Electrica.	• The CEM 2013 highlighted the challenge of further reorganizing the ownership function in SOEs. • The Bank TA on corporate governance for Transport Sector Enterprise, 2012 • The World Bank Functional Review of the Ministry of Economy and Energy, 2010 • Government report on the implementation of GEO 109/2011; the Bank provided substantial inputs.

[64] Reviving Romania's Growth and Convergence Challenges and Opportunities: *A Country Economic Memorandum,* June 2013.

Prior Action #7: ANRE has issued the order to liberalize the nonresidential gas market. **Prior Action #8**: OPCOM has coupled the Romanian DAM with electricity markets in Hungary, the Czech Republic, and Slovakia.	• The CEM 2013 and the 2010–2011 Functional Review of the Ministry of Economy, the Energy Sector, and Business Environment both emphasized the importance of liberalization of energy markets.
Prior Action #9: The Government has approved the National Climate Change and Low Carbon Green Growth Strategy for 2016-2020 and the National Action Plan on Climate Change for 2016-2020.	• The RAS on Romania Climate Change and Low Carbon Green Growth Program, 2013-15.
Prior Action #10: Parliament has enacted Law 150/2015 and the Government has adopted Emergency Ordinance (GEO) 35/2016, all amending Law 7/1996 on cadaster and real estate registration.	• The RAS on cadaster has spelled out the institutional and operational strategy for rolling out registration in Romania and provided input into the drafting of the law.
Prior Action #11: Parliament has adopted amendments to the capital markets law through Law 268/2015 to modernize the regulatory landscape, and to enhance the governance and accountability of ASF.	• Capital markets and ASF rapid assessment

4.3 LINK TO CPS AND OTHER WBG OPERATIONS

59. **The FEG-DPL series is a CPS core activity for 2014–2017**. The objective of the CPS is to help reduce poverty in Romania and foster sustainable income growth for the bottom 40 percent of the population. These goals will be achieved in the context of Romania's economic convergence process within the EU and the EU2020 "smart sustainable and inclusive" agenda. The CPS focuses on three pillars: (1) Creating a 21st century government, as public sector management for efficient and effective service delivery is at the heart of achieving the twin goals and an area where the Bank has a strong comparative advantage; (2) Growth and job creation - Ensuring robust economic growth is the key to convergence, poverty reduction and shared prosperity goal; and (3) Social inclusion - Ensuring that all Romanians can benefit from growth and improved service delivery. This DPL series supports all three pillars of the CPS.

60. **By focusing on fiscal effectiveness, SOEs, and the private markets agenda, the FEG-DPL complements other Bank operations in Romania.** The FEG-DPL has been closely coordinated with and complements the following operations: (a) the Development Policy Loan-Deferred Drawdown Option, which supports reforms in the public sector, health, and energy; (b) the Revenue Administration Modernization Project (FY14); (c) the Social Assistance System Modernization (FY12) Project; and (d) the Health Sector Reform Program.

4.4 CONSULTATIONS AND COLLABORATION

61. **The Bank has consulted with a wide range of stakeholders on the measures supported by the DPL series.** It has advanced the reforms under different governments and discussed the proposed reforms with social partners, including unions, business associations, and stock market participants as well as other stakeholders, including the Parliament and political parties, when appropriate. Several of the proposed reforms have been debated in conferences, workshops, and the media. Legislative measures, such as the law on corporate governance of SOEs, the cadaster law and the law on the Minimum Social Inclusion

Program (MSIP), have been subject to thorough consultation with social partners, civil society, and groups likely to be affected by law. All legislative policy initiatives must be posted on the Internet for 30 days for consultations and feedback. IFC provided inputs on energy sector and capital market reforms. The Bank has collaborated closely with the EC and the IMF during the design and implementation of this operation; with the European Bank for Reconstruction and Development on SOE-related issues; with the European Investment Bank on public investment management; and with the World Health Organization on centralized procurement in health.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1 POVERTY AND SOCIAL IMPACT

62. **Poverty and social impacts of the DPL are expected to be positive.** The measures aim to make public spending more effective, and include improving the targeting of the social assistance program and the functioning of energy, property and capital markets. This should help individuals and businesses to mobilize human and physical capital, thus creating the basis for sustained poverty reduction and improvements in shared prosperity. The overall distributional effects are expected to be positive largely as a result of the introduction of the MSIP, which aims to improve the coverage, targeting, and generosity of the existing social assistance system.

63. **Reforms on improving fiscal management supported under pillar A of this operation are expected to have an overall positive effect on poverty and shared prosperity.** Prior actions related to the prioritization of investment projects and the use of buy-backs and exchanges are expected to be neutral in the short term and potentially positive in the medium to long term as enhanced transparency and improved debt management can reduce spending and should help support investments in critical human and physical projects. Implementation of centralized procurement in the Ministry of Health could provide significant savings in the health sector which could be used to scale up primary care health services, benefitting the poor.

64. **Most importantly, the MSIP targeted to the poor is likely to reduce poverty.** The new law on the MSIP will consolidate three small means-tested programs and is expected to improve coverage, targeting and generosity of benefits. Given the proposed increase in funding, the coverage of households in the poorest quintile can be expected to increase from the current level of 60 percent to about 80 percent, with progressive coverage and larger benefit levels for the poorest. The adoption of a benefit formula that exempts part of labor earnings will open the program to a larger number of in-work poor, as households with adult members who work will have higher eligibility thresholds than household whose adult members do not work. Moreover, by strengthening the conditionality elements of the current programs to encourage active job searches and keeping children in school, the MSIP program is likely to increase school attendance and improve the school outcomes of children in beneficiary families as well as increasing the employment rate of work-age adults.[65]

65. **Reforms supported under pillar B are also expected to have an overall positive impact, but the impact of several reform measures is expected to be ambiguous.** In principle the liberalization of non-residential gas prices could lead to tariff increases that could impact households indirectly if passed on to consumers via higher prices. However, liberalization of non-residential gas prices coincided with a period

[65] Projections from World Bank (2015) "Romania: Advisory Services Agreement on Provision of Inputs for the Preparation of a Draft National Strategy and Action Plan on Social Inclusion and Poverty Reduction (2014-2020)."

of deflation which has characterized Romania since the second quarter of 2015. Falling prices are partly the result of low international oil prices; lower VAT rates on food; and lax monetary policy. Going forward, this trend could reverse if energy prices increase. Increases in transportation and fuel costs would adversely affect the poor, not only directly but also indirectly through potential increases in food and other prices. Simulations of the inflation impact of oil shocks in the EU from the European Central Bank suggest a marginal indirect effect: a 50 percent increase in the oil price is associated with a 0.3 percent increase in the harmonized CPI index, excluding unprocessed food and energy, after 4 years. In addition, the liberalization of residential gas prices, as put forward in the NCC Action plan, could lead to price increases. To mitigate this risk, the MSIP supported by this DPL is expected to improve the ability of vulnerable households to cope with heating costs and other price increases through better targeting and higher coverage of vulnerable populations. The NCC also proposes the removal of the social energy tariff which would be replaced through the better targeted energy support under the MSIP.

66. **The cadaster reforms are expected to have a positive distributional impact**. Cadaster reforms are expected to boost land registration, benefiting the entire population, especially those in the bottom 40 percent. Only 15 percent of rural land and 51 percent of urban land were registered in April 2016. In 6 out of 42 counties the share of registered land is less than 10 percent.[66] Security of land tenure tends to be associated with improvements in productivity, greater agricultural investment, and participation in the rental market.[67] The new law on cadaster is expected to help streamline the registration process and reduce the cost of initial registration, which is currently prohibitive. This should be particularly beneficial to low-income, low-education households, who are less likely to have ownership documents: 60 percent of low income households have ownership documents compared to 93 percent of higher income households. High cost of registration is the main constraint to obtaining ownership documents in both urban and rural areas, and the current registration process is perceived to be time-consuming and overly complicated.[68] For vulnerable groups in rural areas, a land registration pilot program found that the most significant short-term benefits of formalizing property ownership relate to: registering an address; entering into contracts with utility providers; and resolving inheritance processes and family conflicts. These positive effects may potentially lead to other outcomes, such as better quality public services and greater security. A detailed PSIA has identified measures to ensure that the Roma, who are less likely to have a formal ownership of land, can also benefit from the reform. [69]

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[66] The poverty rate here is the predicted AROP rate from the county-level poverty map of Romania. The predictions are obtained using small area estimates based on data from the EU-SILC 2012 survey and the 2011 Population Census.

[67] Deininger, K., Jin, S., 2003. “The impact of property rights on households’ investment, risk coping, and policy preferences: Evidence from China.” *Economic Development and Cultural Change*, 51 (4), 851-82.

Deininger, K., Jin, S., 2006. “Tenure security and land-related investment: Evidence from Ethiopia.” *European Economic Review*, 50, 1245-1277.

Deininger, K., Ali, D. Alemu, T., (2011). “Impacts of land certification on tenure security, investment, and land market participation: Evidence from Ethiopia.” *Land Economics*, 87 (2), 312-334.

[68] Metro Media Transylvania (2016). "Poverty and Social Impact Analysis of Systematic Registration on the Inhabitants of Romania’s Vulnerable Communities” and “Poverty and social impact analysis of systematic registration on Romanian urban areas”.

[69]The World Bank financed project Complementing EU Support for Agricultural Restructuring (CESAR) supports the systematic registration of 50 administrative areas (UATs) with particular focus on ensuring that procedures are in place to ensure that the Roma are indeed being included. Its pilot program led to the formalization and registration of real property rights of the 16,000 Roma identified and, when it did not, explain why and what should be done. The analysis produced evidence of the impact of the pilot on the occurrence of conflicts over the land these individual

67. **The overall gender impact of the DPL is expected to be positive.** Most reforms supported by this DPL will not affect men and women in different ways. However, the planned revision of the benefit formula for the MSIP aimed at incentivizing work is expected to be particularly beneficial to poor working women. In addition, the child bonus of the MSIP will be larger for single parents. This is likely to be particularly beneficial to women, who comprise the majority of single parents. Reforms aimed at improving the functioning of property markets can also support gender equality in land registration if expansion of property registration is gender-responsive. In Romania, as in most countries in Europe and Central Asia, women are allowed to own and inherit land and property equally to men. However, if titles and deeds to land are by default in the name of the head of household, who is usually male, then this can preclude women from exercising any formal rights over the property. Tools and experience from rural Romania and other ECA countries are available to ensure that expansion of urban land registration takes place in a gender-responsive manner.[70] Similarly, experience on mining restructuring in Romania has been shown to disproportionately affect the welfare of women in a negative way through: lower employment probability; increased burden of domestic responsibility; intra-household tensions; and the impact of migration, which should be taken into account when designing social mitigation strategies for the Jiu Valley.[71]

68. **The overall impact of the DPL on the Roma population is expected to be positive.** Measures, such as the MSIP, targeting the poor will positively impact the Roma population. Roma are also likely to benefit from cadaster reforms which will particularly help the population in the bottom 40 percent. Roma people are 10 times more at risk of being poor than non-Roma: 33 percent of Roma were in absolute poverty in 2013 compared to only 3.4 percent of non-Roma.

5.2 ENVIRONMENTAL ASPECTS

69. **With the exception of the prior action on climate change (DPL2 Prior Action #9), policies supported by the proposed DPF series are not expected to have significant effects on Romania's environment, water resources, habitat, or other natural resources.** Scenarios for significant direct irreversible impacts appear very unlikely.

70. **The Government has adopted the National Climate Change and Low Carbon Green Growth Strategy (NCCS) 2016-2020 and the corresponding Action Plan which are likely to contribute to a reduction in GHG emissions.** The Strategy aims to mobilize and enable public and private actors in Romania to reduce greenhouse gas (GHG) emissions from economic activities in alignment with the EU targets and pledged EU-28 INDC[72] and to adapt to the effects of climate variability and change. It considers mitigation and adaptation measures. The implementation of the NCCS is formalized in an Action Plan, which specifies targets, associated budgets and responsible institutions for implementation. The Ministry of Environment will monitor the implementation of the Action Plan. The EU's multi-annual financial framework for the period 2014–2020 provides that at least 20 percent of the EU funds are to be invested

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occupy, their perception of tenure security, access to credit and their investment behavior. The recommendations that came out of the PSIA were informative for the implementation of the second stage, and for the overall implementation of cadaster reform nationwide.

[70] For example, training contractors and staff involved in systematic registration on how to be inclusive, such as by asking for both the husband and wife to be present for discussions on property rights when the staff visits the property. (Source: ECA Knowledge Brief on Gender and Land Administration)

[71] Dani et al. 2006.

[72] Intended nationally determined contribution, according to which the EU and its member states are committed to a binding target of an at least 40 percent domestic reduction in greenhouse gas emissions by 2030 compared to 1990, to be fulfilled jointly.

in climate change projects. For Romania, that would total about €6 billion to be dedicated to climate change-compatible mitigation and adaptation actions in relevant sectors (energy, transport, urban, agriculture and rural development, water, forestry, etc.). The transition to a low-carbon and increasingly climate-resilient society supported by these funds is expected to have positive effects on the economy through a greater demand for renewable sources of energy, energy-efficient building materials, more hybrid and electric cars, "smart grid" equipment, and low-carbon power generation.

71. **The implementation of adequate policy guidelines on environmental and social management for SOEs, which include transparency and disclosure requirements, are important aspects of the SOE reform.** The expansion of the cadastral and registry information system is expected to provide indirect benefits for environmental management by enabling authorities to keep cadaster records up to-date; promote investments in productive activities and in soil conservation; and allow low-income producers and groups to enjoy the economic benefits associated with clear property titles. Such expansion would benefit from the implementation of a cadastral database that takes into consideration preservation of natural resources and protected areas, physical properties and privately or publicly owned areas subject to any environmental and or social restrictions.

5.3 PUBLIC FINANCIAL MANAGEMENT, DISBURSEMENT, AND AUDITING ASPECTS

72. **The Bank has a good understanding of the country's Public Financial Management (PFM) system**. World Bank' functional reviews conducted between 2010 and 2012 provided a number of valuable insights and recommendations. A Public Finance Review was conducted in 2015, and included *inter alia:* an assessment of the budgetary process; public accounting and financial reporting; and internal and external audit function. Regular updates of the recent PFM reform activities have been carried out as part of the fiduciary assessments that informed the preparation of investment lending in the last few years, and are reflected in the current assessment.

73. **Romania has modernized its PFM system over the last 10-12 years. The fiduciary risk is assessed as moderate.** The Public Finance Law of 2002 and the Fiscal-Budgetary Responsibility Law of 2010, both amended and supplemented at the end of 2013, provide a comprehensive foundation for operating a well-organized PFM system. The Fiscal Responsibility Law (FRL) - which complements the Public Finance Law - introduced fiscal rules and numerical fiscal objectives for aggregate public spending and its components; established an independent Fiscal Council to issue opinions and analyses of the fiscal impact of public policy decisions; and introduced the Fiscal-Budgetary Strategy (FBS) to set the macro-fiscal framework for the Medium Term Budget Framework (MTBF) and to make it more binding. Progress has also been made in the establishment of a comprehensive Treasury single account. Romania's general government budget is made publicly available in printed form and on the external website for the Romania MoPF[73]. A recent IMF Fiscal Transparency Evaluation[74] report found that Romania performs well in the Fiscal Transparency Code benchmarking and recommends strengthening budget planning and policy orientation. Budget execution is generally well organized, with clear guidelines and regulations, but there is potential for streamlining and further automating procedures.

74. **Reporting and accounting functions are based on well-developed policies, including a unified budget classification and Chart of Accounts; however manual intervention for collection, verification and validation of financial information is still practiced, which limits timely operational reporting and**

[73] http://www.mfinante.gov.ro/buget2016.html?pagina=domenii
[74] *Romania: Fiscal Transparency Evaluation*, IMF, October 2014.

analysis. The quarterly in-year budget reports are reasonably accurate and detailed at the economic and program level. Since 2013, MoPF focused on developing an IT system to strengthen commitments control and to improve the timeliness and quality of financial reporting. Key changes of this new reporting system are: (i) development of Treasury cash accounts of revenues and expenses at COFOG 3 level; (ii) control of payments vs. legal commitments allotted in the Treasury; (iii) transmittal of a standard analytical trial balance to MoPF by each public institution; and (iv) elimination of consolidation of financial statements at the level of primary and secondary budget holders. The system is being implemented and pilot-tested in pilot entities, and it is expected to be rolled out to all public institutions by December 31, 2016. Specific legislation was passed starting December 2013 to set up the framework for the new financial system. Public accounts are generally audited in a professional and comprehensive manner, observing international standards. Deficiencies in internal controls, especially at the local level, remain an area of concern. The internal audit function has a well-formulated legislative basis but lacks capacity to fulfil its mandate.

75. **The Treasury Account in the National Bank of Romania (NBR) can be relied upon to hold proceeds from DPLs**. The 2014 update of the 2011 IMF safeguards assessment, found that the safeguards framework at the NBR remains robust. The NBR continues to publish audited financial statements as part of annual reports and maintains strong controls over management of foreign reserves management, government banking, and vault operations. Furthermore, the latest publicly available audit reports had an unmodified (clean) opinion on the preparation and presentation of NBR`s financial statements for 2012-2015[75]. NBR can be relied upon to account for the Bank`s loan proceeds from development policy operations, assuming that the arrangements are otherwise in accordance with the Banks policies and with specific mutually agreed terms for the operation.

76. **The proposed loan will follow the World Bank`s disbursement procedures for development policy lending.** Loan proceeds will be disbursed in a 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. 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 will be used according to the public debt legislation. If loan proceeds purposes defined as ineligible in the Loan Agreement, the Bank, upon notice, will require the Borrower to refund such amount promptly, and such amount shall be cancelled. Considering the Bank's knowledge of the public finance management systems, the ongoing improvements of these systems and the latest IMF assessment of the NBR, the Bank will not require an audit of the deposit account but the Borrower will provide confirmation to the Bank on the amounts deposited in the foreign currency account within 30 days of receiving the funds, as detailed below. The front-end fee will be covered from the Borrower's own sources.

5.4 MONITORING, EVALUATION, AND ACCOUNTABILITY

77. **Monitoring and evaluation.** The MoPF is responsible for overall government specific monitoring duties for the FEG-DPL program and coordinates actions among all concerned ministries and agencies. The MoPF has provided timely and comprehensive monitoring reports on the implementation of the agreed macroeconomic framework, on progress towards reforms and on the achievement of the proposed outcomes. The Bank will continue to work closely with the MoPF, the Prime Minister's Office, and sector ministries to monitor and assess reform progress and impacts during this operation. Monitoring and evaluation will continue to be coordinated by MoPF through the Directorate for the IFIs

[75] http://www.bnr.ro/PublicationDocuments.aspx?icid=3043

and supported by various ministries as well as through budgetary, legislative, and economic data provided by the authorities and verified in official disclosures, directives, and regulations. Baseline and updated data are provided by the MoPF and the respective line ministries, they are tracked according to the indicators and outcome measures shown in the monitoring and results framework of the policy matrix (Annex 1). The same monitoring arrangements were used in the implementation of FEG-DPL I and in previous DPLs.

78. **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 Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed to address pertinent concerns. Affected communities and individuals may submit their complaint to the Bank's independent Inspection Panel, which determines whether harm occurred, or could occur, as a result of the Bank's noncompliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the Bank's corporate GRS, visit http://www.worldbank.org/GRS. For information on how to submit complaints to the Bank's Inspection Panel, visit www.inspectionpanel.org.

6. SUMMARY OF RISKS

79. **The overall risks to this operation are substantial.** Key risks are related to political uncertainty and ad hoc policy decisions; weak implementation capacity; and adverse global macroeconomic conditions (Table 5).

Table 5. Risk Ratings

Risk Categories	Rating
Political and governance	S
Macroeconomic	S
Sector strategies and policies	S
Technical design of project or program	M
Institutional capacity for implementation and sustainability	S
Fiduciary	M
Environment and social	M
Stakeholders	M
Overall	**S**

Note: S = Substantial; M = Moderate; and L = Low.

80. **Political and governance risks.** Parliamentary elections are scheduled for December 2016. They are not expected to significantly affect the implementation of DPL-supported reforms since the operation benefitted from broad-based political support and was implemented under different administrations. Vested interests may undermine the implementation of some reforms. The authorities have, however, made significant progress in advancing key reforms supported by this operation: the secondary legislation of Law 111/2016 has been approved by government; the procurement of centrally procured antibiotics and oncology drugs has started; and the MSIP Law has been approved by Parliament. The government has taken significant measures to address high-level corruption and has improved its ranking relative to other EU member states.

81. **Macroeconomic risks.** The fiscal code and other fiscal policy measures, which were approved by Parliament in the run up to the elections, have: led to a widening fiscal deficit; put Romania's public debt on an upward trajectory: and increased the risk of Romania entering the EDP. Fiscal pressures are likely to remain high because of significant inefficiencies with respect to public spending and Romania's demographic change. The debt discharge law (*datio in solutum*) has introduced uncertainty into the legal framework of Romania's financial sector with potentially negative effects on financial inclusion, banks' balance sheets and the construction sector. A bill which would allow debtors to convert CHF loans into domestic currency at a favorable historic exchange rate could potentially depress bank profitability, though the number of potential beneficiaries is limited. Externally, increased uncertainty about global economic growth and financial sector volatility have increased the probability of a reversal in investor sentiment in emerging market economies, which in turn could trigger a currency depreciation and an increase in external debt. However, after years of fiscal consolidation and solid growth, Romania has achieved a sound macroeconomic position with a moderate level of public debt; fewer external and financial sector vulnerabilities, and an improved payment discipline from SOEs, which is likely to mitigate the negative impact of recent policy measures.

82. **Sector policies and institutional capacity.** Some of the supported measures aim to establish governance and accountability in institutions, such as the ANCPI, ANRE, and ASF. In a politicized environment with weak implementation capacity, reforms could be reversed. These risks are mitigated in a variety of ways: (a) the DPL series is supporting the government objective to develop its capital markets through supply (government securities and IPOs), demand (improved laws and regulation), and institutional (ASF) measures; (b) the Bank's program and dialogue on property registration, energy, public finance, and financial sector development is broader than that supported by the DPL series and is linked to other types of Bank engagement, including projects; and (c) the overall policy dialogue is supported by and closely coordinated with the EC and the IMF.

83. **As highlighted in the PSIA section, the impact on poverty and shared prosperity of the policy measures supported by this DPL is expected to be positive.** There are no likely risks to Romania's environment, forests, water resources, habitats, or other natural resources. Fiduciary risks are moderate because Romania's PFM systems and the central bank's management of foreign exchange are appropriate.

ANNEX 1: POLICY AND RESULTS MATRIX

DPL1 Prior Actions	DPL2 Prior Actions	Results
Pillar A: Strengthening Fiscal Management and SOE Performance		
Prior Action #1: The MOPF has approved and published the rolling medium-term DMS for 2014–2016 and the corresponding 2014 ABP to build up the government securities market.	Prior Action #1: The MOPF has amended the Government Decision 1470/2007 to enable the use of buy-backs and exchanges of Government securities and has implemented an electronic trading platform for public debt secondary market operations.	The number of the MOPF's liability management operations increased: • Baseline: 0 (2013) • Target: 3 (2017)
Prior Action #2: Parliament has amended the Public Finance Law No. 500/2002 through Law 270/2013 and, based on these amendments, the MOPF has issued a detailed action plan for preparing and executing results-informed budgets.	Prior Action #2: The MOH has approved a centralized procurement plan for 2016, which includes antibiotics and oncology medicines.	The average unit price for centrally procured drugs and devices decreased: • Baseline: Average unit price of RON 22.2 (2015)[76] • Target: Average unit price of RON 20.0 (2017)
Prior Action #3: The GOR has approved GEO 882013 setting up a system for prioritizing significant (over RON 100 million) public investments and has approved Decision No. 225/2014 on methodological norms for the implementation of such system.	Prior Action #3: The MoPF has published the prioritization list of significant public sector investment projects for 2016.	The budget allocated to the portfolio of significant public investment projects monitored by MOPF increased: • Baseline: Ron 5.7 billion (2014) • Target: Ron 6.1 billion (2017)
Prior Action #4: The GOR has approved a memorandum on March 26, 2014, assigning to the inter-ministerial committee on the MSIP the preparation of specific legal and institutional steps to introduce the MSIP in the first calendar quarter of 2016, including provisions to increase incentives for work.	Prior Action #4: The Government has approved and submitted to Parliament the Law on the MSIP.	The budget allocated to means-tested social assistance programs increased: • Baseline: RON 1.2 billion in 2014 budget • Target: RON 1.8 billion in 2018 budget

[76] Baseline has been moved to 2015, because the National Catalogue for Medicine Prices was significantly revised in 2015. The average unit price is calculated for the basket of medicines included in the 2016 centralized procurement plan for antibiotics and oncology drugs, excluding VAT.

DPL1 Prior Actions	DPL2 Prior Actions	Results
Prior Action #5: The GOR has approved a memorandum on April 2, 2014, on state ownership and oversight that clarifies the responsibilities of the line ministries and the MOPF for monitoring, advocacy for good governance, transparency, and financial reporting.	Prior Action #5: Parliament has enacted Law 111/2016 on corporate governance of public enterprises, approving GEO 109/2011.	The number of SOEs with professional Board and management appointed increased: • Baseline: 25 (2013) • Target: 80 (2017)
	Prior Action #6: The Government has completed the IPO for Electrica.	
Pillar B: Improving the Functioning of Energy, Property, and Capital Markets		
Prior Action #6: The ANRE has issued the order fully liberalizing the nonresidential electricity market.	Prior Action # 7. ANRE has issued the Order to liberalize the nonresidential gas market.	Amount of natural gas traded on centralized platforms (in cubic meters): • Baseline: 0 billion (2013) • Target: 2 billion (2017)
	Prior Action #8: OPCOM has coupled the Romanian DAM with electricity markets in Hungary, the Czech Republic, and Slovakia.	International trade in electricity (exports plus imports) (in Twh): • Baseline: 2.6 (end 2012) • Target: 4.0 (end 2017)
	Prior Action #9: The Government has approved the National Climate Change and Low Carbon Green Growth Strategy for 2016-2020 and the National Action Plan on Climate Change for 2016-2020.	Energy sector greenhouse gas (GHG) emissions declined: • Baseline 86.5 million tons (2012) • Target: 80 million tons (2017)
Prior Action #7: The GOR has approved GEO 8/2014 establishing the operational and financial independence of the National Agency of Cadaster and Land Registration for investments covering both the rural and urban real estate registration.	Prior Action #10: Parliament has enacted Law 150/2015 and the Government has adopted Emergency Ordinance (GEO) 35/2016, all amending Law 7/1996 on cadaster and real estate registration.	Coverage of urban real estate registration (percentage of all urban real estate): • Baseline: 39 (end 2013) • Target: 57 (end 2017)

DPL1 Prior Actions	DPL2 Prior Actions	Results
Prior Action #8: The NBR has introduced an electronic auction facility for government securities in the primary market and started to hold auctions in March 2014.		The average duration of an auction decreased: • Baseline: 2:28 hours (2013) • Target: 1:45 hours (2017)
Prior Action #9: The GOR has approved GEO 94/2013 reducing the size of the ASF board from 11 to 9 members and establishing minimum qualification requirements and conflict-of-interest principles for both board members and senior staff, and Parliament has endorsed the revised composition of the ASF board, through Decision No. 60/2013.	Prior Action #11: Parliament has adopted amendments to the capital markets law through Law 268/2015 to modernize the regulatory landscape, and to enhance the governance and accountability of ASF.	Number of benchmarks of the secondary emerging market index: • Baseline: 4 (2013) • Target: 8 (2017)

ANNEX 2: LETTER OF DEVELOPMENT POLICY

Letter of Development Policy

Dr. Jim Yong Kim
President
The World Bank
1818 H Street N.W., Washington D.C., 20433

November 11, 2016

Romania: Second Fiscal Effectiveness and Growth Development Policy Loan

Dear Dr. Kim:

The Government of Romania appreciates the long-standing partnership and cooperation with the World Bank (Bank) on a range of important economic and social reforms; in particular, we remain cognizant of the significant policy financing and implementation support that the Bank has provided to Romania's reform program and transition over the last two decades. Many of these reforms will accelerate the convergence in living standards with the European Union, reduce poverty and strengthen the confidence of the investors in our economy. By promoting a disciplined macroeconomic management and vigorously pursuing structural reforms, we expect to achieve significant productivity gains and enhance the medium term growth potential of our country.

Romania has achieved remarkable progress in the last decade, supported by programs from the European Union, the IMF and the World Bank. This Fiscal Effectiveness and Growth Development Policy Operation (FEG-DPO) is another important milestone. It is the second in a programmatic series of two loans aimed at strengthening fiscal management and the performance of state-owned enterprises (SOEs) and improving the functioning of energy, property, and capital markets. The structural reforms promoted with the support of the FEG-DPO are of critical importance. This letter outlines the main directions of economic policy and structural reforms underpinning this operation.

From crisis to a solid recovery

The Romanian economy has achieved solid growth thanks to a disciplined macroeconomic management and continued structural reforms. In spite of strong external headwinds from the global crisis, market turbulences and regional tensions, Romania grew at an average rate of over 3.4 percent per year from 2013 to 2015. Growth accelerated to 3.8 percent in 2015, the second highest economic expansion in the European Union (EU). Growth was underpinned by a steep increase in household real disposable income as a result of increases in wages, lower taxes and low consumer prices. Investments also experienced strong growth. We expect growth to further accelerate to around 4.8 percent in 2016 and remain at an average of 4.4 percent in the medium term, in spite of the still anemic economic conditions in the Eurozone and the volatility of the financial markets. Our optimism regarding the economic growth of 2016 has been confirmed by a solid performance in the first semester, when the economy advanced by 5.2 percent, the highest in the EU, driven by the domestic demand.

In parallel, the government focused significant effort on restoring fiscal balances in recent years. We have succeeded in reducing the consolidated government cash fiscal deficit from an unsustainable 7.2 percent of GDP in 2009 to 1.5 percent of GDP in 2015, with emphasis placed primarily on curtailing inefficient expenditures, while preserving public investments. This has helped reduce the level of public spending in GDP from 39.5 percent in 2010 to an estimated 34.3 percent in 2016. Our public debt [1] is the fifth lowest in the EU, at 37.9 percent of GDP, at the end of December 2015.

[1] Calculated according to EU methodology

1

Following the rapid and significant fiscal adjustment since 2009, we have also recently taken a number of fiscal relaxation measures in response to expectations from citizens, who bore most of the fiscal adjustment costs. We reduced the level of social contributions in 2014 by 5 percentage points, from one of the highest levels in the EU, cut VAT for food products from 24 percent to 9 percent in June 2015, which benefitted primarily the poor and vulnerable, and reduced overall VAT from 24 percent to 20 percent since January 2016. Public sector wage increase and reforms to move towards a unitary pay law have also contributed to a widening of the fiscal deficit.

Looking forward, we remain determined to implementing a medium term fiscal framework consistent with macroeconomic stability and sustainable and inclusive growth, in line with our commitments under the EU Fiscal Compact, while increasing targeted spending for the social programs. As we have emphasized on each occasion, a solid macroeconomic framework is a precondition for Romania to achieve sustainable economic growth and convergence with the EU in living standards. Thus, we are determined to keep the budget deficit below 3 percent of GDP over the short and medium term and avoid the EU Excessive Deficit Procedure. As presented in our Convergence Program, submitted to the European Commission in May 2016, we plan to gradually reduce our budget deficit from an estimated 2.9 percent of GDP in 2016 to around 1.6 percent of GDP in 2019. As explained below, we are strongly committed to further strengthening tax administration and revenue collection, enhancing the transparency of spending by public entities and improving the efficiency of public spending. We are also committed to continue to put important resources into public investment, including from the EU funds, in order to close the infrastructure gap with the EU. We are currently focusing significant institutional efforts on simplifying the access to and improving the transparency of the EU funds. At the same time, we are working on addressing the distributional aspects of growth. Thus, have launched a major anti-poverty program and will comprehensively reform the social assistance system, concomitantly with putting significantly larger budget resources to ensure that all citizen benefit from economic growth and prosperity.

Solid macroeconomic management has helped us to considerably reduce external imbalances and contain inflation. The current account deficit, at 0.6 percent of GDP in 2015, is one of the lowest in the EU and, since 2013, it has been more than fully covered by FDI inflows. Inflation is currently in negative territory, at around -0.6 percent, aided by the cut in VAT, enabling the central bank to maintain a low interest rates environment and have ample liquidity in the markets. The National Bank of Romania (NBR) expects a gradual return of inflation to positive figures and projects an inflation of -0.4 percent at end-2016 and 2.0 percent at end-2017.

The banking sector is well capitalized. No bank had to be bailed out by the government during or after the global crisis. The capital adequacy ratio, of about 19.1 percent, is comfortable. NPLs have declined steadily from a peak of around 22 percent in 2013 to around 11.3 percent currently, driven by the restructuring of bank portfolios under the strict supervision of the NBR. More than 90 percent of the NPLs are provisioned. Deleveraging has slowed down substantially, and the loans-to-deposits ratio is now around 84 percent, down from a peak of over 122 percent in 2008. The adoption of the debt discharge law by Parliament in April is likely to adversely affect credit growth and conditions and will impact banks' balance-sheets. However, we believe that there are no systemic risks associated with the application of the law, and a number of severely distressed borrowers will benefit, especially those with low incomes.

The authorities have taken firm measures improve the functioning of the non-banking financial markets. Supervision and regulation of the capital, insurance and pensions markets was consolidated into a single Financial Supervisory Authority (ASF). A new capital markets law was adopted and the ASF has passed a number of subsequent regulations to simplify market access for investors. Firm steps have been taken by ASF to address weaknesses in the insurance market. A review of the market was conducted and the largest company has been put into insolvency.

Government's Reform Program

In January 2016, we launched an ambitious reform program focused on boosting sustainable and inclusive economic growth, reforming public administration and enhancing the accountability of the public sector towards civil society and citizens. We revived the structural reforms agenda, stalled in 2015, in a number of areas and have accelerated reforms. In implementing the reforms, we pay considerable attention to maintaining macroeconomic stability; improving transparency and promoting good governance; and ensuring the sustainability of the reforms.

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 Tax Administration (ANAF). Working with the World Bank and benefiting from IMF support and that of a number of EU peer members, we have strengthened the large taxpayer unit and have prepared plans to overhaul the business processes of ANAF; strengthen risk management procedures; consolidate human resources; upgrade services offered to taxpayers; and modernize IT systems. We are currently in the process for an international tender of a modern IT system for ANAF. Our reforms are already yielding results: in 2015, we collected 32.8 percent of GDP in government revenues, 0.7 percent of GDP higher than in 2014. The Ministry of Finance has also made significant progress in strengthening public debt management including by enabling the use of buy-backs and exchanges and implementing the electronic trading platform for the secondary market.

In parallel with reforming the revenue side of the budget, we are putting significant effort into enhancing the efficiency and efficacy of public spending using a number of measures. In order to improve the prioritization of public investments, we have established a Unit for the Evaluation of Public Investment Projects (UEIP) in the Ministry of Public Finance (MoPF). The UEIP, working alongside the relevant line ministries, has prepared a list of prioritized investment projects which has been published on the MoPF's website. We will continue to improve the alignment of the budget allocation with the prioritized list and the list itself by adding more information about project implementation. We also recently established a spending reviews directorate in MoPF that will work closely with the line ministries to review the efficiency of public spending with the view to identifying savings and reorienting public expenditure to higher return activities. This will benefit from technical assistance from the IMF and the World Bank. To improve the transparency of the budget, we have made monthly budget execution public for all government spending agencies at central and local level at the following site: www.transparenta-bugetara.gov.ro

The government is paying important attention to strengthening the linkages between policy-making and planning and budgeting in order to enhance the quality of public spending. The aim is to gradually introduce performance based budgeting, with the goal of moving towards program-based budgeting in the medium term. In this context, we have been working on strengthening the center of the government to improve policy-making oversight and ensure improved policy coordination and harmonization. In this respect, we plan to establish a Strategy Unit within the Chancellery of the Prime Minister and we are working on putting a process for policy-making in place with clearly defined roles, responsibilities and deliverables. In MoPF we are working on conceptualizing the introduction of performance-based budgeting.

A key priority on our agenda is to reform the health sector. With support of this DPL program we are expanding centralization of procurement for medicines and medical devices carried out by the Ministry of Health, through its specific structure. Since 2013, when the Ministry of Health has been assigned, as Centralized Procurement Unit, we have achieved important savings (of around 25 percent per year for each completed tendering procedure) which we would like to expand to other categories of medical and non-medical products used by the health care units. We have expanded centralized procurement in health. This will generate savings, as additional resources for the health sector and consequently ensure an unit price at the national level for centrally procured products. In parallel, we are strengthening the Centralized Procurement Unit in the Ministry of Health by recruiting additional staff. We also plan to build a number of modern regional hospitals with funding from the EU, the national budget and from

IFIs if needed and work on introducing new criteria for selecting managers in the health sector. We are, however, aware that the health sector requires comprehensive reforms, which need strong commitment over a sustained period of time. We have developed pillars for the medium to long term strategy for this reform agenda and plan to work on defining concrete measures for implementation.

Strengthening the corporate governance framework of SOEs and restructuring them is a key pillar of our reform program. The SOE sector remains large in Romania and continues to generate arrears and distort the functioning of the markets. To address these challenges, we have decided to promote legislation enabling SOEs to recruit competent professional boards and management through open, transparent, and competitive procedures, in line with good international practice. In this endeavor we have benefited from support from the EC, the IMF and the World Bank. The new legal framework for corporate governance of SOEs was adopted in May 2016, supported by this DPL program, and the norms of the new law were approved in September 2016. In parallel with the new legal framework, we have accelerated the selection of professional management for a number of key SOEs. We have already launched the selection of professional boards and executive management for 11 SOEs and, in line with, the secondary legislation on corporate governance, more companies will start this process in the next months. MoPF has established and consolidated a unit which monitors SOE performance, and which has also been tasked to oversee the implementation of the new corporate governance framework, and these reforms are already yielding results. Those companies where professional managers and boards have been recruited already show improved profitability. MoPF has begun publishing an annual report on the performance of SOEs, and will prepare unitary criteria and procedures for management selection and SOE reporting. Restructuring SOEs is key reform priority for our government. In recent years, we conducted several IPOs and SPOs, mostly in the energy sector out of which the largest was the IPO of Electrica, supported by the DPL. While privatization stalled in 2015, we aim to re-launch it in 2017, when we expect to conduct IPOs for at least two large SOEs.

We recognize the importance of the energy sector as a driver of growth and we have achieved significant reforms in this sector. To facilitate the functioning of the energy markets and the allocation of resources, we have fully liberalized electricity and natural gas prices for companies, and we are on track for doing the same for households, keeping in mind the need to protect the vulnerable consumers. We have connected the Romanian electricity market with those of Hungary, Czech Republic and Slovakia, and this has facilitated a price convergence and has boosted Romania's exports of electricity to over 10 percent of output in 2015. We have consolidated the gas and electricity exchange on centralized markets OPCOM, the largest and most modern in the region and on the Romanian Commodities Exchange and have adopted legislation requiring all traders to trade electricity exclusively through the market. This has led to a decline in the wholesale prices of electricity and improved the transparency of contracts. Moreover, we have passed legislation requiring gas producers and suppliers to trade a minimum amount of their produced/supplied natural gas on these platforms. In order to address endemic problems with arrears and transparency of contracts, we have taken important steps in terms of restructuring for CE Hunedoara, an important coal-fired generator. CE Hunedoara was placed into insolvency, as evidenced by the Hunedoara Tribunal's certificate dated June 23, 2016. We are also putting in place measures to mitigate the social and environmental consequences of the process, including by allocating complementary payments from the budget during 2016 – 2018. In 2012, we also placed Hidroelectrica, the largest electricity generator, into insolvency in order to facilitate restructuring of its bilateral contracts and in insolvency, Hidroelectrica has undergone a major restructuring program; has had unprofitable contracts removed; and has become one of the most profitable companies in Romania, achieving a profit of around Euro 240 million in 2015. Hidroelectrica has recently exit insolvency and in order to ensure the sustainability of the restructuring, we plan to launch an IPO for Hidroelectrica in the first half of 2017.

In October 2016, we have adopted the National Climate Change and Low Carbon Green Growth Strategy 2016-2020. As a member state of the EU, we are committed to meeting our obligations in terms of reducing greenhouse gas (GHG) emissions from economic activities in alignment with the EU targets and adapting to the effects of climate variability and change, both current and future. By implementing the National Climate Change (NCC) Strategy, Romania aims to transition to a society in which social, economic, and environmental policies and actions are interlinked and designed to ensure sustainable development and shared prosperity, with high living standards for all, as well as a high environmental quality. Based on the NCC Strategy, a National Action Plan on Climate Change Strategy for 2016-2020 has been developed. The Action Plan proposes concrete measures to be implemented between 2016 and 2020 to combat climate change and help to restructure the economy for greener growth. These measures include results indicators, financing sources, and responsible institutions, which we will closely monitor.

In order to accelerate the registration of property and land titles, into the integrated system for cadaster and land book, we have launched a number of measures to reform the legal and institutional framework of cadaster and land registration. In 2014 we granted partial financial and operational autonomy to the Agency for Cadastre and Land Registration (ANCPI), which currently retains and uses all the revenue which it collects from the services provided within the National Program for Cadastre and Land Book, based on which is carried out no-cost the registration of all real estates in Romania into the integrated system for cadastre and land book. With help from the DPL, we are in the process of reforming the legal cadastre and land registration framework by addressing a number of inconsistencies between the relevant legislation in the field and other piece of legislation and by improving the governance structure of ANCPI. A new legal framework was adopted in 2015 and 2016, introducing systematic registration of properties and removing taxes and fees for the first registration of a property. This will benefit primarily the poor and marginalized communities. Furthermore, we are finalizing a comprehensive cadastre law, which will integrate past legislative changes and simplify legislation. Adoption of this law will be a significant step towards boosting investment in Romanian agriculture and the functioning of the property and land markets; it is also expected to improve economic planning. Once the new law is in place, we are strongly committed to scaling up property registration, in the integrated system for cadastre and land book especially in rural areas, which we recognize to be key for facilitating investments, with significant benefits also for the poorest communities, which currently face significant challenges to property registration.

We are cognizant of the fact that poverty remains wide-spread in Romania and disproportionately affects certain groups of the population, particularly the Roma. Thus, fighting poverty features highly on the government's agenda and our efforts are anchored in the National Strategy on Social Inclusion and Poverty Reduction and also in the comprehensive anti-poverty package which we launched in January 2016. A number of anti-poverty measures have been promoted in recent years, including increases in pensions and the minimum wage; reductions in VAT; and increases in the budgets of the better targeted anti-poverty programs: the guaranteed minimum income; family benefits; and heating subsidies. These, together with higher employment as a result of economic growth, have put absolute poverty on a constant decline in recent years. Nevertheless, poverty in Romania remains high. In response to this challenge, we have prepared a comprehensive National Strategy on Social Inclusion and Poverty Reduction for 2015-2020 with support from the World Bank. The overarching objective of the Strategy is that: all citizens are provided with an equal opportunity to participate in the society; feel valued and appreciated; live in dignity; and have their basic needs met and differences respected. The Strategy proposes a series of key interventions to reduce poverty and facilitate social inclusion, with a focus on employment, social transfers, social services, education, health, housing and social participation. We have recently adopted 48 new initiatives aimed at better targeting the poor. These measures include a program to enrol children into kindergarten; subsidies to poor children for school supplies, clothes and food; grants for schools in disadvantaged areas; revival of vocational education; a program to facilitate the employment of graduates with special needs; support for rural and social entrepreneurship, etc. With support from this DPL, we approved the Minimum Inclusion Income Program (MIIP) in April 2016, which was adopted by the Parliament in October. The MIIP consolidates the guaranteed minimum income, family benefits and heating subsidies into one program. MIIP implementation is intended to reduce errors of excluding the poor; increase the generosity of benefits for households in most need; reduce the private costs of the beneficiaries and make them more likely to apply for it; and improve targeting for those with lower incomes. All these elements of the program are expected to have a direct impact on shifting the poverty rate towards EU convergence. The MIIP law has been adopted by Parliament in October 2016. We are confident that the associated IT system and process will be develop in time and that we can launch the program as planned in April 2018. We are also gradually doubling the budget of the MIIP. To facilitate the financing of anti-poverty measures, we have dedicated to this objective a specific Priority Axis under the Human Capital Operational Program with a total budget of Euro 1.110 billion. The interventions under this are focused on the active inclusion at the level of disadvantaged communities, as well as on the accessibility and quality of the medical services, social assistance services and social services of general interest, including here the support of deinstitutionalization process. A special attention we pay to the marginalized communities and communities with Roma people, under dedicated specific objectives, through a multi-sectorial approach – by interventions in education, employment, housing, medical and social assistance services, fighting against segregation measures. The people at risk of poverty or social exclusion will benefit also from the implementation of the Local Development Strategies which will be financed through the Community Lead Local Development instrument. With support from the World Bank Social Assistance System Modernization Project we are working towards improving the performance of our social assistance system by strengthening performance management, improving equity and administrative efficiency and reducing error and fraud.

As mentioned above, our government has an ambitious agenda of public transparency and openness, with the purpose of transforming the manner in which public institutions share and communicate information of public interest. In this respect we have promoted a set of initiatives. The Parliament recently approved a key legislative package on public procurement which transpose the EU Procurement Directives to ensure a reliable, coherent and predictable framework: a public procurement law that promotes transparency (including e-procurement); a law on procurement in the utilities' sector; a law on the award of concessions contracts of works and services; and a law on remedies. A Transparency Registry to record interactions between the public sector and private sector is about to be established. The Ministry of Public Consultation and Civic Dialogue has introduced tools to facilitate and encourage citizens to offer comments and suggestions for legislation in public consultation and to raise awareness on the decisions taken in the weekly government sessions.

Improving the absorption of EU funds is a priority for our government in order to accelerate the convergence with the EU and boost their efficient use for shared prosperity. In spite of improvements, the absorption rate for EU funds for 2007-13 remained below expectations. Gaps in the legal framework, and excessive bureaucracy partially explain these absorption rates; a weak project pipeline, as a result of capacity constraints with strategic planning and project preparation and execution levels, are also contributing factors. We are taking steps to address these issues; we are also improving the legal framework for procurement, concessions and public contracts. With support from the World Bank, EIB and other IFIs, we have prepared sectorial strategies which should help us improve the absorption of the EU funds for 2014-20. We have approved the transport master plan, which provides the roadmap for future investments in infrastructure. We are aware that more effort is required to further simplify procedures and strengthen capacity for project prioritization, preparation and implementation.

We strongly believe that the World Bank will continue to be a major supporter of our reform program. The Bank's knowledge and global expertise provides a key impetus towards the fulfilment of our reform objectives.

Yours sincerely,

Dacian Julien Ciolos

Prime Minister
Government of Romania

Anca Dana Dragu

Minister of Public Finance
Government of Romania

ANNEX 3: IMF ASSESSMENT LETTER

Romania—Assessment Letter for the World Bank

November 7, 2016

Romania made important progress in addressing economic imbalances following the 2008-09 crisis. Prudent policies, partly in the context of successive Fund-supported programs, reduced vulnerabilities, and the fiscal and current account deficits improved markedly. However, economic policies have weakened recently. Fiscal policy has turned pro-cyclical and the fiscal deficit is projected to increase substantially in 2016 and remain high in 2017. Public debt is moderate but on a gradually rising trajectory. Progress on structural reforms has slowed. Some recently passed measures, and others under consideration in parliament, could threaten property rights and damage the otherwise sound financial sector.

Outlook and risks

Macro outlook. The Romanian economy is on a cyclical upswing supported by strong domestic demand. Hikes in minimum and public wages, record low interest rates, low fuel prices, and a VAT reduction have boosted private consumption. Growth is projected to reach 5 percent in 2016 and decelerate to 3.8 percent in 2017. Medium-term growth is constrained by structural impediments. Inflation is projected at -0.5 percent for end-2016 and to rise to 2.6 percent by end-2017 with the dissipation of the impact of the VAT cut and as the positive output gap is expected to widen. The current account deficit is projected to gradually widen in 2016-17 on the back of expanding domestic demand, and reach around 3.0 percent of GDP over the medium term.

Risks. The main risks to the economic outlook relate to electoral and external uncertainties. On the domestic side, populist measures in the run-up to the December elections could weaken the fiscal position and the financial system and undermine market confidence and investment. On the external side, a deterioration in global risk sentiment could trigger capital outflows, a depreciation of the currency and, consequently, an increase in the external debt-to-GDP ratio. Maintaining adequate reserve levels, a flexible exchange rate regime, and fiscal buffers will be key in mitigating risks. Improving Romania's long-term growth prospects to close the gap with advanced EU countries will depend on maintaining prudent macroeconomic policies and advancing the pace of structural reforms.

Policies

Fiscal policy. The fiscal stance remains strongly pro-cyclical. Staff projects a fiscal deficit of 2.5 percent of GDP for 2016, compared to 1.4 percent in 2015, on the back of large tax cuts and salary increases.[77] In cyclically adjusted terms this represents an expansion of 1.6 percent when the economy is already growing above potential. For 2017, the current government's draft budget envisages an overall deficit of 3 percent of GDP in ESA terms (2.9 percent in cash terms),

[77] The fiscal deficit is reported in cash terms unless otherwise stated.

an objective which is in principle supported by the main political parties. Staff estimates that the deficit could be somewhat higher without adjustment measures especially if some of the proposals under discussion are implemented. Staff recommends a deficit of 2 percent of GDP which could be attained by postponing planned VAT and excise cuts until offsetting savings can be found, and substituting domestically financed with EU-funded public investment. This would help maintain public debt at around 40 percent of GDP.

Monetary policy. Headline inflation is currently negative but underlying core inflation has risen to 1.5 percent and projected to increase further over the coming period. While the NBR's decision to keep the policy rate unchanged is appropriate for now, absent fiscal adjustment and given the large wage growth and the increasing positive output gap, monetary policy would need to shoulder a higher burden for managing domestic demand in 2017.

Financial sector. The financial sector is sound but is facing the threat of legislative populist measures. The banking system is —on average—well capitalized, has adequate liquidity and shows falling, albeit still elevated, NPLs. A key near-term risk to bank balance sheets stems from legislative initiatives that would allow unilateral and retroactive changes to contracts. In October 2016, parliament approved legislation allowing the conversion of Swiss Franc loans to domestic currency at historical exchange rates. The NBR has estimated the loss for banks at up to 0.3 percent of GDP. The losses would be considerably larger if euro denominated loans were to be similarly converted. In April 2016, parliament passed a law allowing borrowers to walk away from their mortgages. The Constitutional Court limited the application of the law by requiring lower courts to determine the debtor's eligibility on a case-by-case basis. The ultimate effect on bank balance sheets would only be realized slowly depending on the number of cases considered eligible.

Structural reforms. A strong push for structural reforms is needed to improve public and private investment and raise potential growth. These reforms were one of the main focus areas of the recent Fund-supported program. While some progress has been made to improve transparency and governance, other structural reforms have stalled and seem insufficient to raise private investment, which remains well below pre-crisis levels. One key challenge is to improve the performance of state-owned enterprises (SOEs), including by implementing the recently passed law on corporate governance, as well as restructuring and/or privatizing those SOEs with longstanding financial problems. Other critical areas relate to raising EU-funds absorption, improving the investment climate, strengthening tax administration, and continuing to make progress in the fight against corruption.

IMF Relations

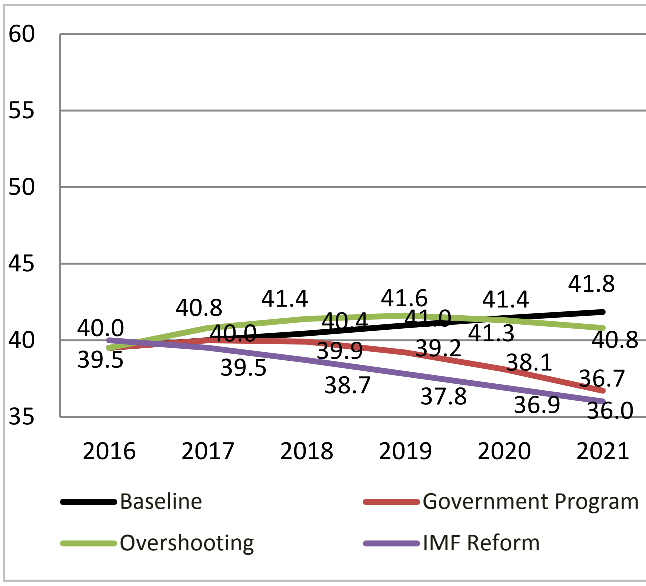
The 2016 Article IV consultation was concluded by the IMF's Executive Board on May 9, 2016.

ANNEX 4 : PUBLIC DEBT SUSTAINABILITY ANALYSIS

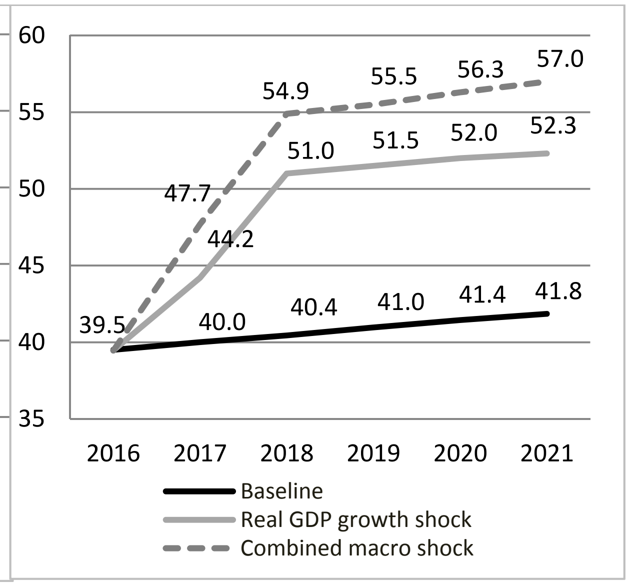
1. **Romania's public debt is expected to rise modestly over the medium term.** As of end-2015, Romania's public debt was 39.3 percent of GDP—the fifth lowest in the EU. Under the baseline assumptions detailed below, the public debt-to-GDP ratio is expected to rise to 41.8 percent of GDP by 2021 (see Figure 2), well within the EU Stability and Growth Pact criteria of 60 percent of GDP. In line with the IMF's Article IV 2016[78], the baseline assumes that the government maintains a fiscal (cash) deficit of 2.8 percent of GDP each year from 2016 to 2021; this is the highest fiscal deficit that the government could implement without triggering an EDP by the EU. Real GDP growth is projected to average 3.7 per year between 2016 and 2021.

Figure 2. Public Debt Sustainability

Public debt in % of GDP under alternative scenarios



Public debt in % of GDP under different shocks



Source: World Bank staff simulations.

2. **The baseline is a rather conservative fiscal scenario compared to other policy paths:**

   (a) An **'overshooting' of the fiscal deficit** to 3.6 percent of GDP in 2017[79] will imply that Romania will enter into the EDP of the EU and be forced to reduce its structural fiscal deficit by 0.5 percent of GDP per year starting in 2018, as stipulated under the procedure. Fiscal deficits in successive years are assumed to amount to 3.0 percent in 2018, 2.5 percent in 2019, 2.0 percent in 2020, and 2.0 percent in 2021. Under this scenario, public debt-to-GDP ratio will peak at 41.6 percent in 2019 and decline to 40.8 percent in2021.

   (b) The **'government convergence program',** currently under preparation, assumes a fiscal deficit of 2.8 percent in 2016 and 2017, 2.3 percent in 2018, 1.6 percent in 2019, 1.1 percent in 2020, and 1 percent in 2021. Under this scenario, the public debt-to-GDP ratio will peak

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[78] IMF (2016) "2016 Article IV Consultation", IMF Country Report No. 16/113, Washington, DC.

[79] On the assumption that the government will implement the fiscal code, will significantly increase public wages, will preserve public investment spending, and does not improve tax collection

at 40.0 percent in 2017 and remain at this level in 2018, before declining to 36.7 percent in 2021.

(c) Under the reforms proposed by the IMF, the **'IMF Reform program',[80]** fiscal deficits are expected to be 2.5 percent of GDP in 2016, 2 percent in 2017, 1.5 percent in 2018, and 1 percent in 2019. Under this scenario, the public debt-to-GDP ratio is expected to decline from 40 percent in 2016 to 36 percent by 2021.

3. Adverse macroeconomic shocks could have a significant impact on public debt. If the economy were to enter a recession in 2017 and 2018, with real GDP contracting by 1 percent and 1.3 percent, respectively (about a quarter of the 10-year standard deviation lower than the baseline growth), Romania's public debt-to-GDP ratio will reach 52.3 percent over the projection horizon (Figure 2), that is, just above 10 percentage points of GDP above the baseline in 2021. A combined macroeconomic shock based on: (a) a recession in 2017 and 2018, with real GDP growth as described above; (b) a real exchange rate depreciation of about 11 percent (which equals the maximum 10-year average) in 2017; and (c) an interest rate hike of 200 basis points, could push public debt close to the 60 percent of GDP limit of the EU's Stability and Growth Pact, at 57 percent in 2021. The recently approved law on debt discharge is unlikely to contribute to a significant deterioration of public debt. Its implementation could lead to a slowdown in the residential construction sector, lowering growth potentially by up to 0.1 percentage points per year. Contingent liabilities from potential bank losses are estimated at 0.4 percent of GDP.[81]

4. In summary, Romania's public debt is sustainable. Romania's public debt remains well below the Maastricht Criteria in all but the most extreme scenarios, interest spending is relatively low at 1.6 percent of GDP in 2016, and risks embedded in the debt portfolio are manageable.

[80] See IMF (2016) "2016 Article IV Consultation", IMF Country Report No. 16/113, Washington, DC.
[81] Other liabilities of government-controlled entities classified outside of the general government are estimated by Eurostat at 9.7 percent of GDP, one of the lowest levels in the EU.

ANNEX 5: POVERTY AND SOCIAL IMPACT ANALYSIS

1. **Overall poverty and social impacts of the DPL are expected to be positive.** The measures supported aim to make public spending more effective, including by improving the targeting of social assistance program and the functioning of energy, property and capital markets. This should help individuals and businesses to mobilize human and physical capital creating the basis for sustained poverty reduction and improvements in shared prosperity. The potential poverty and social impacts of each prior action are summarized in Table 6 and described in detail below.

Table 6. Potential poverty and social impacts for each prior action

Prior Action	Potential Poverty and Social Impact
Pillar A: Strengthening Fiscal Management and SOE Performance	
Prior Action #1: The MOPF has amended the Government Decision 1470/2007 to enable the use of buy-backs and exchanges and has implemented an electronic trading platform for the secondary market operations.	*Neutral short term distributional and gender impacts*, with potentially positive impacts in the medium to long term by reducing roll-over risk interest spending.
Prior action #2: The MOH has approved a centralized procurement plan for 2016, which includes antibiotics and oncology medicines.	*Positive distributional and neutral gender impacts* as centralized procurement could provide significant savings in the health sector which could be used to scale up primary care health services, benefitting the poor.
Prior Action #3: The MOPF has published the prioritization list of significant investment projects for 2016.	*Neutral short term distributional and gender impacts,* potential positive impacts in the long run as enhanced transparency should support investments in critical human and physical projects.
Prior Action #4: The Government has submitted the Law of the Minimum Social Inclusion Program to Parliament.	*Positive distributional and gender impacts*. See detailed discussion below.
Prior Action #5: Parliament has enacted Law 111/2016 on corporate governance of public enterprises, approving GEO 109/2011.	*Neutral short term distributional and gender impacts* but in the long term support the ability of government to mobilize human and physical capital to ensure improvements in shared prosperity.
Prior Action #6: The Government has completed the IPO for Electrica.	*Neutral short term distributional and gender impacts* as the IPO has not led to redundancies.
Pillar B: Improving the Functioning of Energy, Property, and Capital Markets	
Prior Action #7: ANRE has issued the Order to liberalize the nonresidential gas market.	*Neutral short term distributional and gender impacts* as it was introduced at a time of falling prices. Going forward the introduction of the Minimum Social Inclusion Program is expected to mitigate any adverse impacts on vulnerable homes due to market fluctuations.
Prior Action #8: The energy market operator (OPCOM) has coupled the Romanian Day Ahead	*Neutral short term distributional and gender impacts* but businesses are likely to mobilize human and physical

Prior Action	Potential Poverty and Social Impact
Market (DAM) with electricity markets in Hungary, the Czech Republic, and Slovakia.	capital in the longer term, thus creating the basis for sustained poverty reduction.
Prior Action #9: The Government has approved the National Climate Change and Low Carbon Green Growth Strategy for 2016-2020 and the National Action Plan on Climate Change for 2016-2020.	*Negative short term distributional impact.* The elimination of the social electricity tariff may increase electricity tariffs for the poor. The Action Plan includes actions to protect poor households. Additional investments in energy generation and energy efficient households is likely to create additional low-skilled jobs.
Prior Action #10: Parliament has enacted Law 150/2015 and the Government has adopted Emergency Ordinance (GEO) 35/2016, all amending Law 7/1996 on cadaster and real estate registration.	*Positive distributional and gender impacts* as the law is expected to boost land registration, especially benefiting those in the bottom 40 percent.
Prior Action #11: Parliament has adopted amendments to the capital markets aw through Law 268/2015 to modernize the regulatory landscape, and to enhance the governance and accountability of ASF.	*Neutral short term distributional and gender impacts* but in the long term support the ability of individuals and businesses to mobilize human and physical capital, thus creating the basis for sustained poverty reduction and improvements in shared prosperity.

Pillar A: Strengthening fiscal management and SOE performance

2. **Reforms on improving fiscal management supported under pillar A of this operation are expected to have an overall positive effect on poverty and shared prosperity.** Prior actions related to publication of investment projects and the use of buy-backs and exchanges are expected to be neutral in the short term. However, enhanced transparency should support investments in critical human and physical projects over the medium term while improved debt management can reduce roll-over risk and public interest spending. Scaling up centralized procurement in the Ministry of Health could provide significant savings in the health sector which could be used to scale up currently underfunded activities, such as primary care health services. This is likely to benefit the poor.

3. **The consolidation of means-tested programs is expected to benefit mainly the bottom 20 percent of households through better targeting, coverage, and generosity.** The current three sets of eligibility criteria, beneficiary registries, and payment systems will be replaced by unified eligibility criteria, registry and benefit distribution process. The benefits of this reform to the poor will come from efficiency gains from replacing small programs that benefit partially overlapping target groups with a single program that has a larger but clear target group, and from reinvesting financial savings from reduced administrative costs, errors, fraud, and corruption.

4. **The proposed program aims to increase the overall budget targeted to the poor, which will significantly help to reduce poverty and will increase the chances that Romania will meet its national poverty target before 2020.** The policy initiative will increase the number of beneficiaries of means-tested programs, and the benefit levels that they receive. Moreover, given the increase in funds, the coverage of households in the poorest quintile can be expected to increase from the current level of 60 percent to about 80 percent, with progressive coverage and larger benefit levels for the poorest. Simulations have shown that this increase in the budget will have a major impact on poverty in all economic scenarios (Table 7, row A). Assuming a moderate economic growth projection, relative poverty will decrease by about 4.4

percentage points on average between 2016 and 2020. If additional financing were available in 2017, the decrease in poverty due to the program could be even higher. In addition, as the MSIP will have a benefit formula aimed at incentivizing work, 50 percent of wages and other labor earnings and presumed agricultural profit will be exempt, up to a limit of RON 400 per family per month. This means that, for families who receive formal income, the more they work, the higher the effective eligibility threshold and benefit will be. Based on the international literature, these changes in the benefit eligibility criteria are expected to produce a switch from assistance to employment ranging between 7 to 17 percent of the work-able poor who are currently not in employment, education, training, or disabled (NEETD). This is expected to further reduce poverty by 1 to 1.3 percentage points on average between 2016 and 2020 (Table 7, rows A+B1, A+B2).

Table 7. Projected Relative Poverty after the Implementation of the MSIP

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Status quo	22.6	23.1	22.8	22.5	22.4	22.6	22.5	22.8	22.8
A. Increase in budget, as announced					18.1	17.8	17.9	18.7	18.7
A+B1. Income exemption in MSII causing 7 percent of the NEETD to move into jobs					17	16.6	17.1	17.8	17.9
A+B2. Income exemption in MSII causing 17 percent of the NEETD to move into jobs					15.7	15.3	16.1	16.4	16.6

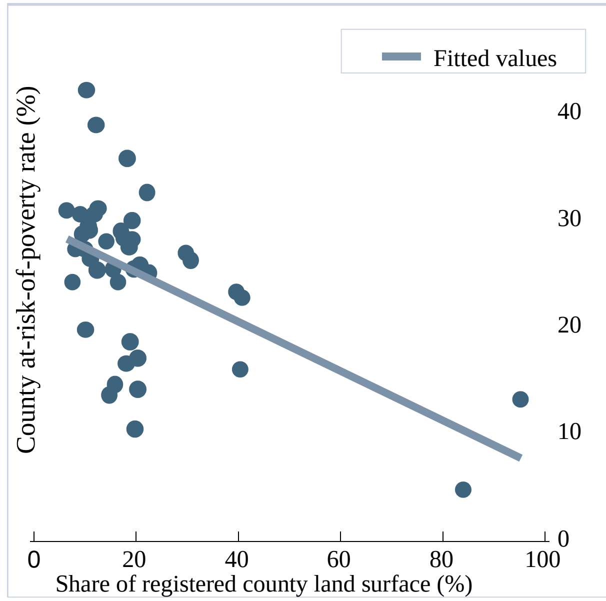
Source: World Bank (2015) "Romania: Advisory Services Agreement on Provision of Inputs for the Preparation of a Draft National Strategy and Action Plan on Social Inclusion and Poverty Reduction (2014-2020)."

Pillar B: Improving the functioning of property, energy and capital markets

5. **Reforms supported under pillar B are also expected to have an overall positive impact, but the impact of several reform measures is expected to be ambiguous.** In principle the liberalization of non-residential gas prices could lead to tariff increases that could impact households indirectly if passed on to consumers via higher prices. However, liberalization of non-residential gas prices coincided with a period of deflation which has characterized Romania since the second quarter of 2015. Falling prices are partly the result of low international oil prices; lower VAT rates on food; and lax monetary policy. Going forward, this trend could reverse if energy prices increase. Increases in transportation and fuel costs would adversely affect the poor, not only directly but also indirectly through potential increases in food and other prices. Simulations of the inflation impact of oil shocks in the EU from the European Central Bank suggest a marginal indirect effect: a 50 percent increase in the oil price is associated with a 0.3 percent increase in the harmonized CPI index, excluding unprocessed food and energy, after 4 years. In addition, the liberalization of residential gas prices, as put forward in the NCC Action plan, could lead to price increases. To mitigate this risk, the MSIP supported by this DPL is expected to improve the ability of vulnerable households to cope with heating costs and other price increases through better targeting and higher coverage of vulnerable populations. The NCC also proposes the removal of the social energy tariff which would be replaced through the better targeted energy support under the MSIP.

6. **The cadaster reforms are expected to boost land registration, benefiting the population at large and especially those in the bottom 40 percent.** Only 15 percent of rural land and 51 percent of urban land is registered. In 6 out of 42 counties the share of registered land falls below 10 percent. There is a negative relationship between the share of registered land at the county level and the county poverty rate (Figure3), which remains even if Bucharest and Ilfov—the outlier counties with registration rates above 80 percent—are excluded. Studies on other countries suggest that security of land tenure is associated with improvements in productivity, greater agricultural investment, and participation in the rental market.[82] Moreover, the Law on Cadaster and Real Estate Registration is expected to help streamline the registration process and reduce the cost of first registration, which is currently prohibitive. This should be particularly beneficial to low-income, low-education households, who are less likely to have ownership documents. In urban areas, 61 percent of low income households have ownership documents compared to 93 percent of higher income households. The same is true in rural areas (Figure4). Most strikingly, 36 percent of households in Roma settlements having no documentation compared to 16 percent for other vulnerable groups. The high cost of registration is the main constraint to obtaining ownership documents in both urban and rural areas, while the current registration process is perceived to be time-consuming and overly complicated. For vulnerable groups in rural areas included in a land registration pilot, the most significant short-term benefits of formalizing property ownership include the ability of households to register an address, enter into contracts with utility providers, and resolve inheritance processes, family and neighbor conflicts. These positive effects may potentially lead to other outcomes, such as better quality public services, greater security, and more productive use of assets.

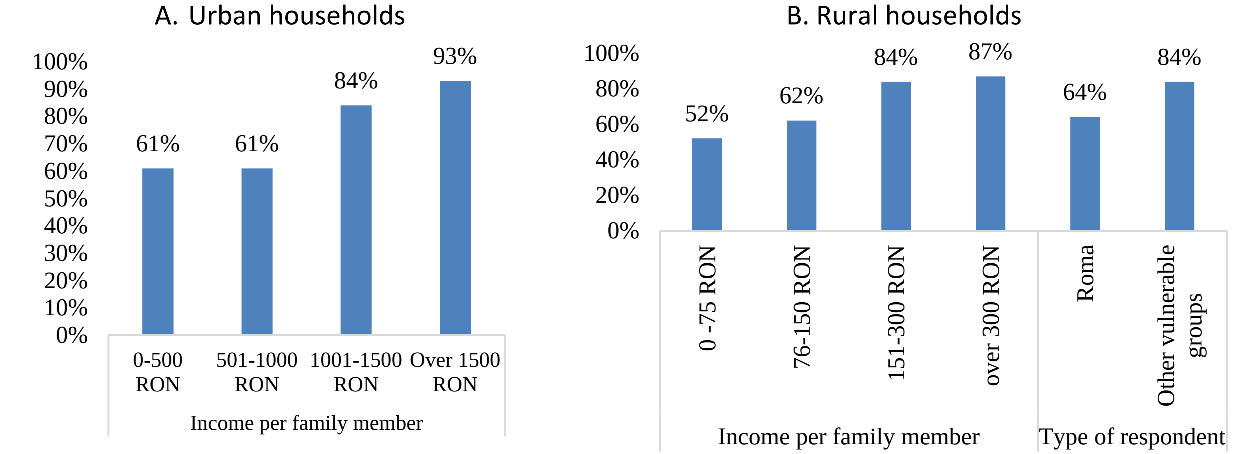
Figure 3. Poverty and land registration



Source: Small area estimation based on data from the EU-SILC 2012 survey and the 2011 Population Census.

[82] Deininger, K., Jin, S., 2003. "The impact of property rights on households' investment, risk coping, and policy preferences: Evidence from China." *Economic Development and Cultural Change*, 51 (4), 851-82.
Deininger, K., Jin, S., 2006. "Tenure security and land-related investment: Evidence from Ethiopia." *European Economic Review*, 50, 1245-1277.
Deininger, K., Ali, D. Alemu, T., (2011). "Impacts of land certification on tenure security, investment, and land market participation: Evidence from Ethiopia." *Land Economics*, 87 (2), 312-334.

Figure 4. Households with Ownership Documents



Source: Metro Media Transylvania (2016) "Poverty and social impact analysis of systematic registration on Romanian urban areas".

Source: Metro Media Transylvania (2016). "Poverty and Social Impact Analysis of Systematic Registration on the Inhabitants of Romania's Vulnerable Communities"

7. **Reforms aimed at improving the functioning of property markets can also support gender equality in land registration if expansion of property registration is gender-responsive.** In Romania, as in most countries of Europe and Central Asia (ECA), women are allowed to own and inherit land and property equally to men. However, if titles and deeds to land are by default in the name of the head of household, who is usually male, then this can preclude women from exercising any formal rights over the property. Tools and experience from rural Romania and other ECA countries are available to ensure that expansion of urban land registration takes place in a gender-responsive manner. Gender-responsiveness is also likely to be embedded in the use of European Union funds for the 2014-20 programming period.[83]

[83] For example, training contractors and staff involved in systematic registration on how to be inclusive, such as by asking for both the husband and wife to be present for discussions on property rights when the staff visits the property. (Source: ECA Knowledge Brief on Gender and Land Administration)