PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

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Operation Name	Second Fiscal Effectiveness and Growth Development Policy Loan
Region	EUROPE AND CENTRAL ASIA
Country	Romania
Sector	Central government administration (70%); Capital markets (10%); Public administration- Industry and trade (10%); Climate change (10%)
Operation ID	P149776
Lending Instrument	Development Policy Lending
Borrower(s)	MINISTRY OF PUBLIC FINANCE
	Ministry of Public Finance Romania
Implementing Agency	Ministry of Public Finance Romania
Date PID Prepared	June 6, 2016
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Corporate Review Decision	June 13, 2016
Other Decision	Following the corporate review, the decision was taken to proceed with the preparation of this operation.

I. Country and Sector Background

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 8.0 percent per capita in Purchasing Power Parity (PPP) terms, and raised its income relative to the EU average from 26 percent to 57 percent. 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; a large infrastructure gap; and inefficient public investment, unless Romania decisively tackles its unfinished structural reform agenda.

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 share of Romanians at-risk-of poverty before social transfers slightly increased in recent years from 28.0 percent in 2012 to 28.5 percent in 2014[1]. 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. **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.**[2]

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. 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. 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**.**

II. Operation Objectives

The proposed Second Fiscal Effectiveness and Growth DPL series supports government reforms to:

(i) strengthen fiscal management and the performance of state-owned enterprises (SOEs); and

(ii) improve the functioning of property, energy, and capital markets.

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-

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

[2] 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.

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. 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, state-owned enterprises (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. 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. Reforms in these areas supported by this DPL include:

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 (ETP) for public debt secondary market operations**. This reform will improve liquidity in the secondary market and reduce rollover risk for government debt.

2. **The MOH has approved a centralized procurement plan for 2016, which includes antibiotics and oncology medicines**. The expansion of centralized procurement in the health sector will help lower prices; improve transparency and oversight of contracts; improve expertise in procurement; and reduce the burden of procurement on hospital staff. This will generate savings that can be ultimately used to finance underfunded activities in the health sector.

3. **The MOPF has published the prioritization list of significant investment projects for 2016**. This is an important step to improve public investment prioritization by helping to increase budget allocations to high-priority investment projects.

4. **The Government has approved and submitted the Law of the Minimum Social Inclusion Program (MSIP) to Parliament.** The MSIP will improve targeting, expand coverage and generosity of benefits and reduce administrative costs of Romania's social assistance program and is an important component of Romania's poverty reduction strategy.

5. **Parliament has enacted Law 111/2016 on corporate governance of public enterprises, approving GEO 109/2011**. This new law helps to strengthen corporate governance of SOEs, which is critical for improving the performance of the Romanian economy.

6. **The Government has completed the IPO for Electrica.** The Romanian energy supply and distribution company Electrica was one of Romania's top 10 network SOEs. Its IPO was a key milestone of Romania's privatization agenda.

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 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. Reforms supported in this area include:

7. **The National Energy Regulatory Authority (ANRE) has issued the Order to liberalize the non-residential gas market.** The liberalization of the residential gas market led to improvements in energy efficiency and reduced the domestic consumption of gas.

8. **OPCOM has coupled the Romanian Day-Ahead-Market with electricity markets in Hungary, the Czech Republic, and Slovakia.** It increased electricity price convergence in the region and stability of energy supply.

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 strategy and the action plan aim to reduce GHG emissions and implement adaption measures to climate change, including in the energy sector.

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**. This law is a critical pillar of the government's strategy to improve real estate registration, especially among the poor.

11. **The Parliament has adopted amendments to the Capital Markets Law through Law 268/2015 to modernize the regulatory landscape, enhance the governance and accountability of the Financial Supervisory Authority.** The new Capital Markets Law and subsequent regulations bring Romania closer to reaching Secondary Emerging Market Status and facilitate financial intermediation and investments.

III. Rationale for Bank Involvement

This DPL 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] The FEG-DPL series 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 the key pillars of Romania's Country Partnership Strategy (CPS) for 2014–2017. Its implementation involved significant WB technical assistance (TA) in the areas of social assistance; SOE corporate governance; cadaster; health; debt management; capital markets and public

[3] Both programs expired in 2015.

investment management. It was also closely coordinated with the EC and the IMF and supported by WB project lending in social assistance and health.

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), 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 Law on Cadaster 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.

The DPL supports climate change mitigation. The DPL support the adoption of 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 and the adoption of climate change mitigation measures.

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 SOEs; one IPO[4]; and the restructuring of a large SOE. These measures are expected to help improve the performance of the large and inefficient SOE sector[5] and its contribution to sustained economic growth. The liberalization of non-residential energy prices has already led to lower wholesale electricity prices. The coupling of the electricity market with Central Europe is boosting energy trade and will lead to energy price convergence. The adoption of the new capital markets framework will increase financial intermediation, which remains shallow in Romania relative to regional peers,[6] and help improve the business environment and investors' confidence. The private sector, bi-partisan reformist politicians, and civil society highly value the technical expertise of the Bank and the role it has played over two decades of partnership in supporting Romania's development and the profound transformation that the country has undergone.

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. 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 state-owned enterprises (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

[4] The largest IPO for the Romanian stock market, also listed in London.
[5] Currently the number of SOEs exceeds 1,200, the largest in the EU.
[6] 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.

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.

IV. Tentative financing

Source:		(EUR m.)
Borrower		0
International Bank for Reconstruction and Development		500
Borrower/Recipient		
IBRD		
Others (specify)		
	Total	500

V. Institutional and Implementation Arrangements

The Bank continues to work closely with the MOPF, the Prime Minister's Office, and sector ministries to monitor and assess reform progress and impacts during the course of this operation. The MOPF has facilitated the overall coordination and implementation of the DPL-supported reforms. Monitoring and evaluation will be supported by various ministries as well as 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 and tracked according to the indicators and outcome measures shown in the monitoring and results framework of the policy matrix.

VI. Risks and Risk Mitigation

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.

Political and governance risks. With parliamentary elections scheduled for December 2016, implementation of some reforms may slow down. Romania strengthened its FRL but enforcement remains weak. Vested interests may also 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.

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. 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.

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.

VII. Poverty and Social Impacts (PSI) and Environmental Aspects

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 the social assistance program and the functioning of energy, property and capital markets. This should 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. The overall distributional effects are expected to be positive largely due to the introduction of the MSIP, which aims to improve the coverage, targeting, and generosity of the existing social assistance system.

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 in the case of single parents. This is likely to be particularly beneficial to women, who constitute 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 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.[7] Similarly, experience on mining restructuring in Romania has been shown to disproportionately affect the welfare of women—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.[8]

The adoption of the National Climate Change Strategy and National Climate Change Action Plan is expected to contribute to a reduction in GHG emission, while all other policies supported by the proposed DPF series are expected to have no significant effects on Romania's environment, water resources, habitat, or other natural resources. Scenarios for significant direct or indirect negative impacts appear very unlikely.

VIII. Contact point

World Bank
Contact: Doerte Doemeland
Title: Lead Economist
Tel: (202) 458-1238
Fax:
Email: ddoemeland@worldbank.org
Borrower
Contact: Boni Cucu
Title: General Director, International Financial Relations General Directorate
Tel: +40 21 319 9854
Email: Boni.cucu@mfinante.ro

IX. For more information contact:

The InfoShop
The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 458-4500
Fax: (202) 522-1500
Web: http://www.worldbank.org/infoshop

[7] 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)
[8] Dani et al. 2006.