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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A

PROPOSED LOAN

IN THE AMOUNT OF EUR 591.9 MILLION (EQUIVALENT TO US$650 MILLION) TO

ROMANIA

FOR THE

Romania Second Programmatic Inclusive and Green Growth Development Policy Loan
June 1, 2023

Macroeconomics, Trade and Investment and Energy and Extractives Global Practices
Europe and Central Asia Region

GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of April 30, 2023)

Currency Unit

US$1.00 = Ron 4.49 = EUR 0.91

ABBREVIATIONS AND ACRONYMS

ADR	Authority for Digitalization
ANAP	National Agency for Public Procurement
ANRE	Energy Regulatory Authority
ANRM	National Regulatory Authority
ASA	Advisory Services and Analytics
CAD	Current Account Deficit
CCAP	Climate Change Action Plan
CCDR	Country Climate and Development Report
CESEE	Central, Eastern, and Southeastern Europe
CPF	Country Partnership Framework
CPSD	Country Private Sector Diagnostics
DPF	Development Policy Financing
DPL	Development Policy Loan
DSA	Debt Sustainability Analysis
DSM	Demand-side management
EC	European Commission
ECB	European Central Bank
EIA	Environmental Impact Assessment
ETS	Emission Trading Scheme
EU	European Union
EU-SILC	EU statistics on income and living conditions
FCV	Fragility, Conflict, and Violence
FDCs	Forcibly Displaced Children
FDI	Foreign Direct Investment
FDPs	Forcibly Displaced Persons
FEG	Fiscal Effectiveness and Growth
GCRF	Global Crisis Response Framework
GDI	Graduation Discussion Income
GDP	Gross Domestic Product
GEO	Government Emergency Ordinance
GHG	Greenhouse Gas

GMI	Guaranteed Minimum Income
GORo	Government of Romania
GPG	Global Public Goods
GRID	Green, Resilient and Inclusive Development
GRS	Grievance Redress Service
GWh	Gigawatt hours
HBS	Household Budget Survey
IBRD	International Bank for Reconstruction and Development
ICR	Implementation Completion and Results Report
ICT	Information and Communications Technology
ID	Identity Document
IDA	International Development Association
IFC	International Finance Corporation
IFI	International Financial Institution
IMF	International Monetary Fund
IOM	International Organization for Migration
kgoe	Kilogram(s) of oil equivalent
LDP	Letter of Development Policy
LGBTI	Lesbian, gay, bisexual, transgender, and intersex
MABs	Multi-family apartment buildings
MFD	Maximizing Finance for Development
MIP	Ministry of European Investments and Projects
MoF	Ministry of Finance
MRDPWA	Ministry of Development, Public Works and Administration
MW	Megawatt(s)
NBR	National Bank of Romania
NECP	National Energy and Climate Plan
NGO	Non-Governmental Organization
NPL	Non-performing loan
NRRP	National Recovery and Resilience Plan
ONAC	National Office for Centralized Procurement
OSSs	One-Stop-Shops
PA	Prior Action
PCE	Private Capital Enabled
PDO	Program Development Objective
PER	Public Expenditure Review
PFM	Public Financial Management
PIMA	Public Investment Management Assessment
PP	Public Procurement
PPP	Public Private Partnership
RAPID	Romania Rural Pollution Prevention and Reduction Project
RAS	Reimbursable Advisory Services
RI	Results Indicator
RON	Romanian Lei
RRF	Resilience and Recovery Facility
SCD	Systematic Country Diagnostic

SDDS	Special Data Dissemination Standard
SEA	Strategic Environmental Assessment
SEAP	Public Procurement Electronic System
SMEs	Small and Medium Enterprises
SOE	State-Owned Enterprise
SRI	Social Reference Indicator
TA	Technical Assistance
TJTPs	Territorial Just Transition Plans
TSI	Technical Support Instrument
UN	United Nations
UNECE	United Nations Economic Commission for Europe
UNHCR	United Nations High Commissioner for Refugees
VAT	Value Added Tax
VMI	Venitul Minim de Incluziune (Minimum Inclusion Income)
WB	World Bank
WBG	World Bank Group
Y-O-Y	Year-on-year

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ROMANIA

SECOND PROGRAMMATIC INCLUSIVE AND GREEN GROWTH DEVELOPMENT POLICY LOAN

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SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Programmatic	If programmatic, position in series
P179297	Yes	2nd in a series of 2

Proposed Development Objective(s)

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

Organizations

Borrower:	ROMANIA
Implementing Agency:	Ministry of Finance

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Financing	**650.00**

DETAILS

International Bank for Reconstruction and Development (IBRD)	650.00

INSTITUTIONAL DATA

Climate Change and Disaster Screening

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

Overall Risk Rating

Moderate

Results

Indicator Name	Baseline (2021)	Target (2024)
Results Indicator #1: Cumulative share of women FDPs from Ukraine that use healthcare services as a share of those registered	0	12% of registered FDP women
Results Indicator #2: Access to Minimum Inclusion Income Program (component of VMI – or Venitul Minim de Incluziune)	165,205 families	Increase by at least 20%
Results Indicator #3: Number of social services provided in the community	59	Increase by at least 20%
Results Indicator #4: Share of FDPs from Ukraine aged 15-64 in employment as a share of FDPs from Ukraine registered with the National Agency for Employment	0	40% of FDPs aged 15-64, of which: 50% are women aged 15-64
Results Indicator #5: Share of hosting schools in total schools hosting FDPs from Ukraine implementing integrated measures for students	0	75%
Results Indicator #6: Collections from individual dividend tax	1,774 million lei (2019)	Increase in real collections by at least 10%
Results Indicator #7: Number of ministries adopting program-based budgeting	0	At least 2
Results Indicator #8: New renewable capacity contracted, of which: Electricity generation capacity Green hydrogen generation capacity (electrolyzers)	0 MW 0 MW 0 MW	1,050 MW 950 MW 100 MW
Results Indicator #9: Operational coal fired power generation capacity	3225 MW	Reduction of at least 15%
Results Indicator #10: Surface area of buildings to undergo energy efficiency renovation for which financing is secured	0 m^2	2,170,000 m^2
Results Indicator #11: New storage capacity (batteries) contracted	0 MW	120 MW
Results Indicator #12: New area under afforestation or reforestation works (artificial regeneration)	4,745 ha	Increase by at least 9,500 ha

IBRD PROGRAM DOCUMENT FOR A PROPOSED DEVELOPMENT POLICY LOAN TO ROMANIA

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed operation of US$650 million is the second in a programmatic series of two operations to support the Government of Romania to enhance inclusion; strengthen fiscal management; and foster decarbonization and climate resilience.** Following the first operation comprising a EUR 600 million IBRD loan (equivalent to US$641.7 million) and a US$24.2 million grant from the IBRD Fund for Innovative Global Public Goods (GPG) Solutions, this second operation comprises a proposed US$650 million IBRD loan. Romania continues to see substantial poverty and inclusion challenges, as reflected in the forthcoming Systematic Country Diagnostic (SCD) Update, as well as the 2018 SCD. Regional income and service delivery disparities are wide: the population has one of the highest poverty rates and is among the most unequal in the European Union (EU), also showcasing one of the lowest impacts of social transfers on reducing poverty and inequality. Hence, the inclusion agenda is paramount in the country, gaining added significance with Russia's invasion of Ukraine and the unprecedented influx of forcibly displaced persons (FDPs) into Romania.[1] The country has also been running a large structural fiscal deficit, averaging 3.5 percent of GDP during 2010-21, fueled by tax cuts and numerous exemptions, and untargeted permanent spending increases. With the economic and humanitarian spillovers of Russia's invasion of Ukraine (particularly support to households and firms in the face in of skyrocketing energy prices and accommodation of the refugees), fiscal pressures are on the rise. Russia's invasion of Ukraine has also raised issues of energy security and independence at the country level and solidarity at the regional level, adding to the debate on the sector's role in achieving reduced greenhouse gas (GHG) emissions. As an EU member, Romania is signatory to the European Green Deal with its ambitious, timebound decarbonization targets of reaching the net zero emissions by 2050, and the REPower EU[2] which includes a regional energy solidarity perspective. In the case of Romania, this solidarity also translates in to supporting the Republic of Moldova, which currently is almost fully dependent on electricity from Romania (about 70 percent of total consumption) and gas imports (about 27 GWh/day). This adds pressure to the already challenging situation of the power and gas systems to deliver affordable energy in the context of the broader energy crisis and decarbonization process.

2. **The proposed Development Policy Financing (DPF) series supports the Government's efforts in addressing inclusion and other structural constraints impeding development progress in Romania.** The key constraints to growth and prosperity identified in the SCD Update include weak institutions (resulting in low tax collection rates and spending inefficiencies), limited coverage and adequacy of social assistance, unequal access to quality public services, concerns on quality and quantity of labor, infrastructure and other impediments to the business environment and the added challenge on reaching climate change mitigation targets in a resilient way and without deepening existing inequalities. The proposed Development Policy Loan (DPL) series supports the Government's efforts in many of these areas. First, it supports inclusion – through social protection reforms, integration of the FDPs while supporting host communities, and integration of disabled persons into communities; fiscal management – through measures eliminating tax loopholes and strengthening the budgetary frameworks, alongside substantive technical assistance for long-term pension

[1] Inequality is visible across population groups with self-employed, single elderly and the Roma population at a higher risk of poverty.
[2] The REPowerEU Plan is the European Commission strategy to end reliance on Russian fossil fuels before 2030 in response to the hardships and global energy market disruptions caused by Russia's invasion of Ukraine.
https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal/repowereu-affordable-secure-and-sustainable-energy-europe_en

and public wages reforms; and climate – through decarbonization effort as well as carbon sinks.[3] Second, the measures supported by the DPL will help unlock and complement EU funding and promote private investment in the coming years, primarily in renewable energy, energy efficiency and forestry, supporting infrastructure development and the business environment, as well as inclusion (just transition) objectives. Third, the DPL is complemented by technical assistance in several areas, including social assistance, deinstitutionalization, pension and wage reforms (along with support from the EU), tax policy, and tax administration which will support institutional strengthening of the public sector. On decarbonization, the WB technical assistance spans the development of an offshore wind roadmap, energy efficiency renovation of the building stock, hydrogen regulation and markets, development of hydrogen-ready infrastructure, improvement of competition in energy markets and evaluation of renewable energy projects to accelerate its implementation. The support for institutional strengthening is in line with the FY19-FY23 Country Partnership Framework (CPF)[4] for Romania, as a country above the IBRD Graduation Discussion Income (GDI) level, and the operation also meets the CPF filters for WBG financing, namely (i) developing innovative solutions that benefit the most poor and vulnerable, including Roma; (ii) maximizing finance for development, including catalyzing private sector investment or leveraging additional resources (e.g., better use of EU funds); and/or (iii) contributing to regional and global public goods (through both FDP and climate change action). Meanwhile, the successful integration of FDPs could support labor supply in Romania while the adaptation and mitigation efforts supported by the DPL series will help support the climate change agenda.

3. **Minimum inclusion income reforms can increase the impact of social protection on reducing poverty, while the influx of FDPs can support growth, if adequate short- and medium-term actions are taken to integrate the FDPs and mitigate the impact on host communities**. Over a quarter of Ukraine's population is estimated to have fled their homes since February 24, 2022, making this the fastest growing refugee crisis since the World War II.[5] Romania is the second largest recipient of FDPs after Poland, with over 3,200,000 arrivals and around 127,000 remaining in the country as of early-April 2023, according to the Government's estimates. The majority of the FDPs are women and children. The FDP arrivals include significant vulnerable groups that will require tailored support, including those with serious health conditions and disabilities.[6] In the scenario where the FDPs decide to stay, and the Government enables their integration into the Romanian society and labor markets, while simultaneously supporting the host communities, the influx can provide an opportunity in boosting the Romanian labor force. Fragmentation of Romania's three means-tested benefits has limited their effectiveness in reducing poverty and strengthening shared prosperity, while limited incentives for employment, skills strengthening and links to job opportunities have negatively impacted the labor market participation of social assistance beneficiaries. As a result, the impact of social transfers in reducing poverty and inequality in Romania is among the lowest in EU countries. Besides, the impact of the COVID-19 pandemic on the poor and vulnerable and the influx of FDPs from Ukraine could increase the share of households at risk of poverty.

4. **Enhanced fiscal management remains a central priority in the context of additional spending needs to accommodate the influx of FDPs and mitigate the impact of rising prices.** The COVID-19 pandemic significantly increased the already high fiscal deficit to 9.2 percent of GDP in 2020 which led to a sharp increase in public debt to 46.9 percent of GDP in 2020, up from 35.1 percent in 2019. More recently, because

[3] More details available in the forthcoming Romania Country Climate and Development Report (CCDR).
[4] Report No. 126154-RO, discussed by the Board of Executive Directors on June 19, 2018.
[5] UNHCR April 27, 2022, Ukraine Situation Flash Update # 10.
[6] IOM Displacement Survey, from March 25 - April 8, 2022.

of Russia's invasion of Ukraine and the associated support measures to shield the population from the key economic impacts, the deficits remain elevated, and the public debt continued to rise due to the support to vulnerable households and small businesses given the impact of higher energy prices, while also spending for social services and assistance to FDPs. Endemically low tax collection (26-27 percent of GDP collected from taxes, the second lowest in the EU) due to tax loopholes and low tax administration capacity exacerbates the fiscal situation. The budget execution and formulation processes are largely input-based, lacking a performance–driven culture. The public pensions fund runs an annual deficit of around 2 percent of GDP raising questions about its sustainability, while the pension benefit formula is complex and non-transparent, leading to inequities among cohorts of pensioners. However, this sensitive reform, where steady progress is being made along with support from the EU, may take somewhat longer than anticipated in part due to additional emergency pressures requiring attention of the capacity-strained government. With the added fiscal pressures, the deficit is expected to remain high at around 5.4 percent of GDP in 2023.[7] The direct cost of provision of public services to FDPs is estimated at just below 0.2 percent of 2022 GDP. In addition, the cost of the measures[8] to shield consumers and industries from the impact of higher energy prices is estimated at around 1.1 percent of 2022 GDP (although this estimate does not fully include the end of the year and thus does not fully reflect the impact during the heating season). The authorities are planning to recover a share of the additional costs of the social protection measures extended to shield households from the higher energy prices through a surcharge imposed on the windfall profits of energy companies, higher dividends from energy State-Owned Enterprises (SOEs) and from higher Value Added Tax (VAT) and excise collections as a result of higher prices.

5. **Accelerating the energy transition will increase resilience to climate change, enhance energy security and free up resources for regional solidarity, although Russia's invasion of Ukraine could potentially delay the process.** Romania's vulnerability to climate change is relatively high, while its readiness to adapt is rated as relatively low.[9] By 2050, monthly maximum temperatures are expected to rise by 1.2°C-3.9°C, leading to more frequent and persistent heat waves, an increase in the annual number of hot days by 12.9 days, and more intense and frequent spatially extended droughts (impacting hydropower generation, among other effects). As an EU member, Romania is committed to deliver on the European Green Deal targets of achieving net zero GHG emissions by 2050. To achieve these targets, decarbonization will be required across all economic sectors, with significant frontloading of decarbonization actions in the energy sector. The energy sector is the main emitter of GHG in Romania with a share of 66 percent of total national emissions. Increasing locally produced renewable energy, coupled with electricity storage (batteries) to smoothen its integration in the electricity network, and boosting energy efficiency in buildings will contribute to achieving the decarbonization objectives, with hydrogen having a promising role. It will also reduce dependence on energy imports and strengthen climate change adaptation efforts, including reduced dependence on hydropower (which accounts for about 20 percent of total electricity production), and free up resources which could strengthen Romania's regional role supporting neighboring countries, like Moldova. In addition, to support both mitigation and climate change adaptation, measures laying down binding rules for afforestation and reforestation will help rebuild forested areas, which act as carbon sinks and support emissions reduction. While Russia's invasion of Ukraine shifted priorities in the short run towards security of supply, strong messages from the European Commission, especially through the REPower EU efforts, stress the need to increase energy independence by accelerating the energy transition at the EU

[7] World Bank Staff estimates.
[8] Currently approved until end-March 2025 for household consumers and companies as reflected in the legislation (GEO 27, 119/2022, Law 357/2022).
[9] 2021-2025 WBG Climate Change Action Plan.

level.

6. **Addressing these challenges is compounded by the limited institutional capacity of the public sector in Romania.** Limited government coordination and lack of alignment between strategic priorities and investments continues to reduce effectiveness of public institutions. The European Public Administration Country Knowledge assessment[10] ranked Romania's coordination capacity as medium with high fragmentation, a low level of inter-institutional coordination and low consistency of reforms and policy making. These institutional weaknesses result in inefficient spending, limited absorption of EU funds, and inadequate public service delivery. Institutional constraints account for at least half of the top-cited constraints to private sector growth.[11] This DPL series supports institutional strengthening in key areas of engagement (such as fiscal management, tax regulation, and public service delivery) through policy changes along with complementary technical assistance and Reimbursable Advisory Services (RAS) programs.

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

8. **The proposed operation builds on the World Bank Group's (WBG) Green Resilient and Inclusive Development (GRID) approach, the WBG Strategy for Fragility, Conflict, and Violence (FCV) 2020-2025, the Global Crisis Response Framework (GCRF) and is private capital enabling (PCE).** In addition to the Paris Agreement, Romania's green transition agenda is anchored in the European Green Deal, the EU's joint Nationally Determined Contributions, as well as the 2021-30 Integrated National Energy and Climate Plan. The actions to support the integration of the FDPs and host communities are aligned with the WBG FCV Strategy 2020-2025, specifically, pillar 4, "Mitigating the spillovers of FCV," and pillar 1, "Preventing violent conflict and interpersonal violence." This DPL series is also aligned with the strategic framework of the "WBG Response to Global Impacts of Russia's invasion of Ukraine – A Proposed Roadmap" (April 2022) that discusses the short- and medium-term responses to Russia's invasion of Ukraine. The series is also aligned with all the four GCRF pillars (itself underpinned by the GRID agenda) through the social protection measures (GCRF Pillar 1), special support for FDPs (GCRF Pillar 2), climate and macro-fiscal resilience (Pillar 3), and green and sustainable growth measures and domestic resource mobilization (GCRF Pillar 4), among other

[10] European Commission 2018. Public administration characteristics and performance in EU28: Romania. https://op.europa.eu/en/publication-detail/-/publication/90311e18-95fe-11e8-8bc1-01aa75ed71a1/language-en
[11] World Bank Group 2019. Enterprise surveys. Romania 2019 – Country profile. https://espanol.enterprisesurveys.org/content/dam/enterprisesurveys/documents/country/Romania-2019.pdf

measures. The proposed operation is private capital-enabling under the Maximizing Finance for Development (MFD) framework, as it supports the legislative and regulatory changes to unlock private investment in renewables and fosters the revitalization of the building renovation market.

9. **The operation faces moderate risks.** Among the risk categories, political and governance risk and implementation risk are deemed to be substantial, while the technical design risk is low. All the remaining risk categories are rated moderate. Political risks are mitigated, in part, by the Government's commitment to the policies being supported by this DPL series, the strong backing of the European Commission (EC) for these reforms, and the Bank's strong policy dialogue with the Government of Romania. Institutional risks are mitigated by the significant assistance to the government of Romania from the World Bank, the EC and other development partners for institutional capacity strengthening.

2. MACROECONOMIC POLICY FRAMEWORK

10. **Romania has made impressive strides in raising its economic performance over the past two decades, albeit characterized by volatility**. Romania's real GDP per capita grew by 4.6 percent a year on average in the last two decades, although the high average masks large growth volatility. The 2000s were a period of fast but unsustainable growth, driven by procyclical fiscal policies that boosted domestic consumption. The global financial crisis led to a painful adjustment in output in 2009-10, but the growth cycle gradually resumed, boosted again by procyclical fiscal policies that created new macroeconomic imbalances. Despite 15 years of EU membership, infrastructure is still inadequate given Romania's income level – with connectivity (particularly transport density) substantially below the EU average, constraining private investment and productivity. Productivity is further hindered by unsustainable wage dynamics and an aging and shrinking labor force. The ongoing crises due to the impact of spillovers from Russia's invasion of Ukraine may also imply longer-term scarring, further lowering the country's potential growth. However, the overall macroeconomic management remains sound, including fiscal adjustment efforts and tightening monetary policy in response to inflation.

2.1. RECENT ECONOMIC DEVELOPMENTS

11. **Romania's output recovered to pre-pandemic levels in 2021, and growth continued to be robust in 2022.** Romania's economy performed better than expected throughout 2022, posting a 4.8 percent GDP growth. Growth was driven by robust private consumption, benefiting from the phasing-out of COVID-19 restrictions, higher wages, and lower unemployment. Investment also picked up significantly, boosted by new construction works and – to a smaller extent – by machinery and equipment production. Nevertheless, strong private consumption coupled with global value chain disruptions and the terms of trade shock led to a widening goods trade deficit. On the supply side, growth was led by the Information and Communications Technology (ICT) sector, which benefited from businesses adopting digital technologies. Construction activity was also strong, supported by the revival of the non-residential buildings segment and capital repairs.

12. **Monetary policy has been tightened in response to higher inflation**. Prices started rising in 2021, averaging 5.1 percent, amidst increasing energy prices and supply bottlenecks. Russia's invasion of Ukraine led to a further spiraling of prices which accelerated to 16.4 percent by December 2022, led by soaring electricity, gas, and central heating prices (up 39.7 percent). In addition, food prices have also increased substantially in the second half of 2022 and were up by 22.1 percent in December. In response to higher

inflation, the National Bank of Romania gradually increased the policy rate to 7 percent in early January 2023 from 1.25 percent in early August 2021, aimed at bringing down inflation to the 2.5 (+/- 1) percent target. The government capped energy (gas and electricity) prices for minimum consumption households and companies until end-March 2025[12]. This will, however, add to government spending. The pressure on the exchange rate increased after Russia's invasion of Ukraine but subsided subsequently. The currency (RON) appreciated by 0.4 percent year-on-year (y-o-y) against the Euro as of March 2023.

13. **The current account deficit (CAD) widened, driven by the deteriorating trade deficit, but reserve coverage remained stable**. During the pandemic, the CAD remained relatively stable compared to pre-pandemic trends, at around 5 percent of GDP, as imports contracted in line with exports. Trade volumes recovered in 2021 benefitting from the gradual reopening of the EU economies but import recovery (supported by high consumption) outpaced the export rebound, adversely impacting trade balance. The deterioration of the primary income balance, reflecting mainly larger investment income deficit, and external price increases added to the current account pressures, leading to a widening of the CAD to 7.2 percent of GDP at end-2021. The CAD continued to widen in 2022, increasing to 9.3 percent of GDP, despite the narrowing of the import and export prices differential. The changes were driven by a widening goods trade deficit and deteriorating primary income balance. The CAD is primarily financed by foreign direct investment (FDI) (around 3.8 percent of GDP), currency and deposits (around 2.9 percent of GDP), and capital account net inflows (around 2.4 percent of GDP). Foreign exchange reserves remained relatively stable and provided a cover of 4.4 months of imports of goods and services at end-December 2022, comparable to 4.5 months at end-2019 prior to the pandemic.

14. **Following the increase in the fiscal deficit during the pandemic, the authorities have started fiscal adjustments, but spending pressures stemming from the impacts of Russia's invasion of Ukraine are slowing down the consolidation efforts.** Romania had high structural fiscal deficits already prior to the pandemic and has been under the EU excessive deficit procedure since 2020, in part driven by past increases in the public wage bill and pensions. During the COVID-19 pandemic, despite a lower fiscal stimulus than in other EU Member States, Romania's fiscal deficit surged to 9.2 percent of GDP at the end of 2020. Since then, the fiscal deficits have been narrowing (though remain at elevated levels) in 2021 and 2022 at 7.1 percent and 6.2 percent, respectively, supported by higher revenue collection in line with the rebound in the economy, and a curtailment in public spending. Policies to cushion against the impact of higher energy prices stemming from the impacts of Russia's invasion of Ukraine, mainly energy price capping, will continue to add to spending pressures in 2023. The Government announced increases in public wages (10 percent nominal increase) and pensions (12.5 percent increase in the pension point) from January 2023 in response to high inflation remain below inflation levels and, thus, present a contraction in real terms, supporting the consolidation efforts. The deficits over the past three years (and particularly during the pandemic) added 12.2 percentage points to the public debt, increasing its stock from 35.1 percent of GDP in 2019 to 47.3 percent in December 2022. The public debt level is, however, low compared to many of the other EU member states. The new EU fiscal framework is likely to further strengthen national ownership of fiscal adjustments and facilitate a more gradual and sustainable adjustment of public debt ratios.

15. **The government is advancing reforms critical for long-term fiscal sustainability (pensions and public wages), albeit with modifications to their timeline**. The government is in the process of strengthening the management of the pension system and addressing existing inequities with the adoption of a new Public

[12] Law 357/2022 adopted by the Romanian Parliament in early December 2022 extended the capping of energy prices for household and companies until end-March 2025 and extended the degree of coverage for companies.

Pension Law. The current benefit formula in the general pension system is inequitable and non-transparent. While the subsequent benefit formula introduced by the Law no. 127 of 2019 would practically resolve issues of inequity, it is unaffordable. The new pension law currently being prepared will help address these deficiencies in the public pension system. The overall pension reform in Romania is supported by extensive technical assistance by the World Bank through an ongoing RAS on both general pension and special pension (for diplomats, parliamentary staff, civil aeronautics personnel, judges and prosecutors, auxiliary court staff, and Court of Accounts staff; as well as military service) reforms. Similarly, through extensive technical assistance (RAS), the World Bank is supporting the draft law on amending the current legislation on the public sector wage system to make it more equitable, based on the preliminary findings included in the Review of the legal framework conducted by the Bank. While the ongoing crisis and the effort needed to build consensus on these sensitive reforms across the nexus of stakeholders (national and supranational) induce delays to the timeline (envisaged during the preparation of the first operation in the series), the progress to date shows strong commitment to these critical reforms. It is further strengthened by their inclusion in the National Recovery and Resilience Plan (NRRP), with substantive scrutiny from the EC, and would unlock sizeable EU funds upon satisfactory completion.

16. **The bank-dominated financial system remains sound and resilient.** The banking sector accounts for 76.5 percent of the financial system and has assets estimated at 52.5 percent of GDP (Q2, 2022), less than half of peer countries (Hungary, Czechia), and approximately a fifth of the EU-27 average. Financial intermediation is relatively shallow in all segments, resulting in the lowest loan and deposit (26 percent and 40 percent of GDP, respectively, in 2021) penetration in the EU. The share of green assets in the banks' portfolios is currently at about 3 percent, less than half the Euro area average. The COVID-19 crisis stressed the financial system in Romania through the high exposure to government securities (mainly local-currency-denominated), which accounted for around 21.8 percent of the banking sector's aggregate assets, as of September 2022, the highest in the EU. On a positive note, Romania's banking system's non-performing loan (NPL) ratio remained low and decreased further to 2.8 percent as of September 2022, compared to 3.8 percent at the end of 2020, and now falls into the low-risk bucket, as defined by the European Banking Authority.[13] The non-performing loan coverage by provisions stood at 65.9 percent in September 2022, well above the EU average at 43.8 percent. Also, there have been no spillovers from the banking sector turmoil to Romania. Romania remains vulnerable to capital flow fluctuations: FDI fell by 60.4 percent in 2020, mainly amid a drop in intercompany lending, reflecting the adverse effects of the pandemic. However, FDI recovered to the pre-pandemic levels in absolute terms in 2021, benefiting from the resurgence of some of the postponed pre-pandemic investments and increased greenfield investment. The positive trend continued in 2022, with FDI increasing further by around 20 percent y-o-y.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

17. **Romania's economy is projected to grow at 2.6 percent in 2023, with the pace of growth moderated by the spillovers from Russia's invasion of Ukraine, and with risks tilted to the downside**. Romania's short-term growth prospects have been downgraded due to the spillovers from Russia's invasion of Ukraine which has resulted in higher inflation, increased uncertainty, and further disruptions to supply chains. The growth outlook depends on the dynamics of global prices and domestic inflation, especially related to energy and food, the duration and severity of Russia's invasion of Ukraine, and its impact on the

[13] The World Bank is also supporting the strengthening of the deposit insurance system.

European economy (Table 1). Structural reforms, especially in the energy sector, supported by this DPL are expected to boost investment, while adequate integration and inclusion of FDPs would help harness the medium-term growth-enhancing potential of migration by boosting Romania's declining labor force. Romania's capacity to increase its absorption of EU funds will be critical for a sustainable, green, and inclusive recovery, as the country has access to up to EUR 80 billion in EU funding by 2027 (around 33 percent of 2021 GDP) under the Resilience and Recovery Facility (RRF), the multiannual financial framework 2021-2027 and other programs.

18. **Inflation is expected to moderate over the medium term as demand side pressures abate and the global supply side shocks gradually fade out.** The monetary tightening cycle and medium-term fiscal consolidation will anchor inflationary expectations and accelerate the closing of the output gap. The energy prices should also lose some of the momentum, as a result of the base effects and the extension of the Government capping scheme until end-March 2025. Inflation is expected to gradually decline to 10.1 percent in 2023 and more firmly to 5.4 percent in 2024. Nonetheless, a protracted Russia's invasion of Ukraine and an unfavorable evolution of energy and food prices could upset the decline in prices.

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

	2019	2020	2021	2022e	2023f	2024f	2025f
Real economy							
GDP nominal in US$, billions	249.9	249.5	284.1	299.9	311.5	337.2	363.5
Real GDP growth	3.9	-3.7	5.8	4.8	2.6	3.9	4.1
Private consumption	3.4	-3.9	8.1	5.5	3.2	5.1	5.4
Public consumption	7.2	1.1	1.3	-2.0	1.1	1.2	1.2
Gross Fixed Capital Investment	12.6	1.1	1.9	9.2	6.9	7.2	7.4
Exports, Goods and Services	5.4	-9.5	12.6	8.6	6.7	7.1	7.0
Imports, Goods and Services	8.6	-5.2	14.9	9.2	8.1	8.6	8.5
Unemployment rate (ILO definition)	4.9	6.1	5.6	5.6	…	…	…
GDP deflator (2015 = 100)	121.6	126.3	133.2	151.1	156.9	163.2	169.0
Selected monetary accounts							
Base money (% change) 1/	17.8	21.9	20.5	-2.1	…	…	…
Credit to nongovernment (% change, y-o-y)	6.6	5.5	14.8	12.1	…	…	…
CPI (% change, average)	3.8	2.6	5.1	13.8	10.1	5.4	4.2
Balance of payments							
Current account balance	-4.9	-4.9	-7.2	-9.3	-7.9	-6.8	-6.5
Exports (goods)	28.1	26.1	29.1	30.0	29.8	30.5	31.1
Imports (goods)	36.1	34.7	38.7	41.3	40.4	40.5	40.6
FDI	2.3	1.4	3.7	3.8	3.9	4.0	4.0
Gross Reserves (in EUR billions) 2/	37.5	42.5	45.8	52.3	…	…	…
in months of next year's imports	4.5	5.6	4.9	4.4	…	…	…
in percent of short-term external debt	105.6	127.8	117.4	111.7	…	…	…
Exchange rate (RON/EUR, average)	4.75	4.84	4.92	4.93	…	…	…
Source: Ministry of Finance; National Bank of Romania; Eurostat; IMF; Bank staff estimates. As of early-April, 2023.							

Legend: 1/ Comprises currency in circulation plus overnight deposits; 2/End of Period

19. **The current account deficit will remain elevated in 2023 but is projected to decline in the medium term**. The spillovers from Russia's invasion of Ukraine are affecting Romania's trade mainly through higher import prices, primarily for energy and food, and their passthrough to other goods. Nevertheless, the direct impact is expected to be limited, as Russia and Ukraine accounted for only 1.4 percent and 0.9 percent of Romania's exports of goods and 3.2 percent and 1.1 percent of imports from 2018 to 2021. However, exports could be adversely impacted, given the importance of Russian gas to some of Romania's main trading

partners, mainly Germany. Lower domestic demand and further fiscal adjustment should slow down the growth in imports supporting an improvement in the terms of trade. The secondary income surplus may decrease reflecting lower remittances from major EU economies, while the primary income balance may benefit from companies relocating operations to Romania in the context of Russia's invasion of Ukraine. In the medium term, the CAD is expected to converge to the pre-pandemic and pre-invasion levels, as import price growth eventually decelerates and global growth and trade pick up.

20. **Medium-term fiscal consolidation remains critical, but a significant reduction of the fiscal deficit in 2023 is not imminent due to additional fiscal pressures resulting from Russia's invasion of Ukraine and inflation**. The pressures on public expenditure items will carry over in 2023. The direct costs related to the influx of FDPs are estimated to be below 0.2 percent of the 2022 GDP and are likely to remain low, since the number of FDPs appears to have stabilized. Additional pressures stem from spending to protect the poorer households from the high food prices and, to some extent, the cost of energy subsidies to partially shield households and firms. The EU is expected to cover a part of these costs, and increased EU funds absorption would alleviate some of the short- and medium-term fiscal pressures. As the COVID-19 crisis has subsided, public spending to limit its health and economic consequences have largely been unwound. Over the medium-term, fiscal consolidation is largely predicated on increased tax collections (through measures supported by this DPL), improvements in tax administration, unwinding of crisis related support measures and contained increases in wages and pensions. In addition, government efforts need to be focused on reducing inefficient expenditures and strengthening revenue mobilization, as Romania has the second lowest tax revenues to GDP in the EU, estimated at 27.4 percent in 2022. Reforming the pension system and the public sector wage and employment framework; introducing elements of performance budgeting; eliminating tax loopholes; and strengthening tax administration are key for strengthening fiscal management and for placing the fiscal deficit on a sustainable downward medium and long-term path and stemming the increase in public debt. Additionally, meeting the NRRP milestones should also help in maintaining control over fiscal expenditure, as well as support the revenues through grant disbursements. Prior to Russia's invasion of Ukraine, the deadline to end the excessive deficit (specifically, to bring the fiscal deficit to below 3 percent of GDP under existing EU fiscal rules) was extended to 2024. Fiscal financing needs are projected at 10.9 percent of GDP in 2023, with most of the financing coming from domestic sources. Disbursements by bilateral and multilateral creditors are projected at 0.5 percent of GDP, and the proposed operation accounts for 0.23 percent of the 2021 GDP (Table 2). Further external financing will come from the EU under the NRRP and from commercial creditors.[14]

21. **The debt sustainability analysis indicates that public debt will gradually stabilize in the baseline scenario**. Public debt is assessed as sustainable and is projected to gradually stabilize, reaching 50.4 percent of GDP by end-2025 in the baseline scenario, below the 60 percent threshold set forth by the Maastricht Criteria. The debt trajectory in the baseline scenario is conservative, supported by a stable and prudent borrowing profile. Given the geopolitical situation in the region and the uncertainty surrounding its impacts, the projections are, however, subject to a high degree of uncertainty. Debt levels are most vulnerable to growth and primary deficit shocks: difficulties in containing the fiscal deficit could push public debt to 52.3 percent of GDP by end-2025, while a combined macro shock (see Figure 1 and footnote 14) could raise public debt to around 60.2 percent of GDP. Nevertheless, Romania enjoys robust market access with well diversified funding sources both on the domestic and external market, and access to EU financing. While relatively high shares of foreign-currency-denominated debt (53.8 percent as of end-2022) present additional risks, most

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

non-local-currency-denominated debt is issued in Euros (45.3 of total public debt). In terms of maturity, the share of short-term debt[15] increased to 5.8 percent of total public debt as of end-2022 from 3.1 percent at end-2019 but remains significantly below levels registered during the financial crisis of 2008-09, continuing to mitigate refinancing risk. Interest rate risks are mitigated by the high share of debt with a fixed interest rate at 75.6 percent as of end-2022. Nevertheless, a volatile and uncertain economic and geopolitical environment coupled with existing macroeconomic vulnerabilities emphasizes the need for increased attention to the management of public debt over the medium term. The Government's debt management strategy for 2022–2024 aims to diversify debt instruments in local currency, lengthen maturities, maintain a comfortable level of reserves and prepare to issue green bonds.

22. **Romania's macroeconomic policy framework is adequate for this operation.** The Government implements a macroeconomic policy mix aimed at reducing the fiscal deficit and containing imbalances, while advancing on the structural reforms. The Government's response to the impact of the COVID-19 pandemic was rapid and effective in spite of the limited fiscal space. While government support cushioned households' welfare and limited adverse consequences on the economy and the labor market, it also led to an increase in the fiscal deficit to a record high of 9.2 percent of GDP in 2020. Growth rebounded in 2021 and the Government consolidated its fiscal position, with further fiscal consolidation in 2022. In response to inflationary pressures, the central bank raised policy rates. The Government remains committed to fiscal prudence, as evidenced by its commitment to undertake politically difficult reforms on public sector wages and pensions, supported by the World Bank and the European Commission. The Government is also mobilizing effectively to support the short-term needs and longer-term integration of FDPs from Ukraine and shield poor households from the high energy and food prices, while continuing to support Moldova's energy needs. The Government's commitment to the ambitions of the European Green Deal is evident in its efforts to increase the share of renewables and support energy efficiency and carbon sinks. Going forward, the key risk stems from the duration and intensity of Russia's invasion of Ukraine. The risk is mitigated, in part, by the Government's efforts to maintain macroeconomic stability, support recovery, integrate the FDPs and build fiscal space.

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

	2019	2020	2021	2022e	2023f	2024f	2025f
Total Revenues	**31.6**	**32.3**	**32.7**	**33.5**	**33.8**	**34.0**	**34.2**
Tax Revenues	26.6	26.8	27.2	27.4	27.9	28.1	28.3
Direct Revenues	4.8	4.7	5.1	5.9	6.5	6.7	6.9
Social Insurance Contributions	11.2	11.8	11.3	10.6	10.5	10.4	10.3
Taxes on Goods and Services	9.6	9.5	9.9	10.2	10.4	10.5	10.6
Taxes on International Trade	0.1	0.1	0.2	0.2	0.2	0.2	0.2
Other Taxes	1.0	0.8	0.9	0.5	0.5	0.5	0.5
Non-Tax Revenues	4.1	4.3	4.0	4.4	4.3	4.3	4.3
Other Revenues	0.9	1.2	1.5	1.7	1.6	1.6	1.6
Total Expenditures	**36.0**	**41.5**	**39.8**	**39.7**	**39.2**	**39.1**	**38.8**
Current Expenditures	31.6	36.0	34.4	33.6	33.1	32.9	32.4
Wages and Compensation	11.2	12.1	11.1	9.9	9.8	9.7	9.6
Goods and Services	5.6	6.0	6.1	5.8	5.7	5.6	5.3
Interest Payments	1.0	1.2	1.1	1.2	1.4	1.5	1.7
Current Transfers	13.5	15.7	15.6	16.7	16.2	16.1	15.8
Pensions	6.7	7.8	7.7	7.1	7.2	7.3	7.3
Capital Expenditures	3.5	4.6	4.2	4.2	4.3	4.4	4.6
Other Expenditures	0.9	0.9	1.2	1.9	1.8	1.8	1.8

[15] Below one year of maturity.

General Government Balance	**-4.3**	**-9.2**	**-7.1**	**-6.2**	**-5.4**	**-5.1**	**-4.6**
Primary Balance	-3.3	-8.0	-6.0	-5.0	-4.0	-3.6	-2.9
Public Financing Needs	**8.6**	**14.1**	**11.1**	**10.5**	**10.9**	**9.1**	**8.2**
Fiscal Balance	4.3	9.2	7.1	6.2	5.4	5.1	4.6
Amortization	4.3	4.9	4.0	4.3	5.5	4.0	3.6
Public Financing Sources	**8.6**	**14.1**	**11.1**	**10.5**	**10.9**	**9.1**	**8.2**
Domestic	6.3	7.7	7.7	6.1	6.1	5.6	5.0
External	2.3	6.4	3.4	4.4	4.8	3.5	3.2
Government consolidated gross debt	**35.1**	**46.9**	**48.6**	**47.3**	**48.8**	**50.1**	**50.4**

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

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

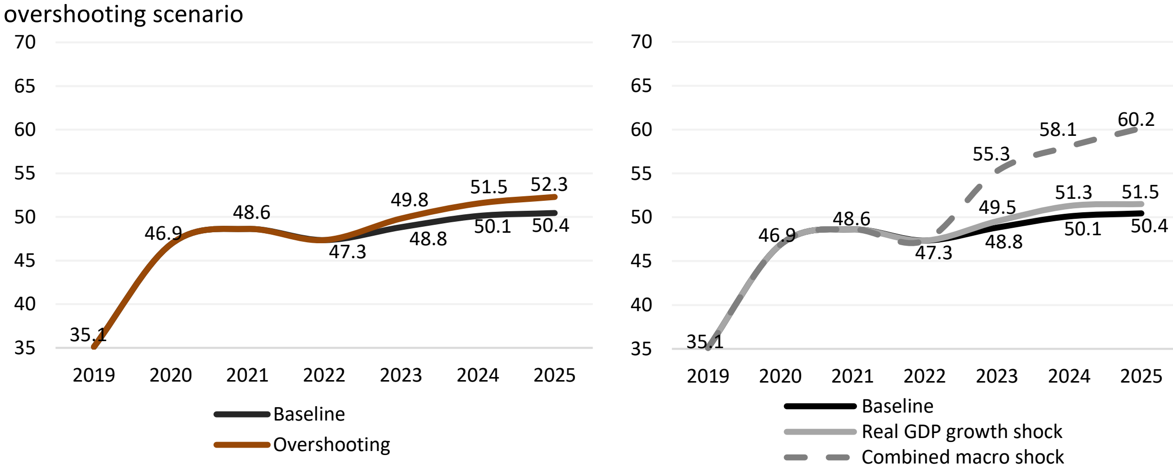
	2019	2020	2021	2022e	2023f	2024f	2025f
External Financing Needs	**25.8**	**28.0**	**27.1**	**28.5**	**27.1**	**26.3**	**26.1**
Current Account Deficit (positive number stands for deficit)	4.9	4.9	7.2	9.3	7.9	6.8	6.5
External Amortization	20.9	23.1	19.9	19.2	19.2	19.5	19.6
Financing Sources	**25.8**	**28.0**	**27.1**	**28.5**	**27.1**	**26.3**	**26.1**
External borrowing (new and debt rollover)	23.8	28.9	24.8	27.0	24.3	23.5	23.4
Foreign Direct Investment (net)	2.3	1.4	3.7	3.8	3.9	4.0	4.0
Change in Reserves (-)	-0.3	-2.3	-1.4	-2.3	-1.0	-1.2	-1.3

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

Figure 1. Romania Public Debt Sustainability

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

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



Source: World Bank simulations based on MoF and Eurostat historical data[16]

[16] The overshooting scenario reflects a fiscal deficit increase to 6.4 percent of GDP in 2023 due to difficulties in curbing government spending, as planned, and a higher deficit for 2023-2025, averaging 5.7 percent of the projected GDP. The real GDP shock scenario simulates a trajectory 1.5 p.p. below the baseline in 2023, 0.9 p.p. below in 2024 and an average GDP growth of 2.7 percent for 2023-2025. The combined macro shock reflects: (a) a moderate economic recovery; (b) overshooting of the fiscal deficit; (c) a real exchange rate depreciation of about 13 percent (which equals the maximum 10-year average) in 2022; and (d) an interest rate hike of 674 basis points.

2.3. IMF RELATIONS

23. **The last IMF Article IV review for Romania was approved in September 2022**. The Article IV Staff Assessment acknowledged Romania's robust economic recovery from the pandemic but noted the downside risks and higher uncertainty stemming from the spillovers of Russia's invasion of Ukraine. It also stressed the importance of implementing prudent macroeconomic policies and boosting economic growth through renewed structural reform efforts. The report also underlined the need for medium-term fiscal consolidation to improve fiscal buffers, ensure fiscal sustainability and reduce external imbalances. The Bank and Fund teams collaborate closely on macroeconomic, fiscal, and debt issues and hold regular discussions.

3. GOVERNMENT PROGRAM

24. **The Government's program for 2021-2024 aims to build a cohesive and open society that benefits from improved education and health systems, and from reduced inequalities between men and women and between urban and rural areas**. At an operational level, the Government's program aims to implement the reforms included in the NRRP. The NRRP is a Government document outlining its reform and investment priorities, proposing programs and projects that support resilience and crisis preparedness and promote adaptability, sustainability and inclusive growth through major reforms and key investments. It is also a prerequisite for accessing funds from the European Resilience and Recovery Facility. The NRRP is primarily focused on six pillars: (i) green transition; (ii) digital transformation; (iii) smart, sustainable and inclusive growth; (iv) social and territorial cohesion; (v) health, and economic, social and institutional resilience; and (vi) policies for the next generation, children and the youth. The key reforms that will be undertaken in these six areas include pension reforms; judicial reforms; public administration reforms; tax reforms; reform of the social inclusion programs and the minimum wage; education and healthcare reforms; and decarbonization reforms, particularly in energy and transport.

25. **The Bank has been providing support to the Government of Romania in many of these key reform areas over several years, both prior to and during the formulation of the NRRP.** These include the decarbonization and climate resilience measures, the long-term renovation strategy, social inclusion measures, reforms in education and health sectors, and fiscal and pension reforms. Given the long-term engagement of the World Bank with the Government of Romania in these key sectors, the outputs of the Bank's technical assistance helped shape the Government priorities, which were then formalized in the NRRP, and the World Bank continues to support the Government in their implementation. In addition, the Bank's technical assistance is complementing and facilitating the delivery of the NRRP priorities.

26. **The Government's program to support the FDPs from Ukraine was set up swiftly and is evolving depending on the needs**. The Government's coordination structure for the response to this humanitarian crisis was established on the first day of Russia's invasion of Ukraine with the setting up of three task forces. These included: (i) the high-level decision-making Taskforce; (ii) an operational taskforce, called "Ukraine Commission"[17]; and (iii) a Humanitarian Assistance Strategic Coordination Group to focus on the strategic framework of humanitarian response and to facilitate the inter-agency cooperation among national, European, and international partners. Romania has elected to structure its response to the FDP crisis through

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

two layers of intervention: (i) Emergency Response, and (ii) Protection Response. The first layer of response essentially deals with providing immediate humanitarian aid to incoming FDPs while the second layer of response is targeted at the medium- to longer-term integration of those FDPs who plan to stay on in Romania.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

27. **The proposed operation supports the Government in all of the six pillars of the NRRP, facilitating increased absorption of EU Funds.** The measures implemented to facilitate the access of the FDPs to social services and the labor market and their integration in the host communities are aligned with the NRRP pillars of smart, sustainable and inclusive growth; social and territorial cohesion; health, and economic, social and institutional resilience; and policies for the next generation, children and the youth. The social assistance and integration of the disabled promote inclusive growth. Budget and tax reforms aid fiscal sustainability. The measures aimed at improving energy efficiency, promoting renewable energy and green hydrogen, transition away from coal and reforestation are in line with the green economy pillar of the NRRP, and will facilitate the absorption of EU Funds channeled under the RRF to incentivize growth and the green transition, as well as broader economic and social development objectives. The proposed operation is also contributing to the Government's program explicitly developed for FDPs from Ukraine and the broader crisis response.

28. **The design of this operation incorporates both general and country-specific lessons from past operations.** The 2019 Implementation Completion and Results Report (ICR) on the previous programmatic Fiscal Effectiveness and Growth (FEG) DPL series (P148957, P149776) included the following lessons: (i) DPLs require Government ownership and leadership of reforms to ensure sustainability; (ii) legislative reforms supported by DPLs would benefit from outreach to relevant parliamentary commissions and inclusion of key parliamentarians in capacity building programs; (iii) the use of emergency ordinances could be more selective but they do enable legislative action in the context of heavy bureaucratic burden; (iv) the RAS program was critical for the design and implementation of the DPL program; and (v) reforms affecting market functioning should be contingent on the capacity of regulatory agencies to prevent market distortions. The following lessons have been incorporated in the current operation: prior actions are underpinned by significant analytical work; capacity building efforts and technical assistance are being provided on most of the reforms, mostly through RAS and Advisory Services and Analytics (ASAs); and the DPL series is designed as a programmatic series to aid reform momentum and yield development impact/results. However, given the ongoing emergency context under which this operation is being delivered, some measures may be promoted through emergency ordinances.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

29. **The first operation in the DPL series supported reforms to provide emergency relief to FDPs from Ukraine, strengthen** fiscal **management and foster decarbonization and climate resilience.** To support the FDPs, DPL1 included measures to provide them with temporary protection, education and health services, housing, social assistance and access to the labor market. As a result, among others, FDPs have the right to receive free medical assistance, FDP students can be enrolled in Romanian schools and adult FDPs may be employed without an employment permit and also have access to unemployment insurance system. It also

includes measures to support host communities by increasing the capacity of the Government by enabling hiring of additional staff at national and local levels. To enhance fiscal management, DPL1 included measures aimed at the use of program based budgeting and increased use of electronic platforms. To foster decarbonization and climate resilience, the first operation included increased energy efficiency of buildings, amendments to the energy law to support private sector participation in renewables and increased afforestation and reforestation.

30. **DPL2 builds on the progress achieved in the first operation of this series and strengthens the inclusion, fiscal management, and decarbonization agendas.** To further assist the FDPs and host communities, DPL2 supports the government in the provision of social services and integration of FDPs. In addition, it also facilitates the provision of public employment services and Romanian language training to FDPs to ensure that FDP and host community students benefit equally from resources provided to FDP hosting schools. To enhance inclusion, DPL2 aims to support measures that will strengthen the adequacy of social assistance, enable implementation of the Minimum Inclusion Income Program and the deinstitutionalization of persons with disabilities. To strengthen fiscal management, the current operation supports measures that will enhance tax collections by reducing tax expenditures. On the green transition, this operation supports critical measures to advance Romania's climate goals and international commitments, particularly the European Green Deal, with very concrete and legally decarbonization timelines for the member states to achieve net zero emissions by 2050 (please see the forthcoming Romania CCDR for the importance of energy decarbonization and the whole-of-economy approach that is required to achieve these targets). DPL2 supports Romania's legal commitment to phase out coal by 2032 following Just Transition principles, a strong and critical step to meet the EU targets to become the first carbon neutral region by 2050. Moreover, the DPL supports policy actions which set the foundations for the decarbonization of hard-to-abate sectors through the development of green hydrogen and energy efficiency; storage capacity for renewables; as well as further strengthening afforestation and reforestation efforts, which will be particularly important contributor to net zero targets through sequestration (i.e. negative emissions).

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

Changes to the Policy Matrix

32. **In response to the evolving policy environment, some prior actions and results were modified without compromising the strength of the overall program.** As a result of Russia's invasion of Ukraine and its spillovers, the government has been dealing with the cost-of-living crisis, and issues related to energy security, while also supporting the FDPs and the economy. With increased focus on crisis response, the timeline for completion of some of the policy actions in DPL2 has been extended. Nevertheless, the government remains committed to the key policy reforms supported by this DPL series and the World Bank

will continue to remain engaged in supporting the reform programs through technical assistance. In particular, the government is making steady progress on the pensions and wage law; both reforms are being supported through technical advisory support via RAS. Satisfactory reforms in these areas would also enable the government to unlock financing from the EU. Table 4 below summarizes the changes to the policy and results matrix along with the justification. In addition, some prior actions have been reworded to provide greater granularity on the actions being taken (PA #5, #6, #8, #9).

Table 4: Changes to the Policy Matrix

Original	Revised	Reason
	DPL2 Policy changes	
Trigger #1. The Borrower has established (i) an identity registry of FDPs from Ukraine and issued government recognized IDs; (ii) systems for access to the database of FDPs from Ukraine for relevant national and sub-national authorities; and (iii) consolidated service centers (One-Stop Shops) for FDPs from Ukraine for registration and information dissemination.	Dropped	This prior action has been dropped. Nevertheless, the registry of FDPs continues, with basic information collected at the time of temporary protection. In addition, a European platform for the registration of beneficiaries of temporary protection is currently operational and government-recognized IDs have been issued (residence permits of beneficiaries of temporary protection). Access to this platform can be granted to other agencies provided they submit a request for access. Also, the establishment of One-Stop-Shops (OSSs), nationwide, has been dropped from the matrix. These changes have happened because the number of FDPs from Ukraine did not increase exponentially as was originally envisaged. Hence, the government did not scale up its interventions in these areas. In addition, eight of the ten municipalities which host the largest number of FDPs have set up their OSSs and cost implications do not justify the establishment of OSSs across the country. Therefore, this action has been dropped from the matrix.
	Prior Action #2. The Borrower has adopted measures to accelerate the deinstitutionalization of adults with disabilities to enable their transition from public institutions to communities, as evidenced by the enactment of the Law no. 7/2023.	Resulting from a significant technical advisory support on the deinstitutionalization of adults with disabilities and given its significance for the social inclusion agenda, this new measure has been added to the matrix.
Trigger #4. The Borrower has approved integrated measures in the hosting schools for (i) FDPs from Ukraine and host community students to benefit equally from funding and other	**Prior Action #4.** The Borrower has approved integrated measures in the schools hosting FDPs from Ukraine and host community students to benefit equally from funding	Part (ii) on FDP and host teachers benefiting equally from the training facilities was dropped. Although trainings have been offered, the uptake has been scant because FDP teachers still hope to return back to Ukraine and are providing classes remotely to

amenities; and (ii) FDPs from Ukraine and host community teachers to benefit equally from teacher training facilities.	and other amenities, as evidenced by the adoption of the Order no. 6127/2022.	Ukrainian students, who are still continuing with Ukrainian education, online.
Trigger #5. The Borrower has: (i) published in the Official Gazette the amendments to the Unitary Pay Law ensuring that further wage increases and existing inequities are addressed in a fiscally sustainable manner; and (ii) taken appropriate measures to reduce preferential tax regimes and exemptions for various taxpayer categories thereby reducing tax expenditures and improving tax coverage	**Prior Action #5.** The Borrower has taken appropriate measures to reduce preferential tax regimes and exemptions for various taxpayer categories thereby reducing tax expenditures and improving tax coverage by: (i) strengthening the microenterprise regime; (ii) raising the tax rate on dividends to individuals; and (iii) increasing VAT on various products, as evidenced by the enactment of the Government Ordinance no. 16/2022, as approved with amendments through the Law no. 370/2022..	Part (i) on the Unitary pay law has been dropped from the matrix as the government needs additional time to complete the action. Nevertheless, the authorities are progressing steadily on the comprehensive reform of public wages. Progress has been made in assessing the current wage system, finalizing the report on the legal framework on public sector wages, completing the report on international experience with centralized wage systems while assessment is underway on the job ranking system and the wage data. The World Bank will remain engaged in the reform process through a RAS and the government is keen to complete the reforms, as this will help unlock funding from the EU (as it is a key component of the NRRP).
Trigger #6. The Borrower has approved a new Public Pension Law to ensure the sustainability of the public pensions system and address existing inequities	Dropped.	The pension law has been dropped from the matrix as the government needs additional time to complete the action. Nevertheless, the authorities are progressing steadily on the reform, with the law on special pensions already in Parliament. Data on public pensions has been shared with the World Bank team and work on assessing the pension system sustainability is underway. The World Bank will remain engaged in the reform process through RAS. The government is keen to complete the reforms as this will help unlock funding from the EU (as it is a key component of the NRRP).
Trigger #8. The Borrower has approved an offshore wind framework for the development and operation of offshore wind farms	**Prior Action #7.** The Borrower has approved a legal framework that: (i) establishes a clear timeline for the country to phase out coal mining and coal fired power; and (ii) incorporates principles to implement the transition away from coal in a transparent and inclusive manner, mitigating the impacts on communities and the environment, as evidenced by the enactment of Emergency Ordinance no. 108/2022, as approved with	The government has decided to adopt a law on offshore wind instead of the earlier envisaged 'framework'. This would need to go through the entire legislative process and hence will not be completed during the timeline of DPF2. There is a clear political commitment to this action, evidenced by the ongoing work on the draft legislation and commitment under the NRRP. The Ministry of Energy is working on the draft Law and the World Bank is providing technical assistance on it. This prior action has been replaced with the Decarbonization Law which will be the cornerstone for a just transition out of coal, greatly supporting Romania's commitment

	amendments through the Law no. 334/2022.	towards net zero by 2050.
	Prior Action #9: The Borrower has approved a state aid mechanism to support investments in storage technologies (batteries) to improve the reliability of the power system and better integrate new capacities of renewable energy, as evidenced by the adoption of Order no. 1229/2022.	This new measure has been added to the matrix to complement efforts under this pillar on advancing the green agenda. This action will support efforts to mobilize private investment for the installation of storage capacity (batteries), critical for the smooth integration of variable renewable energy like wind and solar.

Pillar I: Strengthening Inclusion and Fiscal Management

33. **The Government of Romania continues to support FDPs from Ukraine and host communities.** In response to the influx of FDPs from Ukraine, the Romanian Government acted swiftly, passing a series of government decisions and emergency ordinances to host them. Over 3.2 million FDPs have entered Romania, of which about 127,000 have remained in the country (early-April 2023). The FDPs are, overwhelmingly, young, educated mothers with children. Currently, it is unclear what fraction of FDPs are of Roma origin. All FDPs who have registered for temporary protection in Romania have been issued a personal identification number that serves as their government recognized ID. Basic demographic information on FDPs, such as age, gender, address, contact numbers, civil status and family situation are collected at the time of registration of temporary protection or at the initiation of asylum.[18] The existing database on FDPs is currently accessible to the General Inspectorate for Immigration, and other national and sub-national agencies can request access to the database. The government continues to work with civil society organizations, UN Agencies, and other international organizations to provide services to the FDPs. In partnership with these organizations, the government also adopted the three-year 'National Plan of Measures' to support the longer-term integration of FDPs. The FDP-related measures supported by the DPL series are aligned with the building blocks of the Global Principles of Refugee Response[19], aiming to put forward durable but transitional solutions to enhance refugee self-reliance and ease pressures on host countries. For those FDPs who plan to stay for the longer term, the DPL series supports their long-term integration. At the institutional level, the Chancellery of the Prime Minister is coordinating the activities of the agencies involved in the management of the FDPs along with working groups focused on labor, housing, education, health, children and youth, and vulnerable persons. To support vulnerable groups, the government has trained over 700 people on the concept of refugee protection, children have been referred to specialized services, and FDPs have received information on protection services related to gender-based violence, sexual exploitation, and abuse. In addition, the government continues with its information campaigns and awareness raising activities. These include an online platform (protectieucraina.gov.ro) with information on the rights and services available to the FDPs, distribution of fliers at border crossing points and dedicated helplines with Ukrainian language support. The government also continues to support the host communities to ensure that they retain adequate access to

[18] The EU data privacy laws govern the information collected.
[19] United Nations Refugee Agency 2018. Global Compact on Refugees. https://www.unhcr.org/5c658aed4.pdf

public services aided by the flexibility to increase manpower based on needs (latter supported by DPL1).

34. **While government efforts on the integration of FDPs continue, challenges remain.** The uncertainty surrounding Russia's invasion of Ukraine has implications for and consequences on the behavior of the FDPs and in response, to the support of the government. Despite a year since Russia's invasion of Ukraine, many of the FDPs hope to resume their lives back in Ukraine. This has, to an extent, hampered the integration process in labor markets and schools, in particular. The school enrolment of FDP children has been limited because of the lack of recognition of studies in Romania by Ukrainian authorities as well as the language barrier, although efforts are underway to address both these challenges. Language classes have been offered abundantly in schools with large FDP children and a memorandum of understanding has been signed between Ukraine and Romania to recognize each other's educational qualifications and skills. Similarly, the willingness to join the labor market in Romania is low with a continued hope to return back to Ukraine and this has impacted the uptake of Romanian language and entrepreneurship courses and more generally, efforts to look for jobs. As a result, the government's support to the FDPs continues to evolve. In addition, since the number of FDPs in Romania did not increase exponentially, the government has also scaled back its plans on the development of systems, processes and institutions to support them, one of them being the One-Stop-Shops. Nevertheless, such centers have been opened in certain municipalities in response to a relatively larger influx of FDPs. Examples include Oradea City Hall in partnership with Non-Governmental Organizations (NGOs), Cluj City Hall in partnership with NGOs, Brasov City Hall with local authorities and NGOs, UNHCR and UNICEF Blue Dot border centers, and Bucharest City Hall Refugee Center at Romexpo. Since the number of refugees staying on in Romania did not increase substantially compared to the situation in June 2022, the government has not gone ahead with the opening of these OSSs throughout the country, given cost implications. About 10 municipalities account for 70 percent of the refugees and eight of them have OSSs.

35. **The government remains committed to the broader inclusion agenda and fiscal prudence and sustainability.** On inclusion, the government has made steady progress in improving the social protection programs to enhance their coverage and adequacy. Another critical reform undertaken by the government relates to the deinstitutionalization of people with disabilities. This reform will support the integration of people with disabilities into communities, which will in turn lead to a substantial improvement in their quality of life. On fiscal management, the government has undertaken key reforms to broaden the tax base by removing tax expenditures. It is also making steady progress on two other critical reforms – wages and pensions. On pensions, the broader reform seeks to reform both special pensions and public pensions through legislative changes to increase the overall sustainability of the public pension system. The government has made significant progress on special pensions (which relate to, inter alia, the military, judges and prosecutors and diplomats) and is in the process of drafting the public pension law. On wages too, the government is making steady progress and is in the process of drafting the amendments to the law. Both these reforms are being supported by the World Bank through RAS' and are also subject to review by the EC. Given the contentious nature of the reforms, the difficulty in bringing all stakeholders to consensus, and the government's dealing with multiple crises, these reforms are taking longer than earlier envisaged. Nevertheless, the government remains committed to these reforms to support fiscal management and they will also help unlock the much needed EU financing through the NRRP.

Measures to strengthen inclusion

Prior Action #1: The Borrower has: (i) adopted regulations to implement the Law no. 196/2016 that provides protection to low-income families and single persons in Romania that are in relative monetary poverty, as evidenced by the adoption of the Government Decision no. 1154/2022; and (ii) adopted measures to adjust on an annual basis the level of the VMI (minimum inclusion income) to incorporate the average annual inflation rate, as evidenced by the enactment of the Emergency Ordinance no. 114/2022, as approved with amendments through the Law no. 56/2023.

36. **On the more structural issues impeding inclusion in Romania, the social protection system requires administrative and efficiency improvements**. Fragmentation of Romania's three means-tested benefits has limited their effectiveness in reducing poverty and strengthening shared prosperity, while limited incentives for employment, skills strengthening and links to job opportunities have negatively impacted the labor market participation of social assistance beneficiaries. The three programs have different eligibility thresholds, different social assistance units, different equivalence scales, and different implementation procedures. Parallel but unconnected delivery of these benefits without a shared database increases the system's administrative costs and beneficiaries' private costs (to apply, recertify and receive the benefit). As a result, the impact of social transfers in reducing poverty and inequality in Romania is among the lowest in EU countries: in 2020,social assistance contributed a 16 percent decrease in the share of the population at risk of poverty, and a 7 percent decrease in the Gini coefficient of equivalized disposable income, compared to the EU average of 33 percent and 14 percent, respectively. Besides, the impact of the COVID-19 pandemic on the poor and vulnerable and the influx of FDPs from Ukraine could increase the share of households at risk of poverty.

37. **To resolve these challenges, DPL2 supports the adoption of regulations to implement the Law on the Minimum Inclusion Income (also referred to as VMI Law – or Venitul Minim de Incluziune (VMI)).** It consolidates two of the three means-tested programs into a single anti-poverty program (VMI). The two programs include the Guaranteed Minimum Income and the Family allowance benefits and the consolidated program will have a single eligibility criteria and simplified administration procedures. It will also increase the adequacy of the benefits and the coverage of the poor and help deliver on the targets of the approved Romania Poverty Reduction Strategy. The implementation of the VMI is expected to significantly improve the targeting efficiency and poverty impact of the social protection system in Romania and is being supported through a RAS. The simplification of the program for both beneficiaries and social workers is expected to improve the effectiveness and efficiency of social assistance directed at households. The vast majority of the VMI beneficiaries are expected to be Roma and other vulnerable groups. The government plans to undertake intensive communication campaigns through multiple media, specifically targeted towards the Roma and other vulnerable groups to ensure that they are socialized into the program. Furthermore, a key element of the VMI program is the activation of adults by connecting them to the labor market and the activation of children by ensuring their school attendance. As a result, the VMI is expected to boost human capital and empower people to pursue their education and seek opportunities to lift themselves and their families out of poverty.

38. **In addition, the current operation also supports the indexation of the VMI benefits to the average annual inflation rate.** Launched in 2008, the Social Reference Indicator (SRI) was supposed to serve as a benchmark for indexing the values of different social protection benefits in a systematic manner. However, subsequent Governments did not follow the systematic SRI indexation. Some benefits were indexed in an ad-hoc manner based on the separate laws. As a result, some benefits shrank in value while others were

disproportionally increased. In response, the government adopted an adjusted SRI to maintain key social benefits (unemployment and social assistance) at an adequate level, which is expected to substantially advance the shared prosperity and poverty impacts of the social protection system in Romania. The SRI value is updated each year on March 1, with the average annual inflation rate from the previous year, with the latter communicated by the National Institute of Statistics. The current operation supports a similar indexation to average annual inflation of the VMI benefits to ensure that they are maintained at an adequate level.

Prior Action #2: The Borrower has adopted measures to accelerate the deinstitutionalization of adults with disabilities to enable their transition from public institutions to communities, as evidenced by the enactment of the Law no. 7/2023.

39. **Many of the adults with disabilities in Romania reside in public institutions and their reintegration into communities will support an inclusive society.** Currently, there are about 16,900 people with disabilities living in public institutions that were once seen as the best way to care for them. However, evidence suggests that institutional care typically provides poorer outcomes in terms of quality of life, as it leads to social exclusion and segregation, and institutionalization is also acknowledged as a violation of human rights. In contrast, the quality of life in a community results in far superior outcomes. For these reasons and also in line with the UN Convention on the Rights of Persons with Disabilities, institutionalization is increasingly acknowledged as poor policy. The deinstitutionalization of people with disabilities is a part of the government's NRRP, and the authorities aim to increasingly transfer these people into communities, so that they can have a better quality of life. The process, nevertheless, needs to ensure that the new systems of care and support respect the rights, dignity and needs of each individual and their families. This process of deinstitutionalization is afoot in many other EU countries as well.

40. **DPL2 supports the reintegration of people with disabilities from public institutions to communities**. This is a critical reform that will support inclusion in Romania. The objective of this reform is to increase the number of adults with disabilities living independently in the community, with the support of tailored services as per their individual needs, as well as services aimed at the general population, in an inclusive society. In this respect, a law was passed in January 2023 laying out the framework for accelerating the transition of adults with disabilities from public residential institutions to living independently and being integrated in the community. The law follows the earlier adoption of a National Strategy for governing this process and aims to support its implementation. The Bank provided technical assistance for the preparation of a Strategic Note that informed the Government in their preparation of the National Strategy, based on a significant amount of evidence from analyses of residential centers, community services, minimum quality standards, case management, and international recommendations and best practices. The National Strategy included brief Guidelines for the acceleration of deinstitutionalization, to serve as a methodological guideline. Detailed implementation guidelines are under finalization, and piloting in 5 residential centers is expected to be approved through the order of the President of the National Authority for the Protection of Rights of Persons with Disabilities. The pilots will further inform the implementation guidelines. The law is also aligned with the Convention of the Rights of Persons with Disabilities, the Common European Guidelines on the Transition from Institutional to Community-based Care, and practices in other EU countries. The implementation of this law will also be supported by a World Bank RAS on deinstitutionalization. The World Bank has a strong track record in supporting deinstitutionalization for children in Romania and is now supporting the implementation of the deinstitutionalization of adults with disabilities. Among others, the Bank will provide assistance in training and capacity building to ensure that the transition to communities results in a better quality of life

for adults with disabilities.

41. **The law includes several actions that were envisaged in the National Strategy for accelerating deinstitutionalization and will result in a fair and dignified transition of people with disabilities.** It covers: (i) the creation of coordination mechanisms at national and county level to ensure the process is similarly understood and applied nationally; (ii) the introduction of a person-centered approach in providing social services to adults with disabilities, with focus on changing how disability is managed, to ensure that support is tailored to the person's individual preferences, choices and needs; (iii) the development of community services to support independent living of persons with disabilities, targeting both persons with disabilities living in institutions who will transition to the community, and persons who are at risk of institutionalization; (iv) the provision of training to staff of social services dedicated to adults with disabilities; (v) the provision of support to families of persons with disabilities in helping them live independently; and (vi) the increase of societal awareness with regard to the right of persons with disabilities to live independently and included in the community.

42. **Results (for PAs 1 and 2):** The actions on social programs will support inclusion, in general, with increased access of low-income families in relative poverty to the Minimum Inclusion Income program, adequate levels of VMI benefits through indexation and increased services to enable integration of persons with disabilities into communities.

Access to employment for FDPs

Prior Action #3: The Borrower has: (i) approved guidelines to support the access to public employment services for FDPs from Ukraine, as evidenced by the adoption of the Order of the Minister of Labor and Social Solidarity no. 301/2022; and (ii) adopted measures to provide Romanian language classes to adult FDPs from Ukraine to foster their integration into the Romanian labor market, as evidenced by the adoption of the Order of the Minister of Education no. 6129/2022.

43. **To enable longer-term integration of FDPs into the labor market, they will need access to public employment services and language training.** This action is supported by the current operation. In the longer term, labor market integration can include skills assessment to facilitate access to the labor market, training needs assessment, including language training, and the establishment of matching platforms to facilitate the connection between employers and FDPs. To support longer term access of FDPs to the Romanian labor market, DPL2 supports access of FDPs to public employment services (like active labor market programs, job matching services, and others) and Romanian language training for adults. As a result, FDPs from Ukraine will receive free assistance from the National Employment Agency in contacting employers, receiving information, training (including on Romanian language), assessment, and recognition of informal professional skills, among others. These services will become available to the FDPs upon registration. The services include information and professional consultations (advisory support on the Romanian market, help with profiling, and the specifics of finding a job in the country). The agency will support refugees with professional training (retraining, advanced training); assist with recognition and assessment of professional skills, help find vacancies and contact prospective employers and also receive unemployment benefits. The government has disseminated information on labor market access and has also held job fairs to support the process.

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

Support to host communities and FDPs

Prior Action #4: The Borrower has approved integrated measures in the schools hosting FDPs from Ukraine and host community students to benefit equally from funding and other amenities, as evidenced by the adoption of the Order of the Minister of Education no. 6127/2022.

45. **In a global context of protracted crises and protracted forcible displacement, early actions to support FDPs and host communities are critical.** Recognition of the immediate humanitarian needs created by forced displacement is well understood and largely managed by receiving countries with support from relevant United Nations (UN) and international actors. However, increasingly it is recognized that there is an urgency to focus on the long-term development impacts in refugee hosting communities, given the protracted nature of most crises.[20] Significant refugee inflows can strain service delivery in host communities and increase tensions due to potential food insecurity, additional strains on service delivery, and competition for limited housing and economic opportunities. Appropriately designed policies and investments directed to both FDPs and host communities that address these stresses can generate positive development outcomes. Failure to consider the needs of both FDPs and the hosting communities can reduce social cohesion and result in negative outcomes for both groups. In line with the above, DPL1 supported the government's efforts to enable hiring of additional staff to maintain adequate levels of public service delivery to both host communities and FDPs.

46. **Ukrainian Forcibly Displaced Children (FDCs) arriving in Romania have the right to education under the same conditions as Romanian students.** According to data provided by UNHCR, as of January 2023,[21] minors accounted for about 39,000 persons. According to the Romanian legal framework in place,[22] Ukrainians, including those who do not request protection under the Asylum Law, have the right to free accommodation in boarding schools, food allowance, supplies, clothing, shoes, and textbooks. Hence, all Ukrainian students arriving in Romania, with or without official status as refugees, can be enrolled, upon request, in groups/classes/study formations in schools.

47. **DPL2 supports integrated measures in the hosting schools for FDPs from Ukraine and host community students to benefit equally from funding and other amenities**. Integrated measures refer to a combination of funding and measures such as accelerated education programs, remedial programs, and teacher training opportunities. This operation supports these integrated measures in FDP hosting schools to ensure that FDPs and hosts benefit equally from these resources. This will in turn support longer term integration of FDPs, while also benefiting host communities. Ukrainian FDCs can be enrolled in Romanian schools following the decision of their parents, legal guardians, or representatives of the operative groups responsible for unaccompanied minors. Minors are integrated into schools regardless of the maximum class size as an exception to the current regulations in place to provide children the right to education. Enrolment can be either as fully registered students, once the process of diploma recognition and other documents are completed, or as listeners. Regardless of their application, FDCs can receive Romanian language courses. Alternatively, Ukrainian FDCs can continue with their Ukrainian studies online and, thus, not register in the Romanian education system but participate in Hubs or Island Schools.

48. **Nevertheless, Ukrainian parents have shown limited preference in placing their children in**

[20] Globally, three-quarters of refugees are displaced for more than 5 years, which underscores the importance of planning for medium to long-term actions to address potential issues associated with forced displacement.

[21] Source: UNCHR https://data.unhcr.org/en/situations/ukraine/location/10782

[22] Emergency Ordinance no. 20/07.03.2022 regarding the establishment of support measures and humanitarian assistance

Romanian schools. At the same time, many schools are not yet ready to offer them Romanian language support in addition to the regular school program. Since arriving in Romania, 68 percent of school-age FDCs attend Ukrainian distance learning[23], and only a relatively small share is enrolled in Romanian schools. In a recent "Romania Multi-sector Needs Assessment" released in December 2022 by UNCHR and REACH[24], most respondents reported a preference for enrollment in the Ukrainian distance learning system. Online learning represents a preferred option for 85 percent of secondary school-aged children (12-17 years old) and 52 percent for primary school-aged children (6-11 years old). While uptake has been low, the government has put in place the measures that are needed to integrate FDCs into the Romanian education system while also providing access to these additional resources to host community students.

49. **Results**: The actions supported in this area will enable the government to cater to the needs of increased number of Ukrainian FDCs. It will also help host communities to benefit from the support measures put in place in schools for FDP students, thereby strengthening FDP integration and inclusion.

Tax and spending efficiency

Prior Action #5: The Borrower has taken appropriate measures to reduce preferential tax regimes and exemptions for various taxpayer categories thereby reducing tax expenditures and improving tax coverage by: (i) strengthening the microenterprise regime; (ii) raising the tax rate on dividends to individuals; and (iii) increasing VAT on various products, as evidenced by the enactment of the Government Ordinance no. 16/2022, as approved with amendments through the Law no. 370/2022.

50. **Romania has the second lowest tax revenues in the European Union, with 26.3 percent of GDP (including social security contributions), as compared to 41.3 percent average in the EU in 2020.** There are extensive preferential tax regimes and exemptions for various labor categories and microenterprises, reduced VAT rates for a broad range of goods and services, together with a low flat personal income tax rate of 10 percent, down from 16 percent in 2018. All these exemptions and changes in the tax policy regime, coupled with a low capacity of the Tax Administration to collect tax revenues, have diminished the tax base and introduced considerable distortions, which have negatively affected revenue collection and the fairness of the tax system.

51. **DPL2 supports the Government in reducing tax exemptions and collecting additional revenues.** The government implemented a number of fiscal reforms in 2022 and 2023. These were aimed at tackling the discrepancies in the Romanian tax system with the objective of increasing tax revenues and enhancing the efficiency and equity of the tax system. Many of the tax reforms have been introduced starting January 1, 2023. These include, among others: (i) increased VAT for a number of products; (ii) restrictions on the application of the favorable microenterprise taxation regime; and (iii) increasing the tax on dividends. These changes are expected to bring additional revenues to the budget of around 5.3 billion Ron (EUR1 billion, about 0.5 percent of 2023 GDP), according to computations done by the Ministry of Finance (MoF). In addition, the Bank advises the MoF on further tax policy changes under an ongoing RAS.

52. **Details of the tax changes implemented by the government include the following.** In the area of VAT, the government has increased VAT on soft drinks, non-alcoholic beverages based on sweetening or sugar and/ or containing added sugar from 9 percent to 19 percent, starting January 1, 2023. In addition, the

[23]https://reliefweb.int/attachments/f5d5f3b3-2df2-4e38-9db9-33393b212f65/ROU2204_REACH_Romania_2022_MSNA_Report-1.pdf
[24] https://www.reachresourcecentre.info/

government hiked VAT for the hospitality industry from 5 percent to 9 percent and has restricted the use of the reduced 5 percent VAT on the purchase of houses to buying only of a first house under the value of Ron 600,000 (around EUR 120,000). The purchase of houses of higher value will be taxed at the regular 19 percent VAT rate. The government has also reduced the threshold for the turnover of companies qualifying as microenterprises from EUR 1 million equivalent to EUR 500,000 and has given the option for microenterprises to opt either for a one percent income tax or a regular 16 percent profit tax. Other restrictions were also introduced, including the exclusion from microenterprise status of companies operating in banking, insurance and reinsurance, capital market and those carrying out intermediation activities in these fields, gambling, exploration, development, exploitation of oil and natural gas deposits. In addition, tax exemptions for the hospitality industry were lifted, and companies operating in this area can now choose between the microenterprise income tax regime/turnover tax of 1 percent and the profit tax of 16 percent.[25] Furthermore, the tax rate on dividends obtained by individuals has been raised from 5 percent to 8 percent starting with 2023.

53. **Results**: The measures supported in this area will result in improved revenue collection and tax effectiveness.

Pillar II: Fostering Decarbonization and Climate Resilience

54. **In line with the European Green Deal, the Government of Romania is taking steps to achieve climate neutrality by 2050, that will encompass, among others, a transition to clean energy and out of coal.** Romania is committed to contribute to the achievement of the regional decarbonization targets of the EU. For sectors under the Emission Trading Scheme (ETS), the Romanian NECP sets an overall emissions reduction target of about 44 percent by 2030 compared to 2005. This second pillar of the DPL fosters decarbonization and climate resilience by addressing key gaps in the legislative framework with respect to renewable energy generation and storage, the strengthening of energy efficiency in industrial activities, transitioning out of coal and deepening of carbon sinks. The support to the transition out of coal, increased investments in renewables and the integration of renewable energy by adding storage capacity, and other new technologies such as green hydrogen and reduced energy consumption through energy efficiency measures will contribute to the Government's efforts to achieve its international commitments on climate change and increase resilience and adaptation to climate change. It will support preparedness of the energy sector to reduced and more extreme rainfall patterns through reduced dependence on hydro power via diversification of the energy matrix with renewables. It will also support adaptation through increased energy efficiency in buildings and industries –an important action to reduce energy imports–, a key component of increasing energy security.

55. **Climate neutrality can only be achieved through a structural transformation facilitating the creation of new green markets and businesses founded on low-carbon productive processes.** The policy actions supported by Pillar II will enable the shift to a green economy and boost green growth by (i) creating a regulatory framework for hydrogen, which is expected to play a relevant role in the decarbonization of hard-to-abate sectors; (ii) improving energy efficiency in the hard-to-abate industrial sector, with spillovers on the country's competitiveness, energy security and energy prices through a reduction in the use of expensive generation units and imports; (iii) contributing to a Just Transition by establishing a legal framework conducive to support vulnerable population impacted by the energy transition and the closure of coal mines and coal-fired power plants; (iv) improving the integration of renewable energy and a reliable

[25] The microenterprise threshold (of EUR 500,000) does not apply to the hospitality industry.

operation of the electricity system by adding storage capacity; (v) attracting private sector investment in energy efficiency, electricity storage (batteries), and green hydrogen; (vi) increasing forest cover; and (vii) facilitating the use of EU funds, mainly the RRF and the Modernization Fund.

56. **The energy sector is the main emitter of greenhouse gas (GHG) in Romania with a share of 66 percent of total national emissions, and green hydrogen has a promising role in the decarbonization of the sector.** Emissions in energy industries (electricity and heat production, petroleum refining and manufacturing of solid fuels) accounts for 25.2 percent of emissions in the energy sector, transport accounts for 25.3 percent, manufacturing industries and construction account for 20.3 percent, and other sectors and fugitive emissions account for the remaining 29.3 percent. As anticipated in the preliminary results of the ongoing Romania CCDR, a strategy entailing the progressive electrification of economic sectors, where this technology is commercially available, and the decarbonization of the electricity generation in parallel, is key for accelerating the decarbonization of the economy in a first phase. The second phase will include the implementation of currently nascent technologies (which are still under development) to decarbonize other hard-to-abate sectors. Coal represents about 10 percent of the total primary energy supply in Romania, and about 80 percent of this coal is used for heat and electricity production. While electricity generation from coal is about 18 percent of the total electricity generation matrix, this generation is responsible for over 68 percent of total electricity sector GHG emissions.[26]

57. **Reducing emissions in the electricity sector would be a priority in the short term to accelerate the decarbonization of the economy and meet the climate targets set for ETS sectors in the NECP.** The decarbonization of the electricity sector encompasses improvements in energy efficiency, decommissioning of polluting electricity generation, addition of renewable energy, and investing in infrastructure to maintain security standards in the operation of the electricity sector. The NECP sets a target for renewable energy share of 30.7 percent of the gross final energy consumption by 2030, as interim milestone towards the net-zero decarbonization commitments by 2050.

58. **Pillar II will support a holistic set of core reforms to decarbonize the economy.** Policy actions supported under pillar II tackle key aspects necessary to support the green transition, including a) coal phase-down (moratorium on new coal plants and a calendar for decommissioning), b) scale-up and development of renewable energy sources for electricity generation and green hydrogen production, and c) demand-side measures to reduce energy consumption (energy efficiency). These actions will not only support Romania's energy transition, but also contribute to the EU's objective of becoming the first net-zero region by 2050. Romania will benefit from the EC's support, monitoring and oversight on these challenging reforms, which mitigate some of the risks associated with these reforms.

Decarbonization of hard-to-abate sectors and mobilizing private capital

Prior Action #6: The Borrower has approved a regulatory framework to define quality and security standards for green hydrogen, as evidenced by the adoption of the ANRE Order no. 63/2023.

59. **The current operation supports the adoption of a regulatory framework to facilitate the deployment of green hydrogen particularly in hard-to-abate sectors, conducive to incentivizing investments in the sector and the absorption of relevant EU funds.** There are sectors where technological options to electrify or to reduce their emissions are not currently competitive and commercially available.

[26] ANRE annual report of the electricity market 2022.

For these hard-to-abate sectors –mainly requiring energy sources for heat production, freight transport and industrial processes– green hydrogen has a promising potential to help meet the EU target of becoming a Net-Zero region by 2050.

60. **The operation supports the adoption of regulation defining quality and security standards for green hydrogen, which will create regulatory certainty for developers to promote green hydrogen projects for production, transport, storage, and use**. Moreover, the regulatory framework for green hydrogen would enable investments already incorporated in the NRRP to commission at least 100 MW of electrolyzer capacity for hydrogen production and to develop 1,870 km of hydrogen-ready natural gas distribution network in the Oltenia region. The latter, with technical capacity to distribute a 20/80 hydrogen/natural gas blend progressively shifting to 100 percent hydrogen by 2030. This framework will be developed in parallel with the National Hydrogen Strategy, which is currently well advanced and in public consultation, setting the timetable for the implementation of the measures in the Strategy. The reform shall remove legislative and administrative obstacles for the development of renewable hydrogen technology and contribute to the achievement of the future national and European targets for the production, storage, transport and use of renewable hydrogen by 2030. While the electrolyzer technology to produce hydrogen is not new, the deployment of hydrogen at scale will entail risks associated with technologies for new final uses, the market (demand and supply), and logistics. Thus, supporting green hydrogen in its early stages of development at scale entails risks but will help Romania make progress on a potentially transformational agenda.

61. **This measure will contribute to unlocking funds from the NRRP, while enabling future private investment and EU Funds mobilization in the development of hydrogen-ready infrastructure.** This action (along with other actions) will contribute to unlocking the second instalment (loan support) of the NRRP from the European Commission. Moreover, the quality and security of the regulatory framework for hydrogen will enable investments in the production and distribution of hydrogen, contributing to accelerating the absorption of EU Funds and attracting private investment to this new sector.

62. **Results:** The supported action will enable the addition of electrolyzer capacity for green hydrogen generation, which will ultimately contribute to the decarbonization of hard-to-abate sectors by shifting the use of traditional fuels to green hydrogen.

Phasing out of coal and Just Transition

Prior Action #7: The Borrower has approved a legal framework that: (i) establishes a clear timeline for the country to phase out coal mining and coal fired power; and (ii) incorporates principles to implement the transition away from coal in a transparent and inclusive manner, mitigating the impacts on communities and the environment, as evidenced by the enactment of Emergency Ordinance no. 108/2022, as approved with amendments through the Law no. 334/2022.

63. **Transitioning from coal is the cornerstone of Romania's decarbonization strategy to meet its climate targets and international commitments.** The phasing out of coal is one of the stumbling blocks to achieve the decarbonization commitments reached in the context of the EU and the wider Paris Agreement. Social, environmental, economic, and energy security concerns, especially in coal regions, are the main bottlenecks to advance the agenda of coal phase out. Strong political commitment, an adequate legal framework, and a good governance structure to drive the process, as well as just transition principles to tackle social (reskilling, jobs, and adequate safety net), environmental, economic, energy security, and asset and land repurposing barriers during the implementation, will be key requisites for a successful transformation process and coal phase out.

64. **This operation supports the adoption of the Decarbonization Law, which sets a clear commitment in the decarbonization pathway of Romania, adding predictability and a consistent narrative to gain public buy-in.** The Decarbonization Law includes firm commitments to (i) ban the construction of new energy capacities for the production of electricity based on lignite or coal, (ii) phase out of lignite and coal-fired electricity generation, decommissioning and closing of the entire installed capacity of lignite and coal-fired power (4,920 MW) by December 31, 2032 –as agreed with the European Commission as part of the NRRP–, (iii) stop lignite and coal extraction/production by December 31, 2032, and (iv) execute safety and shutdown works and greening for quarries and mines. The Law includes some flexibility on the interim milestones of the reform in the context of the energy crisis, contributing to a smooth implementation. While this flexibility may reaccommodate some of the interim milestones, the Bank supports the overarching commitment of complete coal phasing out by 2032 and the adoption of good international practices and principles.

65. **Furthermore, the Decarbonization Law facilitates private investments and EU fund absorption, and integrates just transition principles in the design of the coal phase out process, which will be monitored by the European Commission.** The Decarbonization Law will contribute (among others) to unlocking financing from the EU's Just Transition Fund and contribute to additional mobilization of EU funds through the NRRP, which will provide the medium-term support beyond the DPF. The Just Transition Fund resources have been allocated to the coal counties of Dolj, Galaţi, Gorj, Hunedoara, Mureş and Prahova and will support business and entrepreneurship development, the transition of the workforce, affordable green energy and mobility, and the greening and conversion of buildings or land affected by declining or transforming economic activities. The support will be based on the Territorial Just Transition Plans (TJTPs) prepared by the national and regional authorities in close consultation with local partners, and approved by the European Commission. These plans are analytically founded and identify key challenges and development needs in each territory, and define actions and the governance mechanisms to be implemented (i.e., the TJTPs already anticipate training of about 30,000 workers and creating about 11,000 new jobs). The implementation of this Fund in Romania will be managed by the Ministry of European Investments and Projects (MIPE) through the operationalization of the Just Transition Operational Program, which was approved by the European Commission in December 2022. Whereas there is no unique or definitive set of standards characterizing the process of phasing away from coal or approved guidelines by the World Bank, the Law compares well with other countries which do not necessarily have an overall legal framework and direction on the transition out of coal. The Law covers key aspects of the WB's "Just Transition for All" initiative[27], such as (i) Governance, by establishing control mechanisms to oversee that state aid will be used appropriately and efficiently, an Inter-Ministerial Steering Committee to lead the implementation of the decarbonization process with participation of representatives of the central and local public authorities, a Technical Committee to design and supervise the implementation of specific programs, and an Advisory Committee comprising trade unions, non-governmental organizations, private operators, representatives with the status of guests from the university, as well as groups of experts specialized in the field of energy; (ii) Social, by setting a clear framework to reduce the social impact of the decarbonization process and covering both reskilling of the workforce and creating economic opportunities at the local level to reduce the socio-economic impact; and (iii) Environment, by setting objectives on rehabilitating, repurposing assets and "greening" lands around mining sites and power plants, in compliance with the provisions of the national and European environmental legislation. Furthermore, this action will contribute to unlocking additional funds from the NRRP. The implementation of the TJTPs will be monitored by the European Commission and the World Bank is exploring options to provide support to the GORo during the implementation. While acknowledging the complexity of

[27] https://www.worldbank.org/en/topic/extractiveindustries/justtransition

the reform supported by this PA, the funding made available by the European Commission, the TJTPs developed as result of analytical work in the affected regions, the legal adherence to good international practices and principles, and the overall support and monitoring of the European Commission may mitigate future implementation risks. In parallel, the Law will result in the creation of a governance structure entailing three committees to oversee and drive the process with specific attention to the mitigation of social, environmental, and economic impacts, especially in the coal regions.

66. **Results**: The proposed action will result in the phasing out of coal-fired electricity generation plants and closing of coal mines.

Energy efficiency and mobilizing private capital

Prior Action #8: The Borrower has approved a state aid mechanism to support investments to improve energy efficiency in industrial activities, as evidenced by the adoption of the Orders of the Minister of Energy nos. 658/2022 and 1285/2022.

67. **Accelerating the decarbonization of the industrial sector would be key for Romania to meet its climate objectives and energy efficiency could be the best option to reducing industrial GHG emissions in the absence of commercially viable technologies to decarbonize industrial processes.** Romania is one of the countries with higher levels of energy intensity in the EU. While Romania has reduced its energy intensity by more than 30 percent in the last decade, from 279.68 kgoe per EUR 1,000 in 2011 to 189.10 kgoe per EUR 1,000 in 2020, it is still over 60 percent above the EU average of 116.69 kgoe per EUR 1,000. Energy intensity is a critical factor to either undermine or enhance competitiveness in industrial and commercial sectors. Moreover, manufacturing industries and construction accounts for 20.3 percent of total GHG emissions of the energy sector, and 34.5 percent of their energy consumption is natural gas. These sectors are considered hard-to-abate as there are limited commercially viable options to either (i) substitute existing processes and activities with low-carbon alternatives, or (ii) electrify those activities and decarbonize the electricity generation supplying their electricity needs. In this context, improving energy efficiency in the industrial sector may represent a substantive opportunity to accelerate the decarbonization of the sector with positive spillovers in industrial competitiveness. Romania has committed to reducing primary energy consumption by 37.5 percent[28] by 2030, above the EU target of 32.5 percent. In this respect, Romania has made improvements in energy efficiency in transport and services sectors, while households saw an increase in energy consumption and a steady level of consumption by the industrial sector[29], at least before the impact of the energy crisis resulting from Russia's invasion of Ukraine. More recently, the agreement reached at the European Union level on March 10, 2023, to cut final energy consumption across the bloc by 11.7 percent by 2030 –from the previously agreed levels–, would add pressure on Romania to accelerate the implementation of energy efficiency policies, and both help fight climate change and curb Europe's use of Russian fossil fuels.

68. **The DPL2 supports the adoption of supporting mechanisms to incentivize energy efficiency in the industrial sector.** Coordinated action in different sectors is required to achieve energy-consumption-reduction goals, reduce the aggregate energy intensity of the country and improve energy security in the region. The DPL series will contribute to incentivizing private investment and absorption of EU Funds in energy efficiency measures in hard-to-abate sectors like transport or industry, to ultimately achieve overarching climate targets. While the first operation in the series supported energy efficiency interventions

[28] 2021-2030 Integrated National Energy and Climate Plan
[29] https://energy.ec.europa.eu/2022-report-achievement-2020-ee-targets_en on November 23rd, 2022.

in the building stock, the current operation is supporting the approval of an energy efficiency financial support mechanism for the industrial sector.

69. **The proposed measure will help mobilize EU Funds, while leveraging private investment and reducing at least 30 percent of the energy consumption and GHG emissions in selected projects.** The state aid mechanism to support investments to improve energy efficiency in industrial activities will represent up to 50 percent of eligible expenses, thus mobilizing additional private financing. Only investments resulting in energy and GHG emission savings above 30 percent would be eligible to be co-funded by the support mechanism. Furthermore, policy actions supported by this action will also contribute to unlocking the next instalments of EU financing.

70. **Results**: Policy actions supported by this measure will contribute to the mobilization of private capital and unlocking EU Funds in the short term. They will also contribute to reducing GHG emissions and save energy in the industrial sector over the medium to long term.

Integration of variable renewable energy in the power sector and mobilizing private capital

Prior Action #9: The Borrower has approved a state aid mechanism to support investments in storage technologies (batteries) to improve the reliability of the power system and better integrate new capacities of renewable energy, as evidenced by the adoption of the Order of the Minister of Energy no. 1229/2022.

71. **The decarbonization of the power sector will require the replacement of polluting electricity generation from fossil fuels with renewable energy.** To achieve this, Romania will need to completely phase out its coal electricity generation capacity by 2032 and add 6,900 MW of renewable energy by 2030 (compared to the renewable capacity installed in 2015). Moreover, in the NRRP, the government has committed to install 3,000 MW of solar and wind capacity by 2026.

72. **The installation of variable renewable energy and the parallel decommissioning of firm/dispatchable coal capacity require the addition of storage capacities to offset the variability of the former and contribute to the reliability of the electricity system.** The Romanian NECP recommends installing at least 400 MW of battery storage in the Romanian electricity system to (i) contribute to the integration of renewable energy by smoothening the load curve to reduce power curtailment and better use all available energy generation to meet the demand, and (ii) provide ancillary services to contribute to the secure operation and reliability of the system. Moreover, storage capacity may contribute to the provision of balancing services (short term balancing of demand and supply) and increase the liquidity and competition in balancing markets, contributing to reducing the price of balancing services. Currently the amount of battery storage in Romania is negligible and the installed capacity of hydro-pumped power storage only reaches 50 MW; thus, the committed storage capacity additions are relevant for the system's operation and security.

73. **DPL2 supports the adoption of a scheme to incentivize the installation of at least 240 MW (or 480 MWh) of storage capacity (batteries) by 2025 to support the smooth integration of up to 3,000 MW of renewable energy capacity by 2026 and a reliable operation of the electricity system.** This scheme is expected to mobilize private investment to install storage capacity, needed for the smooth integration of renewable energy and, thus, contributing to the overarching objective to decarbonize the Romanian economy. Beneficiaries will be selected through a competitive process, compliant with EU Directives, in particular on State Aid. The scheme sets limits to the support to be received by each beneficiary to ensure

broad access to the support, and beneficiaries will be selected from eligible projects, ranking first those projects requiring less state aid support, to ensure an efficient use of available resources. The proposed measure will contribute to unlocking of EU financing, while leveraging private investment.[30]

74. **Results**: The supported policy action will contribute to the installation of 240 MW of storage capacity (batteries) in the electricity sector by December 2025 (estimated 120 MW in 2024), which will contribute to the integration of 3,000 MW of renewable energy, while reducing GHG emissions.

Forests

Prior Action #10: The Borrower has adopted: (i) the National Forestry Strategy for 2030, as evidenced by the adoption of the Government Decision no. 1227/2022; and (ii) the technical implementation norms for afforestation and reforestation, as evidenced by the adoption of the Orders of the Minister of Environment, Waters and Forests nos. 2533/2022, 2534/2022, 2535/2022, 2536/2022, and 2537/2022.

75. **In the past few years, Romania has seen increasing levels of deforestation**. Romania has a forest area of 7 million hectares, according to the National Forest Inventory data, representing approximately 29 percent of the total territory of the country, below the EU average of 39 percent. In 2020, the forest land accounted for an offset of about 22 percent in GHG emissions (24,222 kt CO_2 eq. from 109,934.33 kt CO_2 eq. in total). Approximately 50 percent[30] of Romania's forests are administered by the National Forests Administration 'Romsilva' while the remaining privately owned land is administered by forest districts (private or state) or private landowners. The area under forested degraded agricultural land has steadily decreased from 2,355 ha in 2014 to less than 200 ha in 2020. This has resulted in severe surface and wind erosion in these areas. Romania needs to increase the area under forest vegetation to enable the rehabilitation of these tracts of land. In addition, forested areas also act as carbon sinks and support emissions reduction. Given their critical role in climate mitigation and adaptation (primarily through reduction in soil erosion and landslide risks, provision of critical habitat for wildlife and sustainable management of forest resources), the Government is committed to increasing afforestation activities. This is also aligned with the government's National Strategy on Adaptation to Climate Change (2022-2030) which is currently under preparation. DPL1 supported the adoption of a legal framework for providing incentives to accelerate afforestation and reforestation efforts on different categories of land.

76. **The current operation supports the adoption of the National Forestry Strategy for 2030 and the implementation of technical norms for afforestation and reforestation**. On October 5, 2022, the Romanian Government approved the legislative proposal of the Ministry of Environment, Waters and Forests for the National Forestry Strategy for 2030 through the Government Decision no. 1227/2022. The National Forestry Strategy serves as a strategic framework, with general objectives ensuring the balanced integration of social, ecological, and economic functions through the sustainable management of forests. This transposes the Forestry Strategy of the European Union to the forestry sector in Romania. In addition, a series of forestry technical and good practice norms were issued on September 28, 2022, through Ministerial Orders[31], related to: (i) forest management; (ii) composition, schemes and technologies for forest regeneration and afforestation of degraded lands; (iii) the care and management of arboretums; (iv) the choice and application of forest treatments; and (v) forest regeneration and the annual control of regeneration. The operation will support climate change mitigation through sustainable forest management activities that increase carbon stocks and reduce the impact of forestry activities, also enabling the reduction of emissions from the

[30] Investments in renewable energy like solar panels are not eligible expenditures under the supported scheme.
[31] Orders no. 2533-2537, issued by the Ministry of Environment, Waters and Forests, dated September 28, 2022

deforestation or degradation of ecosystems. Furthermore, the afforestation programs would also support adaptation, with treed slopes reducing rainfall run-off (and flood risks) as well as landslide risk and integrating wildfire risk management (depending on the types of trees, inclusion of fire breaks).

77. **Results**: The reforms supported in this area will increase the land surface to be afforested or reforested. Increasing the forestry coverage and ensuring sustainable forest management practices will support climate adaptation and mitigation efforts.

78. **This operation is underpinned by extensive analytical work**. The prior actions of this operation are supported by analytical work prepared by the WBG and are complemented by additional work undertaken by the Government and other development partners. The Government proactively draws upon the WBG's analytical work and technical assistance to formulate the key reform programs (Table 5).

Table 5: DPF Prior Actions and Analytical Underpinnings

Prior Actions	**Analytical Underpinnings**
	Pillar I: Strengthen Inclusion and Fiscal Management
Prior action #1 (Minimum Inclusion Income Program –or Venitul Minim de Incluziune)	• Supporting the Operationalization of Social Protection Reforms – (P178551) • Supporting the Implementation of Romania's Human Development Operational Programme (POCU) 2014-2020 – (P162775) *One of the key recommendations is indexing the current VMI thresholds and benefits to inflation yearly so the real value does not decline over time. The recommendations also included the need to connect better VMI beneficiaries and employment, linking social assistance benefits and social services into an integrated social assistance system.*
Prior action #2 deinstitutionalization of persons with disabilities	• Modernizing the Disability Assessment System in Romania – (P171157) • Support for Speeding up the Transition of People with Disabilities from Residential Institutions to Community-based Services (P168518) *The Support for Speeding up the Transition of People with Disabilities from Residential Institutions to Community-based Services provided assistance and analytical foundations to inform the reform of the government in this area and the corresponding strategy preparation which was adopted in 2022. While the main recommendation was built around the integration of the disabled adults into communities in line with EU best practices, the RAS identified seven directions of action: (i) Coordinating the deinstitutionalization process at national, county, local and central level; (ii) Ensuring a person-centered approach; (iii) Developing community-based services for the independent living of adults with disabilities, including for the prevention of institutionalization; (iv) Training and motivating staff working with and for adults with disabilities; (v) Providing support to the family/legal representative in order to prepare and support adults with disabilities for independent living in the community; (vi) Providing support for adults with disabilities to prevent the risk of reinstitutionalization; and (vii) Raising awareness of the general public and destination communities about the right of persons with disabilities to independent living.*
Prior actions #3, #4 (collectively focused on FDPs and Host Communities)	• **Refugee Policy Review Framework Technical Note (2021) World Bank** *link.* The review and framework build on experience on forced displacement and development and highlights the criticality of support towards host communities to manage the shock of refugee inflows as well as actions to reduce the vulnerabilities of FDPs. The technical note highlights five critical policy dimensions: i) Support to host communities, including ensuring adequate public resources, promoting social cohesion and preparedness for hosting; ii) Regulatory and governance measures ensuring legal status of FDPs, access to civil registration and documentation, justice and security; iii)

<table>
<tr><td></td><td>Economic opportunities through freedom of movement, right to work, and access to housing and financial services; iv) access to national services for education, health, social protection, and protection of vulnerable groups; and v) cross-sectorial actions to reduce gender based barriers to access services and economic activity and social inclusion.

• Forcibly Displaced (2017), World Bank Group. link. This report highlights the context of forced displacement with more than 50 percent of FDPs, displaced for more than four years. The report examines how to support host communities to manage the sudden inflows of large numbers of FDPs, and the pressures to expand services, create jobs and address intractable development issues. It also underscores the importance of collaboration between humanitarian and development actors, and the need to prepare early for long lasting solutions.

• The Impact of Forced Displacement on Host Communities: A Review of the Empirical Literature in Economics. (2019) World Bank. link. The report reviews 49 empirical studies across 17 forced displacement crises to understand the impact on household wellbeing, prices, employment and wages, and concludes that in most cases positive outcomes for host communities can be expected.

• The Economic and Fiscal Effects of Granting Refugees Formal Labor Market Access (2018) Center for Global Development Working Paper 496. link The report argues that granting formal access to the labor market has the potential to create substantial benefits for FDPs and their host communities.

• TA to Support Implementation of the National Recovery and Resilience Plan and response to Forcibly Displaced – (P177798)

The key recommendation is to ensure planning beyond the emergency response to prepare early for long lasting solutions, for both FDPs and host communities, and to take into account the importance of collaboration between humanitarian and development actors.</td></tr>
<tr><td>Prior action #5 (Tax and spending efficiency)</td><td>• The RAS on the Development of the Capacity of the Central Public Administration to Carry Out Impact Studies (P156807 and subsequent extensions) has helped selected public sector institutions to conduct ex-ante impact assessments for policy changes.

• Romania Public Finance Review – (P180552) and Romania: Policies in Support of a Fiscally Sustainable Recovery – (P175709) assessed the fiscal management on tax and expenditure side, with key recommendations for measures towards fiscal consolidation.

Key findings: Poor collection, certain preferential tax regimes and exemptions reducing the tax base have contributed to low tax revenues, along with relatively low tax rates. As Romania has one of the lowest shares of public spending in GDP in the EU, the space for consolidation is limited on the expenditure side; key areas to look at for savings are the public wage bill and the investment portfolio.</td></tr>
<tr><td colspan="2">Pillar II: Foster Decarbonization and Climate Resilience</td></tr>
<tr><td>Prior actions #6, #7, #8 and #9 (collectively focusing on the decarbonization of hard-to-abate sectors through green hydrogen, energy efficiency, integration of renewable energy and coal phasing-out– and mobilizing private capital)</td><td>• The EU trust funded activity Internal Energy Market and Energy Transition in Romania – (P175774), supports the Ministry of Energy, the Competition Council and the Energy Regulatory Authority ANRE in implementing measures to improve the competition in energy markets and the energy transition, in areas like offshore wind, green hydrogen or demand-side management.
• The EU trust funded activity REPower EU Romania – (under same code as the TA above, P175774), supports the Ministry of Energy and the Ministry of European Investments and Projects in the definition of the REPower EU chapter of the RRP, which will define additional investments and regulatory reforms to reduce the dependency on Russian energy imports while accelerating the decarbonization of the economy, channeling additional funding from the EC.
• The RAS Sustainable Heating and Energy Efficiency Support for the city of Timisoara – (P176373), which provides alternative options to shift to sustainable heating options and decarbonize this hard-</td></tr>
</table>

	to-abate sector, through technologies like green hydrogen, geothermal energy, heat pumps or biofuels. • The EU trust funded activity **Technical Assistance Facility to Support Renovation Wave under Cohesion Policy in Select EU Member States (P177061)**, currently under implementation, supports the design of financial mechanisms and provision of technical assistance to overcome key capacity gaps and bottlenecks to accelerate the renovation of the building stock with energy efficiency measures. • The RAS **Consolidation of the Strategic Planning Capacity of the Ministry of Development, Public Works and Administration for Renovation of the National Building Stock for Energy Efficiency and Seismic Risk in Romania (P169420)**, supported the MRDPWA to design the Long-Term Renovation Strategy of the building stock which establishes the analytical foundation and draws the actions to renovate the building stock with energy efficiency measures. *The key recommendations include the development of specific financial mechanisms and renovation schemes, to facilitate access to financial resources to end beneficiaries and leverage private capital.*
Prior action #10 (Forests)	• World Bank, **Forest Sector Rapid Assessment, Romania** Climate Change and Low Carbon Green Growth Program, 2014 • **Annual report on the state of the environment in Romania in 2020**, Ministry of Environment, Waters and Forests, National Agency for Environmental Protection • **Forest Status Report for 2019**, Ministry of Environment, Waters and Forests • United Nations Economic Commission for Europe (UNECE) **– Romania Environmental Performance Third Review**, 2021 • The forthcoming Romania Country Climate and Development Report (P179052) • Romania Rural Pollution Prevention and Reduction Project (RAPID) – (P179786) *Key recommendations to help reverse the effects of climate change and support the decarbonization effort through expanding the carbon sinks are sustainable forest management, including the fight against illegal logging, and afforestation of abandoned agricultural areas, which require effective national and EU funding.*

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

79. **This DPL series underpins the overarching goal of the WBG Country Partnership Framework for Romania for the period FY19-FY23, - building institutions fit for a prosperous and inclusive Romania, - and is aligned with the CPF's three focus areas**. These areas are: (i) ensuring equal opportunities for all; (ii) catalyzing private sector growth and competitiveness; and (iii) building resilience to shocks. The selectivity of financing of IBRD in Romania, country above GDI, is aligned with selectivity filters referenced above. The first pillar of the DPL series seeks to ensure inclusive access to public services for FDPs and host communities, in light of the influx of displaced people as a result of Russia's invasion of Ukraine. The pillar also supports structural reforms to improve the Government's fiscal position, and inclusion more broadly. This operation supports the Government's efforts in integrating FDPs from Ukraine in Romania by providing sustained access to public services and labor markets, while also supporting host communities. The operation also seeks to address the structural impediments to inclusion in Romania through the implementation of the VMI law and the law on deinstitutionalization. In addition, the reduction in tax expenditures will increase the fiscal space to enable further redistribution while maintaining fiscal sustainability. The second pillar supports decarbonization and private sector growth. Reforms under the current operation will support increased energy efficiency in industrial activities, a just transition out of coal, development of green hydrogen, development of storage capacity for renewables and a larger area under forest cover. These activities will enable Romania to build resilience to climate related shocks.

80. **This operation supports Romania's progress towards the WBG's Twin Goals of ending extreme poverty and promoting shared prosperity and sustainability**. Increased support to and integration of FDPs from Ukraine into the Romanian society will help them become self-reliant and enable them to get employed. This will help them sustain themselves and provide for their families. The implementation of the VMI law and the law on deinstitutionalization will help address the inclusion agenda more broadly, particularly supporting those in the bottom 40 of the income distribution. The reduction of tax expenditures will enable the government to increase revenue collections and increase fiscal buffers to support redistribution which will be beneficial for the poor and those in the bottom 40 percent of the population. Efforts aimed at decarbonization and increased forest cover will promote sustainability and support a reduction in extreme weather events which typically impact the poor and vulnerable to a larger extent, while also supporting the transition to net zero emissions. Finally, the private capital enabling nature of the supported reforms will help generate jobs.

81. **The series is also aligned with all the four GCRF pillars (itself underpinned by the GRID agenda)**. PA #1 and PA #2 help scale up social protection to support the vulnerable (mapping to GCFR Pillar 1). PA #3 provides special support measues for the forcibly displaced (as well as host communities) mapping to GCRF Pillar 2, while PA #4 supports education measures under GCRF Pillar 4. PA#5 supports domestic resource mobilization (DRM) (GCRF Pillar 4). PA #6, PA #7, PA #8, and PA #9 support climate smart policies and incentives, and together with PA #10 they also help green and sustainable growth (GCRF Pillar 4).

82. **Other WBG operations and activities complementing the proposed DPL series include**: (a) the RAS on Improving the Tax Framework in Romania in the context of the National Recovery and Resilience Plan (P178899), supports the tax reform of the Government with analysis of policy options, costing and impact; (b) the ongoing analytical work on the Government's Support for Fossil Fuels in Romania (P178096) assesses the level and distribution of the subsidies to fossil fuels in the country with the purpose of guiding future decarbonization policy dialogue; (c) the Trust Fund Romania: Modernizing the Intergovernmental Transfers System (P176830), financed by the EU under the Technical Support Instrument (TSI) program, supports the Government's effort to modernize the intergovernmental fiscal transfer system in order to improve its efficiency, predictability and transparency; and (d) the RAS on deinstitutionalization, wages and pensions is supporting the government in making progress on these critical reforms. In addition, the CCDR and DPL teams have worked together to ensure that the messages and actions are well aligned.

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

83. **Romania's policy making process is broadly consultative and inclusive**. The Government generally follows a consultative policymaking process with policies going through public scrutiny. Policies are screened for compliance by relevant public bodies, such as the Legislative Council or the Constitutional Court, by regulatory agencies or by consultative bodies, such as the Economic and Social unit of the Fiscal Council, and extensive public consultations with relevant stakeholders are carried out in general prior to their adoption. The European Commission holds regular exchanges with the Government on the status of the implementation of the NRRP. All draft policies are uploaded on the Government website and the initiating ministry holds stakeholder consultations through workshops. Stakeholders can provide comments during workshops and/or send their comments through digital platforms which are then taken into account, to the extent possible, by the authorities. The reforms supported by this operation have gone through prior consultations with relevant stakeholders. On FDPs, there has been extensive collaboration and consultations with UN agencies, other international organizations and civil society to develop the National Plan of

Measures which guides the longer-term integration of FDPs. In addition, the OSS**s** set up in a few municipalities also serve as feedback centers from FDPs. On the fiscal reforms being supported by the operation, consultations were held with the business community, academia, and the European Commission. Measures supporting transition out of coal, energy efficiency, battery storage and green hydrogen were also extensively discussed with the EC and the communities impacted. On forests, consultations took place with the civil society and local governments.

84. **Coordination with development partners**. Collaboration between the IMF and the World Bank staff is effective with regular consultations on macroeconomic, debt management, financial sector, and structural issues. The World Bank has recently completed extensive consultations with the government, development partners, private sector, NGOs, and broader public on the SCD Update and related ongoing analytical work (including the forthcoming Romania CCDR and Country Private Sector Diagnostic (CPSD). Specifically, throughout 2022, the World Bank held over 50 in-person consultation sessions on Romania's priorities in Bucharest, other large cities, and smaller localities in Romania, including semi-structured interviews, roundtable discussions, town-hall meetings, and site visits. Over 500 representatives of the public sector – including central and local Government, Parliament, the Presidency, and the National Bank of Romania—as well as of the private sector, academia, donors, civil society organizations, International Financial Institutions, and UN agencies participated in consultations. A subsequent session of in-person consultations was held in Brussels, Belgium, in November 2022, in which the World Bank team met with NGOs, think tanks, foundations, and representatives of the European Commission and the Permanent Representation of Romania to the EU. Another development partner closely engaged in the policy areas supported by this DPL series is the European Commission. The World Bank and the EC coordinate in the areas of fiscal reforms and the green and digital transition. As part of the preparation of this programmatic series, the task team also consulted extensively with the NGO sector, academia, and the business community, including specific workshops on the LGBTI+.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

85. **Policy reforms supported by this operation are anticipated to have predominantly positive or neutral effects on the well-being of Romanian households in the short term, although some actions could have potential negative effects.** In the medium term, most actions are expected to have positive effects. Most prior actions under Pillars 1 and 2 are expected to bring positive or neutral poverty and social impacts in the short term. However, fiscal measures reducing tax exemptions under PA#5 can have negative short-term adverse impacts. Also, the implementation of the decarbonization law (PA #7) is likely to result in employment reductions, especially in regions dependent on coal, with potential negative welfare impacts. Afforestation and reforestation measures (PA #10) may have adverse impacts on the poor and vulnerable, particularly in areas where food production is a primary source of livelihood, as they can reduce the land available for food production. Government mitigation measures to support a beneficial transition out of coal include reskilling workers and supporting SMEs, as part of the EU's Just Transition Mechanism while a strengthened social assistance system will help with more effective fiscal redistribution. In the medium term, most actions have neutral or positive impacts. On the fiscal side, some of the revenue generated from the increasing taxes (PA #5) could be utilized to alleviate the unequal impact of these policies on low-income individuals and facilitate greater redistribution of resources. The government can potentially employ

mitigation measures to reduce the negative welfare impacts of afforestation and reforestation, including measures to increase agricultural efficiency and the development of alternative livelihood options for affected individuals. In the medium term, most actions are welfare improving, but it remains important to closely monitor the potential negative effects of FDP measures (PA #3 and PA #4) on the host communities.

86. **The inclusion-related actions on the implementation of the VMI law and its indexation to annual inflation, and the law on deinstitutionalization (PA #1 and PA #2) are likely to have neutral or positive effects on the poor and vulnerable in the short and medium term**. A systematic indexation of VMI benefits to inflation likely improves the adequacy of such benefits.. In addition, if the VMI with its planned single eligibility criteria and administration procedure manages to increase the efficiency and effectiveness of the current social protection system, effects are likely positive across the welfare distribution. The challenges of increasing the take-up and coverage of the Roma and other vulnerable groups will be mitigated by the planned targeted communication capmpaigns while implementation support from the World Bank will help smoothen the transition to the new system. On deinstitutionalization, one-third of those who received disability benefits in 2020 belong to the lowest income quintile and one-fourth to the second income quintile. Interventions that improve the situation of people with disabilities likely improve the situation of people affected by a double vulnerability: low income and disability.

87. **The support provided to FDPs on employment and integrated measures in schools for FDPs and host community students (PA #3 and PA# 4) are likely to have neutral or positive distributional effects; potential adverse medium-term effects on host communities needs to be monitored**. Overall, integrating adult FDPs into the labor market (PA #3) can positively impact both the FDPs and the host communities, as it can help promote economic growth, reduce dependency, address labor shortages, increase diversity and innovation, and improve social cohesion. However, studies flag that the pressure on vulnerable population groups created by refugee influxes is high, potentially resulting in anti-immigrant sentiments.[32] However, DPL1 supported the hiring of additional staff by the government to ensure continued service delivery to host populations while also serving the FDPs. Moreover, several studies demonstrate the negative effects of refugee shocks on women's employment and labor force participation.[33] This is a concern in the context of Romania, given that it is one of the most unequal countries in terms of gender equality in labor market outcomes in the EU. One particularity of the Ukrainian refugee crisis is that FDPs are to a large extent females. The evidence in the EU to date shows that the labor market integration of female refugees is especially challenging, and the proposed action does not have a gender sensitive lens.[34] Nevertheless, the average level of tertiary education of women in Ukraine is higher than that in Romania and the host country will benefit with the absorption of skilled FDPs into its labor force. Also, as of March 2023, 73 percent of the registrants in the Romanian employment agency are women. Similarly, PA #4 is likely to have positive impacts on FDPs. Evidence shows that displacement has multilevel, negative effects on children.[35] These adverse effects are

[32] See for example Barslund, M., Di Salvo, M., & Laurentsyeva, N. (2018). The impact of refugees on the labour market: a big splash in a small pond? CEPS Working Document No 2018/07, October 2018.
[33] Example studeis are: Aracı, D. T., Demirci, M., & Kırdar, M. G. (2022). Development level of hosting areas and the impact of refugees on natives' labor market outcomes in Turkey. European Economic Review, 145, 104132; Del Carpio, X. V., & Wagner, M. C. (2015). The impact of Syrian refugees on the Turkish labor market. World Bank policy research working paper, (7402).
[34] Barslund, M., Di Bartolomeo, A., & Ludolph, L. (2017). Gender inequality and integration of non-EU migrants in the EU. CEPS Policy Insights, 6, 1-13.
[35] Rude, B. (2020). Geflüchtete Kinder und Covid-19: Corona als Brennglas vorhandener Problematiken. ifo Schnelldienst, 73(12), 46-57.

especially severe in the case of war-related displacement.[36] While giving displaced students equal access to funding and other amenities might counteract some of the negative effects on children from Ukraine, these measures might not be sufficient. Nevertheless, the government of Romania has trained county level staff and volunteers on protection and provision of psychosocial support activities to provide care to children that have experienced trauma. Another concern is that the significant gaps in several educational indicators between different population groups might worsen by the pressured educational system if mitigation measures are not sufficient. However, the number of FDPs in Romania has not increased exponentially as earlier anticipated and only 18 percent of those 16+ plan to stay in the country (EU Agency of Fundamental Rights (FRA), Ukrainian survey 2022). Moreover, many of those who have remained in Romania are still continuing with online education through the Ukrainian education system. In addition, the government is also making efforts to recruit FDPs from Ukraine as teachers in schools. In addition, close monitoring and evaluation can also address the concerns about medium-term impacts on hosting populations.

88. **The reduction of preferential tax regimes and exemptions (PA #5) is likely to result in neutral or negative effects on the poor and vulnerable in the short run but likely positive welfare impacts in the medium term**. The planned reduction in preferential tax regimes and exemptions for various taxpayer categories could aim to improve the efficiency and effectiveness of the tax system, with some equity concerns remaining that would need to be mitigated. Targeting microenterprises could have an adverse impact on the poor and vulnerable, given that 53.9 percent of the self-employed are at-risk-of-poverty (EU-SILC, 2020)[37]. VAT on sugary drinks could also place a larger burden on low-income households in the short term, though the information on their fiscal incidence is limited. However, the adverse impacts may be contained, as the threshold for taxation (at EUR 500,000) at the rate of 1 percent is not likely to impact those at the bottom of the income distribution. In addition, the funds generated by the rising taxes could be used to offset the disproportionate burden of these policies on the poor and also aid in increased redistribution. Finally, sugary drink taxes are likely to have positive effects in the medium run due to positive impacts on health outcomes, lower medical expenditures, and higher labor productivity.

89. **The measures to scale up green hydrogen (PA #6) will have neutral effects, while the decarbonization law (PA #7) is expected to result in job losses in coal counties with potential negative effects on the poor and vulnerable in the short term; positive impacts are expected in the medium term**. The measures under the decarbonization law (PA #7) are expected to translate into job losses concentrated in the coal counties. Estimates from July 2021 administrative tax data show that 98.6 percent of coal workers in the country are located in Gorj, Hunedoara, Dolj, and Mehedinti, representing less than 1 percent of the formal-sector employment in the country. These job losses are potentially limited in absolute terms: in one of the affected (Hunedoara) counties, the decarbonization measures are expected to affect about 2,250 employees in the period until 2027, most of whom are active in mining operations, according to the Territorial Just Transition Plan for Hunedoara County, 2022, although there may be some secondary jobs impacts through the enterprises in the associated supply chains.[38] The direct impact on the national poverty headcount is expected to be limited since employment in the coal mining sector is geographically concentrated in selected coal counties. Additionally, the data also shows that their wages are higher than

[36] Bürgin, D., Anagnostopoulos, D., Vitiello, B., Sukale, T., Schmid, M., & Fegert, J. M. (2022). Impact of war and forced displacement on children's mental health—multilevel, needs-oriented, and trauma-informed approaches. European child & adolescent psychiatry, 31(6), 845-853.

[37] https://ec.europa.eu/eurostat/web/microdata/european-union-statistics-on-income-and-living-conditions

[38] *Territorial Just Transition Plan for Hunedoara County.* (2022). Retrieved from www.mfe.gov.ro: https://mfe.gov.ro/wp-content/uploads/2022/04/27fa4d3854cd8463f5f869632030315c.pdf

the average formal-sector wages.[39] Moreover, the sector employees are five years older than the average taxpayer and will be closer to the retirement age as the implementation timeline advances. As documented in the literature, climate change and environmental degradation disproportionately affect the poor and vulnerable.[40] Closing coal plants can bring several benefits, including reducing greenhouse gas emissions and air pollution, improving public health, promoting the development of renewable energy sources, and potentially creating new job opportunities in the clean energy sector. Hence, these measures are likely to improve their well-being in the medium to long run.

90. **Mitigation plans and funding to support the just transition are already formulated and in place, and supported by substantive financing from the European Commission, but implementation challenges may remain**. Romania is part of the EU's Just Transition Mechanism, through which EUR 2.14 billion have been allocated to six counties to cushion the transition's geographically and sectorally uneven effect. Among them, Gorj and Hunedoara have been allocated the lion's share of the funds, with more than EUR 600 million going to each. The European Commission approved the Just Transition Operational Program in December 2022, and implementation should start this year. Mitigation measures include reskilling the workforce, supporting SMEs and entrepreneurship for economic diversification, creating start-ups and business incubators, fighting energy poverty, and enabling access to essential public services. Some of these measures are expected to help ease the transition to new positions for the workers that have been laid off, but implementation challenges may arise. A successful transition will depend on the degree to which vulnerable groups in the affected sectors can be retrained promptly and effectively. Effective active labor market policies are needed to foster better matching of employers and employees and other programs to support adversely affected workers.

91. **The action supporting energy efficiency in industries (PA #8) and on battery storage (PA #9) is likely to have positive welfare household impacts**. Increased energy efficiency in industries will increase the competitiveness of the sector by reducing the electricity bill and linked operational costs. More competitive industries are expected to have a positive impact on employment and reduced costs of final products, which are expected to have a positive impact on households. Regarding batteries, lower fluctuations in electricity prices can improve household budget management and more informed energy consumption decisions, and increasing renewable energy production can reduce energy costs, improving energy security, and promoting environmental and health benefits. Expenditures on electricity and renewables,[41] on average, are the largest energy spending component, with poorer households spending a disproportionately large share of their energy expenditure on this subcategory. Lower price fluctuations allow households to manage their budgets better and plan their expenses, as they can more accurately anticipate the cost of electricity usage. This, in turn, can reduce the risk of households falling into debt or struggling to pay their bills on time.[42] Renewable energy sources such as solar and wind are typically cheaper than fossil fuels, which may lead to lower electricity bills for households, and thus to a neutral or positive impact for low-income households if these lower energy costs are passed through to end-user's tariffs. Finally, the shift from fossil fuel to renewable

[39] The mean gross income of taxpayers employed in the coal mining sector is about 174 percent of the mean income (gross salary) of (all) taxpayers. Less than 1 percent of these employees are minimum-wage workers. This evidence suggests that these workers are less likely to be in lower-income deciles.

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

[41] It is not possible to distinguish between spending on electricity and spending on renewables in the household budget survey, given that the information is collected as one joint spending category.

[42] The rate of households with arrears on utility bills was 7.3 percent in 2021, but higher among some vulnerable households. For example, 18.1 percent of single person households with dependent children in 2021 were in utility arrears.

energy sources can also have positive environmental impacts with benefits for households through multiple channels. In particular, transitioning energy systems towards renewable energy sources can improve air quality feeding into better health outcomes, longer life expectancy and fewer working days lost.

92. **Afforestation and reforestation measures (PA #10) could have potential negative effects on the poor and vulnerable in the short term but positive effects in the medium term.** In the short term, land-based mitigation policies like reforestation can reduce land available for food production, threatening the food security of poor households and the livelihoods of poor workers living in rural areas.[43] In addition, Romanians still rely on wood for both cooking and heating, especially in rural areas (HBS, 2019). Nevertheless, sustainable forest management practices, supported by the current operation, will help mitigate some of the risks. The government also has other mitigation measures at its disposal. First, reforestation can be achieved at no or little loss of agricultural output if agricultural efficiency is increased (these efforts, too, are supported by the EU funds through the Common Agricultural Policy). Second, regularly monitoring and evaluating the short-term impacts of the afforestation program can help identify potential negative impacts and adjust the program as necessary. Finally, developing alternative livelihood options for those negatively affected by the afforestation program, such as through sustainable agroforestry or ecotourism, can help provide economic opportunities and reduce welfare impacts. In the medium run, afforestation and reforestation efforts will decrease the exposure of the Romanian population to climate change and natural hazards. Given that the poorest are often most affected by climate change[44], the poorest are likely to benefit most. In addition, the adoption of the National Forestry Strategy and the implementation norms for afforestation and reforestation can result in additional new jobs.[45]

93. **Gender Dimension. Most of the measures under Pillar 1 and Pillar 2 are expected to have differentiated gender impacts**.

- **The measures under PA #1 and PA #2 (the implementation of VMI and the law on deinstitutionalization) could have positive or neutral gender differentiated impacts**. Impacts of PA #1 by gender are likely positive, given that women are slightly more affected by poverty than men (Eurostat, 2023), especially considering substantially lower labor participation rates among women; while the at-risk-of-poverty rate has decreased for both sexes, the gender gap in at-risk-of-poverty has increased (Eurostat, 2023). Tracking beneficiary coverage rates by gender could ensure equal access to the social protection system. Measures under PA #2 could have positive impact on disabled women, as they face multiple layers of discrimination based on their gender and disability status, but the impacts are expected to be small, given that women account for a negligible part of the disabled and those receiving disability benefits (EU-SILC, 2020).

- **The measures to support the labor market integration of FDPs and students (PA #3 and #4), may also have differentiated gender impacts, particularly PA #3, as a large share of the FDPs are female with children.** Previous evidence shows that the most important barriers for finding paid work among female FDPs in EU countries are insufficient knowledge of the host country's language and care responsibilities related to caring for children, or elderly or sick relatives (FRA, Ukrainian survey 2022). To ensure that female FDPs benefit from public employment programs and retraining as well as access to language training, these programs need to factor in the care responsibilities and cultural barriers by design. Example strategies include

[43] Source: World Bank, "Making the Green Deal Work for people", forthcoming.
[44] Organisation for Economic Co-operation and Development (OECD). 2022. "Poverty and Climate Change: Reducing the Vulnerability of the Poor through Adaptation." OECD, Paris. https://www.oecd.org/env/cc/2502872.pdf.
[45] Nair, C. T. S., & Rutt, R. (2009). Creating forestry jobs to boost the economy and build a green future. Unasylva, 233(60), 3-10.

offering childcare services during language courses and training sessions or ensuring safe travel from homes to training centers. Norm-based interventions might also be beneficial because women with migration background are confronted with two-faced harmful social norms: those around xenophobia and gender inequality.[46] Gender-sensitive labor market training and reskilling programs that also factor in the care responsibilities mainly absorbed by women could facilitate female labor force participation. More generally, investments in public and universal childcare would facilitate women's labor market participation (Robayo-Abril and Rude, forthcoming). On PA #4, gender-sensitive integration measures are likely most appropriate, given that gender gaps in education are multi-dimensional (Gender Assessment, forthcoming).

- **The preferential tax regimes under PA #5, particularly those targeting microenterprises, could have gendered impacts, as four out of 10 self-employed are female and female entrepreneurs already face increased barriers** (Gender Assessment, forthcoming). The evidence of gendered impacts of these fiscal measures is limited, as previous CEQs do not have a gender lens to identify the fiscal incidence and poverty impacts of these tax measures among "female" vs. "male" type of households. However, as noted above, the turnover thresholds remain high, with limited potential impact on the poor, including the poor women. In addition, it is difficult to identify sugary drinks in the household surveys.

- **The scaling up of green hydrogen (PA #6), and decarbonization measures and mitigation options under PA #7 are likely to have gender differentiated impacts.** Tax administration data for 2021 shows that most workers in the formal coal sector are males (about 82 percent), so the phasing out of coal mines is expected to disproportionately affect them. In the medium term, the green transition is expected to have differentiated impacts by gender, as women are concentrated in service sectors, such as hospitality and other categories of non-essential services and retail trade. Nevertheless, measures to promote female entrepreneurship to mitigate job losses during the green transition will be important, including in agriculture, as female entrepreneurs seem to be especially active in the primary sector (EU-SILC, 2020), with a corresponding role in the sustainable and green transition (Upcoming Gender Assessment). Again, gender-sensitive actions, such as investing in women networks, mentoring programs and female entrepreneurship trainings in the green energy sector, accompanying this process are important. Given that there is a persistent gender gap in financial access in the country (Robayo-Abril and Rude, forthcoming), information campaigns targeting women, or financial literacy trainings can help.

- **Energy efficiency measures in the industrial sector (PA #8), battery storage (PA #9) and reforestation measures (PA #10) are expected to have gender differentiated impacts.** Males are more likely to be employed in manufacturing and construction than females in Romania; therefore, they could be more affected by employment changes as a result of energy efficiency measures in the industrial sector. On battery storage, impacts may differ by gender, as female-headed households tend to spend a larger share of their budget on electricity and renewables than the average household (6.3 percent vs. 5.6 percent). Afforestation and reforestation activities are likely to be beneficial to them in the medium term through helping them restore and maintain their livelihoods, given that they generally tend to have weaker coping mechanisms to address the impacts of climate change in their livelihoods.

[46] Data from the World Value Survey (2018) shows that three fourth of Romanians believe that employers should give priority to native people over immigrants when jobs are scarce. At the same time, more than four out of 10 Romanians (strongly) agree that men should have more rights to a job than women in such situations (World Value Survey, 2018).

5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

94. **The Pillar I prior actions of this operation are expected to have neutral or positive effects on the environment, forests, and other natural resources**. PA #3 and PA #4 will further ensure the right for FDPs to access social services. Such actions help mitigate the potential adverse environmental effects associated with FDP-affected areas, such as subsistence use of the environment to meet basic needs and unregulated waste disposal or water use. The access of FDPs to services and assistance reduces the risk of establishment of unregulated FDP camps or informal settlements. All other prior actions under this pillar are expected to have neutral effects.

95. **The Pillar II policy and institutional reforms have significant positive effects, while the implementation-related potential negative environmental effects in the medium- to long-term can be mitigated and dealt with by Romania's existing legal framework**.

- **PA #6 has several potential positive environmental effects, as it aims to promote green hydrogen.** Hard-to-abate sectors are those which cannot be electrified or cannot shift to low-carbon options due to a lack of competitive technological alternatives. For these sectors, that use energy for high-temperature heat production or industrial processes, hydrogen could substitute fossil fuels and, thus, reduce greenhouse gas emissions while also reducing some types of air pollution. Thus, green hydrogen will be key for deep decarbonization strategies, including heating and industrial processes. These measures will not only have environmental benefits but will also have positive effects on health and human capital. Potentially, the future implementation of these policies could result in negative environmental effects, but they would be subject to and can be dealt with existing environmental and legal frameworks that are already in place. Examples of potential risks include: (i) land use and habitat fragmentation: the potential construction of any new hydrogen facilities may require land use changes, potentially fragmenting local ecosystems, habitats, and biodiversity; in addition, air, noise and water pollution might be potentially generated during any potential construction phase; (ii) resource consumption: the production of green hydrogen using electrolysis requires significant amounts of electricity and water which might strain local water resources and affect water availability for other uses; (iii) potential leaks and accidents: hydrogen is a highly flammable gas, and leaks or accidents during production, transport, and storage could pose risks to human health, safety, and the environment while noting that the PA is supporting the development of such regulatory framework that will define quality and security standards to mitigate this; (iv) end-of-life management: the decommissioning and disposal of hydrogen infrastructure, including electrolyzers and pipelines, could generate waste and have potential environmental impacts if not managed properly. To mitigate all these potential negative effects at the stage of actual investments, it is crucial to conduct thorough environmental impact assessments, consult and engage local stakeholders, and implement best practices for construction, operation, and end-of-life management of hydrogen infrastructure. Notably, Romania's Environmental Impact Assessment (EIA) regulatory system (to which these investments would be subject) already mandates appropriate mitigation measures such as landscape impact assessment, implementation of adequate waste management protocols and supervision, ex-ante identification of indigenous protected fauna and flora and impact mitigation plans during construction and operation.

- **PA #7 supporting the Decarbonization Law in Romania primarily aims to have positive environmental impacts by phasing out coal-fired electricity generation and coal extraction, thus reducing greenhouse gas emissions and pollution.** Coal-fired generation is responsible for 68 percent of GHG emissions in the power sector, and thus the phasing out of coal will have a high impact in reducing emissions in the electricity sector and indirectly in all electrified sectors. However, there may still be some potential negative environmental effects associated with the transition process. The decommissioning of coal-fired power plants and closing of coal mines may generate waste materials, including hazardous waste. The proper disposal of these materials, which is managed through existing legislation, will be crucial to minimize environmental risks. The repurposing of land previously used for coal mining or power generation could result in land use changes and habitat disruption. Proper land reclamation, reforestation, and ecological restoration efforts could help mitigate these impacts. The Mining Law no. 85/2003, with all its subsequent amendments governs the performance of all mining activities in Romania, including mines conservation, closure and post-closure with environmental restoration and land reclamation works. Its implementation is supported by Government Decision (GD) no.1208/2003 and other National Regulatory Authority orders[47]. This set of existing legislation ensures an adequate framework for mitigating the potential environmental risks posed by this PA.

- **PA #8 aims to accelerate the decarbonization of the industrial sector in Romania by incentivizing energy efficiency improvements.** The primary objectives are to reduce GHG emissions and energy consumption in the industrial sector. As a hard-to-abate sector, reducing energy consumption through energy efficiency is one of the most effective options to reduce emissions in the short term, with spill overs in improved industrial competition and positive environmental impacts. However, there may be some potential negative environmental effects during the implementation process. The implementation of energy efficiency projects in the industrial sector may involve the use of new materials, equipment, and technologies which might result in increased resource consumption and waste generation during the construction, retrofitting, or replacement of existing infrastructure. Proper waste management and disposal (legislation for which is in place) will be important to minimize environmental risks. The construction or installation of new energy-efficient equipment and infrastructure in the industrial sector may cause temporary environmental impacts, such as noise, air, and water pollution; it may also lead to unintended land use changes, habitat fragmentation, or loss of biodiversity. This can be mitigated through careful planning and adherence to existing environmental regulations. Romania's EIA regulatory system mandates appropriate mitigation measures such as landscape impact assessment, implementation of adequate waste management protocols and supervision, and impact mitigation plans during construction and operation. In addition, it will be important to implement regular monitoring and evaluation processes for energy efficiency projects to track their environmental performance, identify any unforeseen impacts, and make adjustments as needed.

- **PA #9, supporting storage batteries, will promote the integration of renewable energy sources, such as solar and wind, with positive environmental effects.** The addition of renewable energy for electricity generation will be key to substitute coal capacity phase out and meet the demands from future electrified sectors. Batteries can contribute to offset the variability inherent in renewable energy sources and, thus, contribute to a more secure electricity supply. However, there may still be some potential negative

[47] National Regulatory Authority (ANRM) Order no. 116/1998 approving the technical instructions for underground and open pit mines closure procedure; Order no. 202/2881/2348/2013, commonly issued with the Ministry of Environment and Climate Change and Ministry of Economy, approving the technical instructions for implementing and verifying the implementation of measures set out in the Environmental Restoration Plan, the Extractive Waste Management Plan and the Technical Project for the environmental restoration, as well as the operation of the financial guarantee for land reclamation and environment restoration; ANRM Order no. 243/2019 approving the technical instructions regarding the framework content for the preparation of the Report on Mine Closure, Greening and / or Post-Closure Monitoring Works. The main legislative framework in the mining field is complemented by other associated acts regarding mainly: EIA – Law no.292/2018 on the assessment of the effects of certain public and private projects on the environment – transposing the EIA Directive 2014/52/EU; Mining wastes - GD no. 856/2008 on the management of waste from extractive industries - transposing the Mining Waste Directive 2006/21/EC; GD no.1403/2007 on the restoration of the areas in which the soil, subsoil and terrestrial ecosystems were affected; and GEO no. 57/2007 on protected areas, the conservation of natural habitats, of wild fauna and flora.

environmental effects associated with the transition process, such as: (i) Waste generation: as the number of batteries increases, so does the potential for battery waste. The disposal of batteries at the end of their lifecycle can result in hazardous waste (legislation is in place) if not properly managed, leading to soil and water contamination. If the batteries used in the storage facilities have a short lifespan, their replacement rate may increase the overall environmental footprint. (ii) Manufacturing emissions: The production of batteries involves energy-intensive processes, which may contribute to greenhouse gas emissions if powered by fossil fuels. Moreover, the manufacturing process may also produce other pollutants, depending on the materials and methods used. Proper waste management and disposal (legislation for which is in place) will, thus, be important to minimize environmental risks. (iii) Potential land-use impacts: Depending on the size and location of the storage facilities, the construction and operation of these sites may have land-use impacts, potentially affecting ecosystems and biodiversity in the surrounding area. This is partly mitigated by the fact that these projects are modular (normally each module is allocated in a standard container) and do not require large amounts of land. All the above risks can be mitigated through careful planning and adherence to existing environmental regulations which are aligned with the environmental legal framework of the EU.

- **PA #10 on laying down binding rules for afforestation and reforestation will contribute to both climate change mitigation and adaptation.** It will increase long-term carbon storage within forests and will help balance the overall national GHG emissions. It will further help to restore ecosystem integrity and enhance forest cover in Romania. Potential negative environmental effects could potentially include: disruption of local ecosystems through inappropriate species selection; planting non-native or invasive species; loss of natural habitats if the conversion of non-forest ecosystems such as grassland and wetlands into forested areas leads to the loss of valuable habitats for various plant and animal species; soil degradation, if inappropriate afforestation and reforestation practices, such as inadequate site preparation, leads to soil erosion, compaction, or loss of soil fertility; excessive application of chemical fertilizers, pesticides, or herbicides in afforestation and reforestation efforts which may harm local ecosystems, pollute water sources, and negatively affect biodiversity. To mitigate any implementation-related potential negative effects of afforestation and reforestation on biodiversity, interventions in these areas will need to be sustainable regarding the selection of trees and related pest management to preserve the habitat-specific type and species and minimize implications on the environment. Romania’s current regulations on forest regeneration and afforestation, coupled with the recently adopted National Forestry Strategy and technical implementation norms supported by this PA will effectively support the mitigation of the above-mentioned potential negative effects.

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

97. **The waste management and chemicals sector have an advanced environmental policy and legal**

framework, smoothing the path towards sustainable development, but further strengthening of enforcement and monitoring are still needed. Romania has introduced many of the principles of modern waste management systems, despite the challenging additional tasks for the Government, municipalities, companies and individuals linked to the evolving nature of the EU environmental legislation and policy. Principles of prioritization of waste generation prevention and its reuse or recovery from disposal are anchored in the legal system but implementation needs to be strengthened. Also, weak enforcement and monitoring due to improper allocation of resources, absence of a long-term vision, shared responsibilities across government institutions, and low technical capacity of central and local governments, undermines effectiveness. However, there are multiple ongoing efforts within the Government to accelerate the transition to a circular economy. Furthermore, Romania plans to use NRRP funds to further improve its waste management governance and accelerate the expansion and modernization of its waste management systems through investments on separate collection, prevention, reduction, re-use and recovery to comply with the applicable EU legislation and transition to the circular economy.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

98. **The country's Public Financial Management (PFM) system has been strengthened in the past few years**. Romania has modernized its PFM system over the last 20 years and initiatives are envisaged in areas such as strengthening strategic planning and budgeting, revenue administration and public investment management. The most recent IMF Fiscal Transparency Evaluation[48] report found that Romania performs well in the Fiscal Transparency Code benchmarking and recommended strengthening budget planning and policy orientation. Romania's general Government budget is made publicly available in printed form and on the external website of the MoF[49]. Budget execution is generally well-organized, with clear guidelines, regulations, and timelines, but there is potential for streamlining and further automating procedures supported by more effective preventive controls. Reporting and accounting functions are based on well-developed policies, including a unified budget classification and Chart of Accounts. However, despite the recent implementation of a national reporting system, manual intervention for collection, verification, and validation of financial information is still practiced, which limits timely operational outputs and analysis. While well-regulated, the effectiveness of the internal public auditing is affected by systemic capacity constraints, particularly at the local level. External public auditing is being reformed to fully observe the international standards and contribute to strengthening the public financial management. Its main areas of focus remain updating its legislative and methodological framework, strengthening performance audits, digitalization of audit processes and enhanced communication of findings to stakeholders.

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

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

Authority for Digitalization (ADR) is in place since April 2018, with 99 percent of the procurement volume being managed through the system. The National Office for Centralized Procurement (ONAC) was set up in 2018 with the scope to run centralized procurement for selected categories of products and services on behalf of other public authorities. Three regional centralized procurement bodies have also been recently set up and started their activity.

100. **In 2020, the Bank assessed Romania's public procurement system and the impact of the national public procurement strategy adopted in 2015**. The goal of the assessment was to analyze the effectiveness of the public procurement framework in Romania after the introduction of the new public procurement legislation and to formulate recommendations for improvement that would help with the creation of an action plan. The assessment included four key areas: procurement cycle and market practices; capacity development; monitoring, oversight and control; and integrity and transparency of the public procurement system. The key recommendations referred to i) the need to ensure the strategic oversight of the public procurement system and the adoption of decisions informed by the latest analysis of performance of the entire system at country, regional and local level; ii) the need to ensure a stable and predictable legislative framework and proper public consultations whenever changes are needed; iii) the opportunities to expand the scope and scale of centralized procurement by creating sectoral and/or regional centralized procurement units; iv) the opportunities to expand the understanding of environmentally and socially responsible procurement across all contracting authorities; v) the implementation of the competency framework for public procurement and continuation of the capacity development program. A new public procurement strategy and action plan are currently being prepared by ANAP with the Bank's support. In addition to including the recommendations from the 2020 assessment, this strategy and action plan also includes actions foreseen by the NRRP which was approved after the World Bank assessment report (such as the introduction of the new eForms established by the European Commission; interconnection of databases and systems; set up of new centralized procurement units at local level), as well as other priorities identified by ANAP (for example, access to justice data on public procurement). The draft has been finalized and has been published for public consultations.

101. **The control and oversight framework of the National Bank of Romania (NBR) can be relied upon to account for the World Bank`s financing proceeds**. The latest 2014 update of the 2011 IMF Safeguards Assessment, found that the safeguards framework at the NBR remains robust. The NBR continues to publish its audited financial statements as part of the annual reports and maintains strong controls over management of foreign reserves, government banking, and vault operations, particularly relevant in the context of the post-pandemic fiscal consolidation. The latest publicly available audit reports had an unmodified (clean) opinion on the preparation and presentation of the NBR`s financial statements for 2016–2020.[50]

102. **Disbursement**. The proposed loan will follow the World Bank`s standard disbursement procedures for development policy operations. 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 and channels other financing as well. Disbursements will not be linked to specific purchases, and no evidence will be needed to support disbursement, nor will procurement requirements be necessary. The loan proceeds will be used in accordance with the public debt legislation. If loan proceeds are used for purposes defined as ineligible in the Loan Agreement, the World Bank, upon notice, will require the Borrower to refund such amount promptly, and such amount shall be cancelled.

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

103. **Reporting and auditing**. Considering the World Bank's knowledge of the PFM systems, the ongoing improvements of these systems and the latest IMF assessment of the NBR, the World Bank will not require an audit for the proposed operation. The Borrower will provide confirmation to the World Bank on the amounts deposited in the foreign currency account within 30 days of receiving the funds. The front-end fee for the loan will be covered from the Borrower's own sources. The closing date of the proposed operation will be September 30, 2024.

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

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

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

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

107. **Grievance Redress**. Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS.. For information on how to submit complaints to the World Bank Inspection Panel, please visi*t* ***www.inspectionpanel.org.***

6. SUMMARY OF RISKS AND MITIGATION

108. **The overall risk rating for this operation is moderate**. Among the risk categories, political and

governance risk and implementation risk are deemed to be substantial, technical design risk is low, while all other risk categories are rated as moderate, including 'other risks' related to the spillovers from Russia's invasion of Ukraine (Table 6).

109. **Political and governance risk is substantial**. The political and governance risk is substantial primarily due to frequent changes in the government in recent years. These political challenges have reduced the reform momentum and continuity. Nevertheless, the current ruling coalition has brought some stability to policy making in Romania through a power sharing agreement which is expected to hold through to 2024, the year of elections for all levels of government. Meanwhile, the authorities remain committed to the policies being supported by the current DPL series, and reform continuity is also ensured by the fact that the current Government is a coalition of traditionally opposing parties, all in agreement of a common agenda and mode of governing. Also, there is a strong backing from the European Commission for these reforms. In addition, the World Bank has a strong policy dialogue with the Government of Romania on all the areas of the DPL series. All these factors mitigate, in part, the political risks. Given the challenges related to ruling coalitions and frequent changes of governments in the past, however, residual risks to the program development objective remain.

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

111. **All other risks are moderate**. On macroeconomic risks, Romania was already in the Excessive Deficit Procedure of the EC prior to the COVID-19 pandemic. The fiscal deficit increased substantially as a result of the COVID-19 pandemic in 2020 but the Government was able to rein in spending, partly, while revenues increased in 2022. As a result, the government managed to reduce its deficit in 2021 and 2022, despite the measures rolled out to protect people from the cost-of-living crisis. The Government remains committed to fiscal consolidation with efforts aimed at reaching a deficit of 3 percent of GDP in the medium term, in accordance with the Stability and Growth Pact. Risks related to sector strategies and policies, fiduciary, environment and social aspects, and stakeholders are moderate. Some of the reforms that are being supported by this DPL are technically complex in nature, especially those related to renewables and energy efficiency. In addition, there are also social and environmental risks related to some of the actions, especially related to the measures supported under Pillar II. Stakeholder risks are largely related to FDPs and those in brown sectors. These risks are mitigated, in part, by technical assistance provided by the World Bank, EC and other development partners, the strong existing environmental and social safeguards in EU countries, as well as communication and citizen engagement on the key aspects of the reforms.

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

Table 6: Summary Risk Ratings

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

ANNEX 1: POLICY AND RESULTS MATRIX

Prior Actions		Results		
Prior Actions under DPF 1	**Prior Actions for DPF 2**	**Indicator Name**	**Baseline: 2021**	**Target 2024**
Pillar I: Strengthen Inclusion and Fiscal Management				
Prior Action #1. The Borrower has: (i) provided temporary protection to forcibly displaced persons from Ukraine ("FDPs from Ukraine") as evidenced by the Government Decision no. 367/2022; and (ii) enabled FDPs from Ukraine access to public services like health, education, housing and social assistance, particularly to vulnerable groups such as persons with disabilities, elderly and minors, as evidenced by the Emergency Ordinance no. 15/2022, as amended by Emergency Ordinance no. 20/2022 and Emergency Ordinance no. 28/2022.	**Prior Action #1.** The Borrower has: (i) adopted regulations to implement the Law no. 196/2016 that provides protection to low-income families and single persons in Romania that are in relative monetary poverty, as evidenced by the adoption of the Government Decision no. 1154/2022; and (ii) adopted measures to adjust on an annual basis the level of the VMI (minimum inclusion income) to incorporate the average annual inflation rate, as evidenced by the enactment of the Emergency Ordinance no. 114/2022, as approved with amendments through the Law no. 56/2023. **Prior Action #2.** The Borrower has adopted measures to accelerate the deinstitutionalization of adults with disabilities to enable their transition from public institutions to communities, as evidenced by the enactment of the Law	**Results Indicator #1**: Cumulative share of women FDPs from Ukraine that use healthcare services as a share of those registered **Results Indicator #2**: Access to Minimum Inclusion Income Program (component of VMI – or Venitul Minim de Incluziune) **Results Indicator #3**: Number of social services provided in the community	0 165,205 families 59	12% of registered FDP women Increase by at least 20% Increase by at least 20%

Prior Actions		Results		
	no. 7/2023.			
Prior Action #2. The Borrower has established the procedures for the employment of FDPs from Ukraine by: (i) reducing barriers such as the requirement to hold work permits and work visa; (ii) eliminating skill recognition barriers; and (iii) enabling access to the unemployment insurance system, as evidenced by the Emergency Ordinance no. 20/2022.	**Prior Action #3.** The Borrower has: (i) approved guidelines to support the access to public employment services for FDPs from Ukraine, as evidenced by the adoption of the Order of the Minister of Labor and Social Solidarity no. 301/2022; and (ii) adopted measures to provide Romanian language classes to adult FDPs from Ukraine to foster their integration into the Romanian labor market, as evidenced by the adoption of the Order of the Minister of Education no. 6129/2022.	**Results Indicator #4:** Share of FDPs from Ukraine aged 15-64 in employment as a share of FDPs from Ukraine registered with the National Agency for Employment	0	40% of FDPs aged 15-64 of which: 50% are women aged 15-64
Prior Action #3. The Borrower has enabled hiring of government staff without competition for a period of up to three (3) years (or till ninety (90) days after the end of the situation that generates a massive influx of FDPs from Ukraine) to support scaled up services in migration and crisis management and the provision of social services at the central and local levels, as evidenced by the Emergency Ordinance no. 15/2022, as amended, and the Emergency Ordinance no. 20/2022.	**Prior Action #4.** The Borrower has approved integrated measures in the schools hosting FDPs from Ukraine and host community students to benefit equally from funding and other amenities, as evidenced by the adoption of the Order of the Minister of Education no. 6127/2022.	**Results Indicator #5:** Share of hosting schools in total schools hosting FDPs from Ukraine implementing integrated measures for students	0	75%
Prior Action #4. The Borrower has adopted regulations to: (i) implement program-based budgeting, as	**Prior Action #5.** The Borrower has taken appropriate measures to reduce preferential tax regimes and exemptions	**Results Indicator #6:** Collections from individual dividend tax	1,774 million lei (2019)	Increase in real collections by at least 10%

Prior Actions		Results		
evidenced by the Government Decision no. 467/2022; (ii) make it compulsory for Romanian companies to register in the electronic platform of the Borrower's Ministry of Finance and the National Agency for Fiscal Administration, as evidenced by Ordinance no. 11/2021; and (iii) implement the national system for electronic invoicing, as evidenced by the Emergency Ordinance no. 120/2021	for various taxpayer categories thereby reducing tax expenditures and improving tax coverage by: (i) strengthening the microenterprise regime; (ii) raising the tax rate on dividends to individuals; and (iii) increasing VAT on various products, as evidenced by the enactment of the Government Ordinance no. 16/2022, as approved with amendments through the Law no. 370/2022.	**Results Indicator #7:** Number of ministries adopting program-based budgeting	0	At least 2
Prior Action #5. The Borrower has increased the employee contributions under Pillar II of pensions to support sustainability of the pension system, as evidenced by the Emergency Ordinance no. 23/2022				
Pillar II: Foster Decarbonization and Climate Resilience				
Prior Action #6. The Borrower has approved amendments to the Law on Electricity and Natural Gas to support renewables and private sector participation in the sector by: (i) enabling hedging and bilateral contracts that protect renewable energy developers from market price volatility; (ii) incorporating balancing and market flexibility measures (such	**Prior Action #6**. The Borrower has approved a regulatory framework to define quality and security standards for green hydrogen, as evidenced by the adoption of the ANRE Order no. 63/2023. **Prior Action #7.** The Borrower has	**Results Indicator #8**: New renewable capacity contracted, of which: Electricity generation capacity Green hydrogen generation capacity (electrolyzers)	0 MW 0 MW 0 MW 3,225 MW	1,050 MW 950 MW 100 MW Reduction of at least 15%

Prior Actions		Results		
as allowing the participation of active consumers in flexibility mechanisms) to increase the capacity of the energy sector to manage larger shares of renewable energy; and (iii) incentivizing the deployment of smart metering, as evidenced by the Emergency Ordinance no. 143/2021.	approved a legal framework that: (i) establishes a clear timeline for the country to phase out coal mining and coal fired power; and (ii) incorporates principles to implement the transition away from coal in a transparent and inclusive manner, mitigating the impacts on communities and the environment, as evidenced by the enactment of Emergency Ordinance no. 108/2022, as approved with amendments through the Law no. 334/2022.	**Results Indicator #9:** Operational coal fired power generation capacity		
Prior Action #7. The Borrower, through its Ministry of Development, Public Works and Administration, has approved: (i) an increase in the ambition of energy renovation measures to reduce heating energy consumption by at least fifty (50) percent in multi-family apartment buildings (MABs); and (ii) the rules and conditions for enabling energy efficiency and resilience renovations in MABs and in public buildings, as evidenced by Orders nos. 440, 441, 442, 443, and 444/2022.	**Prior Action #8.** The Borrower has approved a state aid mechanism to support investments to improve energy efficiency in industrial activities, as evidenced by the adoption of the Orders of the Minister of Energy nos. 658/2022 and 1285/2022. **Prior Action #9.** The Borrower has approved a state aid mechanism to support investments in storage technologies (batteries) to improve the reliability of the power system and better integrate new capacities of renewable energy, as evidenced by the adoption of the Order of the Minister of Energy no. 1229/2022.	**Results Indicator #10:** Surface area of buildings to undergo energy efficiency renovation for which financing is secured **Results Indicator #11:** New storage capacity (batteries) contracted	0 m^2 0 MW	2,170,000 m^2 120 MW
Prior Action #8. The Borrower has adopted a legal framework providing incentives to accelerate afforestation	**Prior Action #10.** The Borrower has adopted: (i) the National Forestry Strategy for 2030, as evidenced by the	**Results Indicator #12:** New area under afforestation or reforestation works	4,745 ha	Increase by at least 9,500 ha

Prior Actions		Results		
and reforestation on certain categories of land, as evidenced by the Emergency Ordinance no. 35/2022	adoption of the Government Decision no. 1227/2022; and (ii) the technical implementation norms for afforestation and reforestation, as evidenced by the adoption of the Orders of the Minister of Environment, Waters and Forests nos. 2533/2022, 2534/2022, 2535/2022, 2536/2022, and 2537/2022.	(artificial regeneration)		

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ANNEX 2: IMF ASSESSMENT LETTER

Romania—Assessment Letter for the World Bank

April 6, 2023

This letter provides IMF staff's assessment of Romania's macroeconomic conditions, prospects, and policies based on available information as of March 28, 2023. The assessment has been requested in relation to development policy loans by the World Bank.

Recent Developments, Outlook, and Risks

- **War spillovers.** Romania has a large degree of self-sufficient in energy. It is therefore able to partially shield consumers and small businesses and, more recently, also large companies, from the impact of global energy prices. Nonetheless, the pass through of higher international energy prices to consumers has been stronger than in most peers. Furthermore, the slowdown of the Euro Area economy is affecting external demand. There are currently slightly above 100,000 Ukrainian refugees registered in Romania.
- **Growth.** The economy has weathered well the impact of the war in Ukraine and the slowdown across Europe, with growth in 2022 at 4.8 percent. Consumption has been solid, but declining real wages due to inflation have slowed consumer spending, and fiscal consolidation has reduced public consumption. However, investment, both public—driven by EU funds in the context of the National Recovery and Resilience Plan (NRRP)—and private, have boosted GDP in the second half of 2022. In 2023, economic growth is expected to slow to around 2½ percent despite continued investment spending, as external demand weakens and real wage growth slows. However, Romania is projected to still grow faster in 2023 than most other EU countries, and over the medium term, growth is set to recover to its potential rate of about 3½ percent as consumption recovers, also supported by robust public and private investment.
- **Inflation.** Headline inflation has risen sharply—despite schemes to limit energy price increases—to 16.4 percent y/y at end-December 2022, but appears to have peaked, with year-on-year inflation at 15.5 percent in February, broadly in line with or somewhat below Central, Eastern and Southeastern Europe (CESEE) peers. However, core inflation is still rising, though moderately. Staff project headline inflation to recede to single digits by end-2023, as base effects fade and a small negative output gap opens. Core inflation is expected to be more persistent.
- **External.** The current account deficit widened further in 2022, to 9.3 percent of GDP, driven by a further deterioration of the merchandise trade balance, which was only partially offset by stronger services exports. The deficit was financed by continued robust FDI inflows, an increase in EU inflows, and external debt inflows (even though total external debt as a percentage of GDP declined). International reserves rose further, and reserve coverage remains adequate. Going forward, the current account is projected to gradually decline but remain elevated, but is expected to be financed to a large extent by EU funds and direct investment flows.

- **Fiscal.** The government is committed to fiscal consolidation and a deficit of 3 percent of GDP by 2024, in line with agreements with the European Commission under the excessive deficit procedure. The deficit in 2022 stood at 5.8 percent of GDP, in line with the target. The fiscal deficit target was achieved in part due to the inflation shock, as revenues grew strongly, and expenditures were only partially raised to adjust for higher prices. Energy price caps for consumers and small businesses were financed by higher dividend payouts from state-owned energy producers, and windfall taxes. Beginning in 2023, the scheme has been altered to regulate wholesale prices in a budget-neutral manner. As of end-2022, public debt declined to 48.7 percent of GDP as nominal GDP rose sharply. Stress tests in the most recent debt sustainability analysis (of September 2022) suggest that vulnerabilities largely stem from a growth and/or combined fiscal-macro shock.

Risks are skewed to the downside. The main conjunctural risk stems from a possible miscalibration of monetary policy—both in Romania and by major central banks—which could prolong the current high-inflation environment, de-anchor inflation expectations, and trigger a wage-price spiral. Relatedly, financial sector turmoil outside Romania may tighten financing conditions for covering the twin deficits, although risks are mitigated by the fiscal liquidity buffer, foreign exchange reserves, and the ECB repo line. Other risks include an intensification of regional conflict, triggering further price shocks and trade disruptions. Domestically, political constraints within the ruling coalition could hamper implementation of reform plans, including in the context of the NRRP.

Policy Framework and Settings

Strong policy measures are needed to underpin further fiscal consolidation. For 2023, the authorities are relying on strengthening of the tax administration and are implementing some tax policy reforms, but they fall well short of staff recommendations. In the staff's view, the planned consolidation for 2023 and beyond will require tax policy measures, for which there is ample room, especially in personal income tax and value added tax. In the absence of such reforms, staff project a fiscal deficit in 2023 of 5¾ percent of GDP, above the authorities' target of 4.3 percent and only modest and gradual further reductions in the fiscal deficit over the medium term. This would also imply a renewed gradual increase in public debt.

Monetary policy should remain tight. The National Bank of Romania (NBR) has focused on anchoring inflation expectations, and raised the policy rate to 7 percent, although market rates have not increased to the same extent. At the same time, the NBR has allowed for an increase in the volatility of the managed exchange rate. Relatively high recent nominal wage increases confirm the need for monetary policy to remain tight, in order to help ensure the return of core inflation within the target band. To absorb external shocks and reduce overvaluation over time, exchange rate flexibility should be gradually increased.

Financial sector. The Romanian banking system has maintained its strong capital, liquidity, and profitability position. Non-performing loans have continued to fall and are now at levels below those of some peers. The share of insured deposits in the Romanian banking systems is high. The recent financial sector turbulence in major markets have no direct implications for Romania but serve as a reminder that the supervisory authorities need to remain vigilant with respect to emerging risks arising from developments abroad as well as domestic macroeconomic conditions.

The structural reform agenda needs to be reinvigorated. The large available EU funds represent an opportunity—and a challenge. The recent efforts to improve the absorption of EU funds, including through intensive monitoring of progress, are welcome. However, utilizing EU funds in a productive way implies a significant strain on the public administration. The authorities should implement the recommendations made in the most recent Public Investment Management Assessment (PIMA). This, in turn, would translate higher spending into better infrastructure and help carry out the climate policies committed under the NRRP, including investments in the green energy transition to achieve a phase-out of coal by 2032. More broadly, SOE reforms to free up fiscal resources and boost economic efficiency, expanding digitalization and strengthening the anti-corruption framework, and strengthening the health system are critical to improve medium-term growth prospects,

IMF Relations

Romania currently does not have an IMF-supported program. A staff visit took place during January 17–20, 2023. The next Article IV mission is scheduled for September 2023.

Table 1. Romania: Main Economic Indicators, 2019-28
(Annual percent change, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
				Est.	Projections					
NATIONAL ACCOUNTS										
Real GDP (expenditure)	3.8	-3.7	5.9	4.8	2.4	3.7	3.8	3.7	3.6	3.6
Final domestic demand	5.8	-2.0	5.8	5.2	4.0	4.2	3.9	3.6	3.3	3.1
Consumption	4.0	-3.0	7.0	4.1	2.9	4.2	4.1	3.5	3.2	2.9
Private	3.3	-3.7	8.0	5.6	3.0	4.3	4.2	3.7	3.2	2.9
Public	7.9	0.6	2.0	-3.2	2.4	4.0	3.8	2.8	3.0	3.0
Gross fixed capital formation	12.4	1.4	2.0	8.8	7.6	4.0	3.3	3.6	3.6	3.5
Private	9.1	-2.3	4.2	9.1	6.2	5.9	3.2	3.8	3.8	4.0
Public	29.5	18.1	-6.0	7.5	13.4	-3.4	3.8	2.8	2.6	1.5
GNFS exports	5.0	-9.7	13.0	8.4	4.3	4.6	4.9	5.0	4.8	5.0
GNFS imports	8.7	-5.6	15.3	9.7	4.8	4.7	4.4	4.1	3.9	3.9
Contribution to GDP (percentage points)										
Final domestic demand	5.9	-2.1	6.2	5.5	4.3	4.5	4.3	3.9	3.6	3.3
Net exports	-2.1	-1.6	-2.2	-1.5	-0.8	-0.6	-0.2	0.0	0.1	0.2
Inventories and statistical discrepancy	0.0	0.0	1.9	0.8	-1.1	-0.3	-0.3	-0.2	-0.1	0.0
Investment (% GDP)	24.3	24.5	25.6	28.2	28.2	27.8	27.5	27.2	27.3	27.3
Public	4.2	5.1	4.7	4.9	5.8	5.3	5.3	5.2	5.2	5.1
Private	20.0	19.5	20.9	23.2	22.4	22.5	22.2	22.0	22.1	22.3
Gross national savings (% GDP)	19.4	19.6	18.3	18.9	20.2	20.1	20.2	20.6	21.0	21.2
Public	-0.3	-4.5	-2.0	-0.9	0.1	0.1	0.4	0.7	0.8	0.7
Private	19.7	24.1	20.4	19.7	20.1	19.9	19.8	19.9	20.2	20.5
Potential output	3.7	3.4	1.9	3.6	3.8	3.7	3.6	3.5	3.6	3.5
Output gap (% potential GDP)	3.4	-3.7	0.1	1.2	-0.2	-0.3	-0.2	0.0	0.0	0.0
LABOR MARKET										
Labor force (15-64)	0.0	-0.4	-6.7	0.1	1.3	0.9	0.4	0.5	0.4	0.5
Employment	-0.1	-1.8	-9.0	0.3	1.3	1.2	0.5	0.7	0.5	0.6
Wages (monthly)	13.0	6.4	7.1	11.3	13.8	10.0	7.5	7.0	7.0	7.0
Unemployment rate (% labor force)	4.9	6.1	5.6	5.6	5.6	5.4	5.3	5.2	5.1	5.0
PRICES										
Consumer prices (avg)	3.8	2.6	5.0	13.8	10.5	5.8	4.2	3.0	2.6	2.5
Consumer prices (eop)	4.0	2.1	8.2	16.4	7.5	4.7	3.0	3.0	2.5	2.5
Core CPI (eop)	3.7	3.3	5.8	14.7	9.7	5.6	3.3	3.0	2.6	2.6
GDP deflator	6.8	4.1	5.1	13.5	11.8	5.6	4.7	3.3	2.5	2.3
MACRO-FINANCIAL										
Broad money (nominal)	10.9	15.3	15.8	6.9	13.6	9.7	...	...	...	...
Credit to the private sector (real)	2.4	3.4	6.1	-3.6	4.1	2.5	...	...	...	...
Corporations	2.2	3.1	10.7	2.1	5.7	3.4	...	...	...	...
Households	3.4	2.6	1.4	-10.4	3.5	2.2	...	...	...	...
GENERAL GOVERNMENT FINANCES (% GDP)										
Revenue	28.8	28.6	30.5	31.0	30.6	30.6	30.8	31.2	30.9	30.9
Expenditure	33.3	38.2	37.2	36.8	36.3	35.8	35.7	35.6	35.3	35.2
Net lending/borrowing	-4.6	-9.6	-6.7	-5.8	-5.7	-5.2	-4.9	-4.5	-4.4	-4.4
Structural balance	-5.0	-4.8	-7.7	-5.8	-5.4	-5.1	-4.8	-4.5	-4.4	-4.4
Structural primary balance	-3.9	-3.5	-6.2	-3.8	-3.5	-3.3	-3.2	-2.8	-2.8	-2.8
Gross debt	36.6	49.4	51.1	48.7	48.3	49.3	50.3	51.4	52.8	54.3
BALANCE OF PAYMENTS										
Current account (% GDP)	-4.9	-4.9	-7.2	-9.3	-7.9	-7.7	-7.3	-6.6	-6.3	-6.2
Export volume (goods and services)	5.0	-9.7	13.0	8.4	4.3	4.6	4.9	5.0	4.8	5.0
Import volume (goods and services)	8.7	-5.6	15.3	9.7	4.8	4.7	4.4	4.1	3.9	3.9
Capital account (% GDP)	1.3	1.9	2.2	2.4	2.6	1.8	1.6	1.6	1.1	0.8
Direct investment, net (% GDP)	-2.2	-1.3	-3.7	-3.4	-3.0	-3.3	-3.2	-3.3	-3.3	-3.3
International reserves (stock, bn €)	37.5	42.5	45.8	52.3	56.8	60.2	60.7	62.3	63.6	64.2
% of short-term external debt	105.6	127.8	119.9	121.8	135.2	130.4	120.6	118.2	111.6	104.2
Int'l investment position, net (% GDP)	-43.1	-47.3	-46.8	-40.0	-40.2	-42.8	-45.4	-47.6	-50.3	-53.1
External debt (% GDP)	49.0	57.5	56.6	49.8	48.7	50.1	51.0	51.8	53.1	54.5
MEMORANDUM ITEMS										
Nominal GDP (bn lei)	1,064	1,067	1,187	1,412	1,617	1,769	1,921	2,057	2,183	2,312
Nominal GDP (bn €)	224	221	241	286	328	357	386	410	433	456
Population (million)	19.4	19.3	19.2	19.0	18.8	18.7	18.5	18.4	18.2	18.1
GDP per capita ($)	12,929	13,005	14,864	15,821	18,700	20,395	22,134	23,654	25,020	26,257
Lei/€ (annual avg)	4.75	4.84	4.92	4.93	...	...	...	...	...	...
Real effective exchange rate	-0.5	1.3	1.0	3.3	4.7	1.5	1.7	0.5	0.1	0.0

Sources: Authorities' data and IMF staff estimates and projections.

ANNEX 3: LETTER OF DEVELOPMENT POLICY

MINISTRY OF FINANCE
MINISTER'S OFFICE

Letter of Development Policy

May 25, 2023

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

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

Dear Mr. Malpass:

The Government of Romania expresses its appreciation for the long-standing partnership and cooperation with the World Bank and the support received for critical reforms and investments that have hastened the convergence of living standards with the European Union, reduced poverty, and strengthened investors' confidence in the Romanian economy. The Government remains committed to promoting prudent macroeconomic management and pursuing structural reforms and investments in the economy to boost productivity, create high value-added jobs, and enhance the country's growth potential for the benefit of all Romanians, while also meeting the ambitions of the European Green Deal.

The effective support provided by the Government through targeted programs and consistent macroeconomic management aided households and companies in mitigating the impact of COVID-19 and the more recent cost-of-living crisis. In spite of strong external headwinds, the Romanian economy achieved robust growth in 2021 and 2022, at 5.8 and 4.8 percent, successfully rebounding from a contraction of 3.7 percent in 2020. A key element behind the sustained revival was the Government's emphasis on supporting people and companies while also maintaining elevated levels of public investments. The upward adjustments to wages and pensions helped preserve household purchasing power.

Regrettably, Russia's invasion of Ukraine in late February of 2022 has dealt a major shock to the global and European economies and led to a sizeable humanitarian crisis. Romania shares a border of approximately 650 km with Ukraine and is the second largest recipient of refugees after Poland, with over 3,200,000 arrivals and around 127,000 remaining in the country as of early-April 2023. The majority of the refugees are women and children and include vulnerable groups that require tailored support, including those with serious health conditions and disabilities. In a remarkable display of solidarity, both the Romanian society and the Government mobilized quickly to provide support to these refugees. This support has included granting them full access to social services, such as health, education, social assistance, and psychological help, as well as working to integrate them into the labor market. The Government is now in the second phase of refugee support, undertaking measures to ensure long term integration of refugees. However, challenges remain with slower than anticipated uptake of education services and integration in the labor market. A large number of refugees are treating their stay in Romania as temporary and are therefore not making plans to integrate fully in the country. Understandably, they want to go back to Ukraine at the earliest and as the situation evolves, the Government is also adapting to the situation but remains fully committed to support the refugees while ensuring that the host communities also remain fully served. This assistance is being customized to best respond to the evolving needs following the war in Ukraine and includes the maintenance of a registry of the refugees, the issuance of personal identification documents to them, and collaboration with government agencies, NGOs and international organizations to ensure that the necessary resources and manpower are available for effective long-term integration.

Despite these adverse global and regional conditions, the Government is firmly committed to advancing structural reforms and promoting investment needed to foster economic growth and improve living standards. We have prepared a solid National Resilience and Recovery Plan (NRRP), which promotes priority reforms and investments for the period 2021-2026, enabling Romania to access important resources under the EU Resilience and Recovery Facility. The quality of the Romanian NRRP was assessed as very good by the EU. Through the NRRP and the national budget, we focus on key investments in Romania's infrastructure, both at central and local levels, to reduce the infrastructure gap with the EU, enhance the competitiveness of the economy and improve the quality of public services offered to citizens.

A key priority for the Government is to put in place mechanisms and resources to accelerate the greening of the economy and promote digitalization. To this end, we aim to decarbonize the energy sector, including transitioning out of coal, by 2032 and target to install more than 7,000 MW of renewable energy and improve the energy efficiency of industrial activities and small and medium enterprises (through the energy efficiency investment fund) along with millions of square meters of private and public buildings. We are also promoting an enabling framework for the storage of renewable energy and the development of green hydrogen to decarbonize the hard to abate sectors. In parallel, we are working on expanding the surface of our forests and have recently promoted a decision to encourage reforestation and afforestation, with a goal of planting more than 50,000 hectares of new forests by 2026. We have set aside in the NRRP important resources for planting new forests. We are also cognizant of the fact that we need to mobilize important levels of private investment in order to meet Romania's investment needs. To this end, we have streamlined and clarified the legal framework for renewable energy and its storage and green hydrogen and we are developing guidelines to facilitate public-private partnerships. We are confident that these measures will help mobilize significant private investment in the Romanian economy, creating green high value-added jobs.

The Government remains committed to promote macroeconomic stability. Together with the National Bank of Romania, we promote a mix of macroeconomic policies with the aim of containing inflation. A primary area of reform for the Government is to strengthen public finances. Mindful of the need to boost budget revenues through the improvement of tax compliance, we have launched a comprehensive reform of the National Agency for Fiscal Administration (NAFA). The reform entails the reconfiguration of business processes, upgrading of the IT system, and development of staff competencies. Furthermore, measures have been instituted to decrease the incidence of fraud and errors and to heighten communication with taxpayers. This includes mandating that all companies register on the NAFA platform, which complements the national electronic invoicing system (RO e-factura), operational in November 2021, a first phase towards making it compulsory for companies. Additionally, the Government is working on measures to reduce tax expenditures and broaden the taxation base.

The ongoing reforms on the revenues side of the budget are being complemented by substantial endeavors to improve the efficiency and efficacy of public spending. To this end, we have enacted measures aimed at strengthening the linkages between policymaking and budgeting and gradually introducing performance-based budgeting. Our objective is to shift towards program-based budgeting in the central administration. We also have been making efforts to strengthen the center of government to bolster policy oversight, coordination, and harmonization. The Government is committed to put in place appropriate reforms on pensions and public wages, which are of paramount importance for ensuring long-term fiscal sustainability. Additionally, efforts are targeted toward enhancing the corporate governance framework of SOEs.

To shield households and businesses from the adverse effects of the high energy and food prices, the Government has temporarily imposed price caps on electricity and gas for a limited time period in a fiscally sustainable manner. Moreover, to safeguard the living standards of the most vulnerable of our citizens, the Government has adjusted upwards the Social Reference Indicator (SRI), to incorporate indexation and an adequate SRI update. Additional steps are taken to develop procedures to implement the social protection legislation for vulnerable consumers in a manner consistent with the Minimum Inclusion Income Program and to reintegrate persons with disabilities into communities.

We would like to express our confidence that the measures we have already implemented or are under preparation and planning will place the Romanian economy on a firmer footing and enhance its competitiveness in an inclusive and sustainable manner. We will continue to work with the World Bank to advance our reform program and boost investments.

Yours sincerely,

Government of Romania

Minister of Finance

Adrian CÂCIU

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Pillar 1: Strengthen Inclusion and Fiscal Management		
Prior Action #1. The Borrower has: (i) adopted regulations to implement the Law no. 196/2016 that provides protection to low-income families and single persons in Romania that are in relative monetary poverty, as evidenced by the adoption of the Government Decision no. 1154/2022; and (ii) adopted measures to adjust on an annual basis the level of the VMI (minimum inclusion income) to incorporate the average annual inflation rate, as evidenced by the enactment of the Emergency Ordinance no. 114/2022, as approved with amendments through the Law no. 56/2023.	Neutral	Potential neutral or positive impacts on the poor and vulnerable in the short-term.
Prior Action #2. The Borrower has adopted measures to accelerate the deinstitutionalization of adults with disabilities to enable their transition from public institutions to communities, as evidenced by the enactment of the Law no. 7/2023.	Neutral	Neutral or positive impacts on the poor and vulnerable.
Prior Action #3. The Borrower has: (i) approved guidelines to support the access to public employment services for FDPs from Ukraine, as evidenced by the adoption of the Order of the Minister of Labor and Social Solidarity no. 301/2022; and (ii) adopted measures to provide Romanian language classes to adult FDPs from Ukraine to foster their integration into the Romanian labor market, as evidenced by the adoption of the Order of the Minister of Education no. 6129/2022.	Yes - positive	Potential neutral or positive impacts on the poor and vulnerable in the short-term; medium-term impacts, especially on female labor market outcomes need to be monitored.
Prior Action #4. The Borrower has approved integrated measures in the schools hosting FDPs from Ukraine and host community students to benefit equally from funding and other amenities, as evidenced by the adoption of the Order of the Minister of Education no. 6127/2022.	Yes - positive	Neutral or positive impacts on FDPs if accompanied by other measures; neutral impacts on the poor and vulnerable.
Prior Action #5. The Borrower has taken appropriate measures to reduce preferential tax regimes and exemptions for various taxpayer categories thereby reducing tax expenditures and improving tax coverage by: (i) strengthening the microenterprise regime; (ii) raising the tax rate on dividends to individuals; and (iii) increasing VAT on various products, as evidenced by the enactment of the Government Ordinance no. 16/2022, as approved with amendments through the Law no. 370/2022.	Neutral	Potential neutral or negative impacts on the poor and vulnerable in the short run; likely positive impacts in the medium run.
Pillar 2: Foster Decarbonization and Climate Resilience		

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Prior Action #6. The Borrower has approved a regulatory framework to define quality and security standards for green hydrogen, as evidenced by the adoption of the ANRE Order no. 63/2023.	Yes – positive, with the potential implementation-related negative effects addressed through EIA and other mitigation measures	Neutral effects
Prior Action #7. The Borrower has approved a legal framework that: (i) establishes a clear timeline for the country to phase out coal mining and coal fired power; and (ii) incorporates principles to implement the transition away from coal in a transparent and inclusive manner, mitigating the impacts on communities and the environment, as evidenced by the enactment of Emergency Ordinance no. 108/2022, as approved with amendments through the Law no. 334/2022.	Yes – positive, with potential implementation-related negative effects being managed through the existing legislation	Potential negative impacts on the poor and vulnerable; neutral or positive if accompanied by mitigation measures.
Prior Action #8. The Borrower has approved a state aid mechanism to support investments to improve energy efficiency in industrial activities, as evidenced by the adoption of the Orders of the Minister of Energy nos. 658/2022 and 1285/2022.	Yes – positive, with potential implementation-related negative effects being managed through the existing legislation	Potential positive impacts
Prior Action #9. The Borrower has approved a state aid mechanism to support investments in storage technologies (batteries) to improve the reliability of the power system and better integrate new capacities of renewable energy, as evidenced by the adoption of the Order of the Minister of Energy no. 1229/2022.	Yes – positive	Potential positive effects
Prior Action #10. The Borrower has adopted: (i) the National Forestry Strategy for 2030, as evidenced by the adoption of the Government Decision no. 1227/2022; and (ii) the technical implementation norms for afforestation and reforestation, as evidenced by the adoption of the Orders of the Minister of Environment, Waters and Forests nos. 2533/2022, 2534/2022, 2535/2022, 2536/2022, and 2537/2022.	Yes – positive with potential implementation-related negative effects managed through existing legislation	Potential negative impacts on the poor and vulnerable in the short term; likely positive impacts in the medium term.