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Report No.83974-RO

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT

ON A PROPOSED LOAN

IN THE AMOUNT OF €750 MILLION

(APPROXIMATELY US$1,034.800.00 MILLION EQUIVALENT)

TO ROMANIA

FOR THE

FIRST FISCAL EFFECTIVENESS AND GROWTH

DEVELOPMENT POLICY LOAN

April 29, 2014

Poverty Reduction and Economic Management
Europe and Central Asia Region

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ROMANIA

JAN. 1- DEC. 31

CURRENCY EQUIVALENTS

(Exchange rate effective as of April 28, 2014)

3.21 RON per US$ and 4.45 RON per €

ACRONYMS AND ABBREVIATIONS

ABP	Annual Borrowing Plan
ANCPI	National Agency for Cadastre and Land Registration
ANRE	Romania Energy Regulatory Authority
AROP	At Risk of Poverty Rate
AROPE	At Risk of Poverty or Social Exclusion Rate
ASF	Financial Supervisory Authority
CAD	Current account deficit
CAP	Common Agricultural Policy
CEM	Country Economic Memorandum
CP	Convergence Program
CFAA	Country Fiduciary Accountability Assessment
COFOG	Classification of the Functions of Government
CPAR	Country Procurement Assessment Report
CPI	Consumer Price Index
CPS	Country Partnership Strategy
CRD	Capital Requirements Directive IV
DAM	Day Ahead Market
DMS	Debt Management Strategy
DPL	Development Policy Loan
DPL-DDO	Development Policy Loan-Deferred Drawdown Option
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECA	Europe and Central Asia Region
ECB	European Central Bank
EDP	Excessive Deficit Procedure
EFC	Economic and Financial Committee
ESA	European System of Accounts
ESF	European Social Fund
EU	European Union
EU11	The 11 newest EU Member States: Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia
EU-SILC	European Union Statistics on Income and Living Conditions
FDI	Foreign Direct Investment
FEG-DPL	Fiscal Effectiveness and Growth Development Policy Loan
GDP	Gross Domestic Product
GDTPD	General Directorate for Treasury and Public Debt
GOR	Government of Romania (PM and Cabinet)
GP	Government Program
HB	Heating Benefits
HBS	Household Budget Survey
IAS	International Accounting Standards
IBRD	International Bank for Reconstruction and Development
IFIs	International financial institutions
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IPO	Initial Public Offering
MOPF	Ministry of Public Finance
MOLFSPE	Ministry of Labor, Family, Social Protection and the Elderly
MSIP	Minimum Social Insertion Income Program
NBR	National Bank of Romania
NPL	Nonperforming loans
NRP	National Reform Program
NUTS	Nomenclature of Territorial Units for Statistics
OECD	Organization for Economic Cooperation and Development
OPCOM	Romanian Power Market Operator
PEIR	Public Expenditure and Institutional Review
PFM	Public finance management
PPP	Public Private Partnerships
PSIA	Poverty and Social Impact Assessment
RAS	Reimbursable Advisory Services
SDR	Special Drawing Rights
SGP	Stability and Growth Pact
SME	Small and medium enterprises
SOEs	State Owned Enterprises
SPO	Secondary Public Offering
VAT	Value-added tax
WB	World Bank

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ROMANIA

FIRST FISCAL EFFECTIVENESS AND GROWTH DEVELOPMENT POLICY LOAN

TABLE OF CONTENTS

TABLES

FIGURES

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LOAN AND PROGRAM SUMMARY
REPUBLIC OF ROMANIA

FIRST FISCAL EFFECTIVENESS AND GROWTH DEVELOPMENT POLICY LOAN

Borrower	ROMANIA
Implementation Agency	MINISTRY OF PUBLIC FINANCE
Financing Data	Amount: €750 million (US$ 1,034,800,000.00) Terms: Flexible Loan at 6 Month EURIBOR for Euro plus variable spread, with a 18 years maturity and 17.5 years of grace, with bullet repayment of principal and May 15 and November 15 as the semiannual service dates. Front end fee: 0.25% of loan amount to be financed from own resources
Operation Type	Programmatic (1st of 2), single-tranche
Main Policy Areas	Debt management, public finance, cadaster, energy, capital markets
Program Development Objectives	This is the first of two development policy loans (DPLs) to support Romania's goals of: (i) strengthening fiscal management (debt management and the quality of public spending) and the performance of state-owned enterprises; and (ii) improving the functioning of property, energy, and capital markets. The proposed DPL series is central to the Bank's engagement in the areas of public finance, growth, energy, infrastructure, and capital market development, as described in the Country Partnership Strategy presented to the Board jointly with this operation.
Results Indicators	(i) By the end of 2016, the average maturity of government domestic debt is 3.7 years, increasing from 2.7 in 2013. (ii) By the end of 2016, the share of total budgets of pilot ministries presented by programs linked to and informed by results indicators is 50 percent, increasing from zero in 2013. (iii) By the end of 2016, the average time to complete a significant project declines to 8 years through the completion, restructuring, cancellation of ongoing projects and the approval of new projects from 12 years at end-2013. (iv) By the end of 2016, coverage of the poorest 20 percent of the population by the Minimum Social Insertion Program (MSIP) during the January to March season has reached 70 percent from 62 percent in 2012. (v) By the end of 2016, the number of SOEs receiving unqualified audit opinion has increased to 20 from 8 in 2013. (vi) By the end of 2016, the number of SOEs reporting under IFRS has increased to 20 from 5 in 2013. (vii) By the end of 2016, registration of urban real estate has increased to 49 percent of all urban real estate from 39 percent in 2013. (viii) By the end of 2016, electricity contracted for same-year delivery on the OPCOM market has reached 45.0 Twh, increasing from 38.3 Twh in 2013. (ix) By the end of 2016, the amount of natural gas traded on centralized platforms has reached 2 billion cubic meters, from none in 2013. (x) By the end of 2016, international trade in electricity (exports plus imports) has reached 4.0 Twh, up from 2.6 Twh at the end of 2012. (xi) By the end of 2016, 18 procedures for capital market participation have been streamlined.
Risk Rating	Substantial
Operation ID Number	P148957

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

I. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed Fiscal Effectiveness and Growth Development Policy Loan (FEG-DPL) of €750 million (about US$1,035 million equivalent) is the first of two DPLs to Romania**. The FEG-DPL series supports measures to strengthen fiscal management (public debt management and the quality of public spending) and SOE performance and improve the functioning of property, energy, and capital markets that are key to private sector investment. After the 2008 global financial crisis, sound macroeconomic policies helped Romania restore stability and modest growth, but medium-term growth prospects are compromised by constraints on productivity that are associated with the ineffectiveness of public interventions and the poor functioning of markets supporting private sector activities. The series, which build upon previous policy lending to Romania, is at the core of the Country Partnership Strategy (CPS) for 2014–18, particularly the pillars on growth and modernization of the public sector.

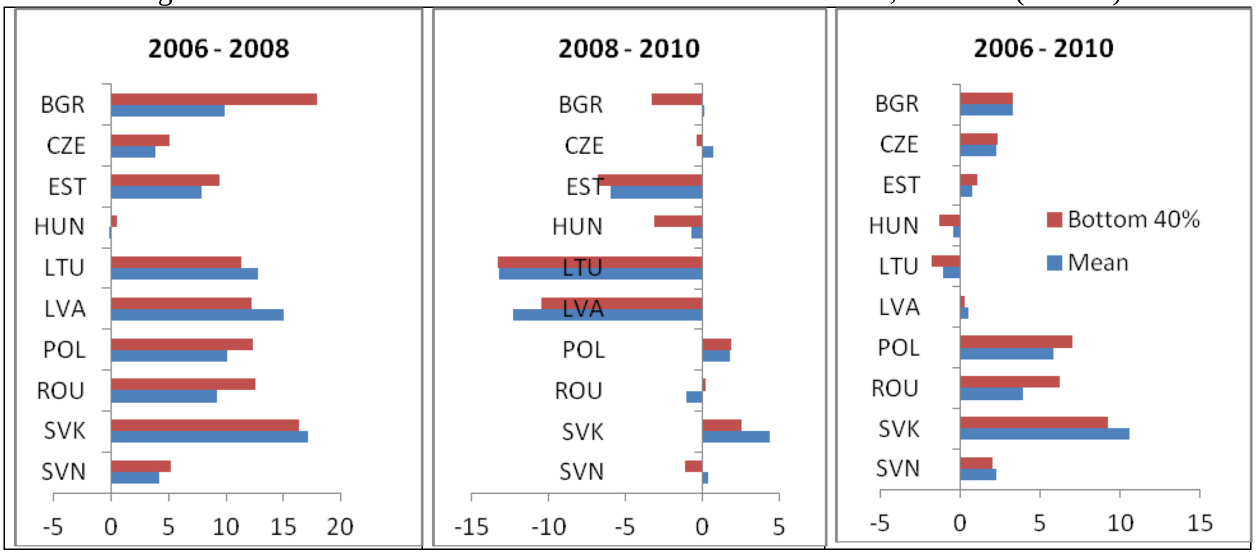
2. **The government is working to make fiscal policy more effective as part of the next stage of fiscal reforms**. Although fiscal adjustment in recent years has been substantial, structural fiscal reforms have advanced slowly, to the detriment of private economic activity, entrepreneurship, and investment. The government is therefore moving to accelerate second-generation fiscal management reforms to improve the efficiency, delivery, and targeting of public programs. Better management of debt and other aspects of public finances would promote continued fiscal adjustment, and more effective social spending would better target the poor.

3. **Though Romania's private sector has developed substantially in recent years, key markets supporting it are not yet functioning efficiently**. Because the rights to only 15 percent of total estimated properties are registered in the electronic Romanian cadastral records, the functioning of both urban and rural property markets and collateral-based credit is severely limited. Also, the stock market capitalization at €17.8 billion (12.5 percent of GDP) and the daily average turnover at €6.9 million, are all far below other European Union (EU) countries. This constraints both corporate finance and credit recovery. In fact, stock market capitalization has *declined* in recent years despite the growth of the economy, the activities of private pension funds, and the recent issuance of shares by state-owned energy companies. Further, incomplete liberalization of electricity and gas markets constrains energy efficiency, investments, and exports. In response, in 2011 the government re-launched reforms to ensure compliance with the EU third energy package for electricity and gas, and it expects to fully liberalize nonresidential electricity and gas markets by the end of 2015.

4. **Pre-crisis economic growth benefitted the entire population, including the bottom 40 percent**. In the initial years of EU membership the surge in global and European trade, capital inflows, and economic activity brought significant advances in well-being for all Romanians. Structural changes in the economy came together to spur growth of the mean income of the bottom 40 percent at an annual rate of 12.6 percent, compared to 9.2 percent for the population overall; this performance lagged behind only Bulgaria, Slovakia and Poland (Figure 1). The absolute poverty rate based on the ECA regional poverty line of US$5 per person per day (2005 USD PPP) fell from 44.4 percent in 2006 to 33.2 percent in 2008.

The steep drop in absolute poverty over this period was observed in both rural (from 59.6 to 47.1 percent) and urban areas (from 23.9 to 16.7 percent). These trends were reversed with the crisis. From 2008 to 2010 average per capita household incomes in Romania fell by 1.1 percent per year, while mean income of the bottom 40 percent increased by only 0.2 percent annually (Figure 1) and absolute poverty increased from 33 percent in 2009 to 37 percent in 2011. Today Romanians are still among the poorest citizens in the EU and are poorer even than the populations of some non-EU European countries. The FEG-DPL series will help Romania lay the foundation for broad-based growth to resume.

Figure 1: New EU Member States Growth in Household Income, 2006–10 (Percent)



Source: World Bank staff estimates using EU-SILC data.
Country abbreviations: Bulgaria (BGR), Czech Republic (CZE), Estonia (EST), Hungary (HU), Lithuania (LTU), Latvia (LVA), Poland (POL), Romania (ROU), Slovakia (SVK), Slovenia (SVN).

5. **The proposed FEG-DPL will complement precautionary financial assistance arrangements with the International Monetary Fund (IMF) and the EU**. The IMF and the EU Council of Ministers approved two-year arrangements of about €2 billion each in fall 2013. The first and second reviews of the IMF program were completed by the IMF Board on March 26, 2014. The FEG-DPL series was designed in close collaboration with the government, the IMF, and the EU. Its focus is on areas where the Bank has a comparative advantage and deep engagement.

6. **There are both external and internal risks**. Tightening global financial conditions could cause a surge in global interest rates and slow the Eurozone recovery, adversely affecting Romania's growth. Also, regional instability could adversely impact Romania if market sentiment towards emerging economies in Europe should worsen. However, Romania is now better prepared to absorb such shocks than before the 2008 crisis and its macroeconomic position is strong. The main internal risk relates to domestic politics (European Parliament elections in May 2014 and national presidential elections in November 2014) and their potential impact on reforms. But the coalition government, as recreated in February 2014, has a comfortable majority in Parliament.[1] Weak implementation capacity combined with the political cycle also poses significant risks to the sustainability of the reform program supported by the operation.

[1] The National Liberal Party broke away from the coalition and was replaced by the Democratic Union of Hungarians in Romania and other small parties. As a result, the government reshuffled about 11 ministerial posts in February 2014.

II. MACROECONOMIC POLICY FRAMEWORK

RECENT ECONOMIC DEVELOPMENTS

7. **In the decade up to 2008, Romania made major strides in income growth and convergence to the EU average**. Income per capita grew from about 27 percent of the EU average in 2000 to 48 percent in 2008. Growth was led by domestic demand fueled largely by Foreign Direct Investment (FDI) and short-term debt, mainly in non-tradable construction and services.

8. **After severe recession and a contraction of real GDP by 8 percent in 2009–10, recovery has been slow and the base for growth has narrowed**. Slow external and domestic demand, protracted recession in the Eurozone, impaired bank balance sheets, and agricultural volatility have impeded recovery. Economic growth averaged 1.5 percent in 2011–12 (Table 1). In 2013 stronger exports and an exceptional agricultural year produced growth of about 3.5 percent, but nonagricultural GDP is estimated to have expanded by only 1.7 percent, while FDI (1.0 percent of GDP) and domestic demand are still unimpressive.

9. **Good economic management has helped reduce twin deficits and restore stability.** Between 2009 and 2013, the government reduced the fiscal deficit (ESA95 basis) from 9 percent of GDP to 2.6 percent through revenue and expenditure measures (Table 2). The current account deficit (CAD) also fell from 11.6 percent of GDP in 2008 to an estimated 1.1 percent last year. Total external debt estimated at 67.5 percent of GDP in 2013 peaked in 2012, and total public debt (external and domestic) estimated at 39.3 percent in 2013, will peak in 2014. Gross international reserves are close to 7 months of imports of goods and services. Inflation is at a historic low and monetary and exchange rate policies have been prudent. Low CPI inflation (less than 2 percent) and the negative output gap have given the monetary authorities room to lower policy rates. The real exchange rate is in line with fundamentals.

10. **With vulnerabilities reduced, Romania's sovereign euro spread fell from 557 basis points in January 2012 to 206 on April 28, 2014**. Fitch Ratings has affirmed Romania's long-term foreign and local currency ratings at "BBB-" and "BBB" citing the country's strong economic growth and its resilience to the recent external turbulence. S&P has kept Romania's rating at "BB+", one level below investment grade, but has raised its outlook from stable to positive.

11. **Since 2009 the government has implemented significant fiscal consolidation, graduating from the EU's excessive deficit procedure in June 2013**. The fiscal deficit of the general government was brought down through cuts in public sector wages and pensions and large increases in the main VAT rate. Public investment, however, was maintained above 6 percent of GDP throughout the crisis. Increased absorption of EU funds has supported the overall fiscal framework with transfers of between 1 and 2 percent of GDP over the 2009-13 period (by the end of 2013 the cumulative absorption rate reached 33.5 percent for structural and cohesion funds and 67 percent for agricultural funds). The 2013 structural fiscal deficit is estimated to be at 1.8 percent[2] of GDP and the overall fiscal deficit (ESA95 basis) at 2.6 percent (Table **2**). The government also maintains a fiscal contingency reserve (including proceedings of the DPL-DDO loan) of €5.8 billion (as of December 2013), about 4.7 months of gross financing needs.

12. **Yet, despite the nascent recovery and sound macro-management, labor market conditions are difficult, especially for youth and the long-term unemployed**. At 7.3 percent in January 2014, Romania's unemployment rate may be lower than the EU average of 10.8 percent, but this is partly because an estimated 25 percent of those in the labor force have emigrated in the past two decades. Youth

[2] IMF estimates. According to the latest EC estimates (Winter Forecast 2014), the structural balance, corresponding to an ESA headline deficit of 2.6 percent in 2013, is 2.1 percent of GDP.

unemployment at 22 percent and the large share of long-term unemployed (about 45 percent of total unemployment) suggest there are structural rigidities in the labor market. In response, the government has simplified hiring and firing rules and extended the use of flexible employment contracts, which has led to some gains in fixed-term employment. With the liberalization of the EU labor market for Romanian and Bulgarian workers in January 2014, however, incentives to emigrate have intensified.

Table 1: Romania - Economic Developments and Prospects, 2009–18

YEAR*	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
1. GDP										
Per capita, Atlas medhology, US$	8680	8430	8520	8560	9170	9416	10076	10729	11448	12165
US$ billion at current prices	164	165	183	169	190	197	202	218	230	238
Growth, % change	-6.6	-1.1	2.2	0.7	3.5	2.2	2.5	2.9	3.4	3.5
By sector, % change										
Agriculture	-3.3	-5.5	12.4	-21.6	13.2	-4.2	2.2	0.8	1.3	3.2
Industry	-1.4	4.0	0.1	-1.0	6.7	4.7	2.9	3.3	3.9	3.8
Construction	-9.9	-4.5	-6.4	-0.3	-1.4	8.0	5.8	3.8	4.4	3.2
Services	-9.1	-3.6	2.2	5.6	2.1	1.8	1.5	2.4	3.0	3.2
By spending category, % change										
Consumption	-7.4	-1.3	0.9	1.2	0.3	1.9	2.4	3.0	3.3	3.4
Government	9.5	-13.7	-0.3	2.4	0.0	0.6	1.4	3.4	2.4	2.4
Private	-9.4	0.1	1.1	1.1	0.3	2.2	2.6	2.8	3.5	3.7
Investment	-28.1	-1.8	7.3	4.9	-5.7	2.1	3.4	3.7	4.5	4.6
Government	-26.6	34.9	8.8	-12.1	-9.3	12.0	-9.3	6.4	10.5	4.8
Private	-28.5	-11.3	6.7	11.7	-2.5	-0.6	4.3	3.2	3.9	4.5
Exports	-6.4	13.2	10.3	-3.0	12.8	5.7	5.9	7.0	8.5	8.6
Imports	-20.5	11.1	10.0	-0.9	2.3	4.0	6.1	7.5	8.6	8.9
Domestic demand	-11.7	-1.1	2.4	1.4	-1.1	1.5	2.6	3.1	3.5	3.6
Memo: Output gap (% GDP)	1.5	-1.5	-1.2	-2.4	-1.2	-1.2	-1.2	-0.9	-0.2	0.6
2. Savings and investment, of GDP										
Gross national saving	21.2	21.2	22.3	21.6	22.1	21.7	20.8	20.6	22.4	22.5
Government	-2.0	0.8	3.4	4.0	3.2	4.0	4.1	4.3	4.8	4.8
Private	23.2	20.3	18.9	17.6	18.9	17.7	16.7	16.3	17.6	17.7
Gross domestic investment	25.4	25.6	26.8	26.0	23.2	23.2	22.7	22.7	24.7	25.1
Government	5.2	7.2	7.7	6.5	5.7	6.2	5.5	5.7	6.1	6.2
Private	20.1	18.3	19.2	19.5	17.5	17.0	17.2	17.0	18.6	18.9
3. Prices and wages, % change, y-o-y										
Consumer price index (CPI average) [1/]	5.6	6.1	5.8	3.3	4.0	2.2	3.1	3.0	2.8	2.8
Average nominal wage growth	8.4	2.5	4.9	5.0	5.0	4.6	4.5	3.8	3.6	3.6
4. Unemployment rate, %	6.9	7.3	7.4	7.0	7.3	7.2	6.8	6.7	6.6	6.6
5. External Sector, % of GDP										
Current Account Balance	-4.2	-4.4	-4.5	-4.4	-1.1	-1.5	-1.9	-2.1	-2.3	-2.6
Merchandise trade balance	-5.8	-6.1	-5.6	-5.6	-2.4	-2.7	-3.0	-3.1	-3.2	-3.4
Service balance	-0.2	0.3	0.3	0.9	1.8	1.7	1.6	1.7	1.7	1.7
Income balance	-1.6	-1.5	-1.7	-2.3	-3.1	-3.1	-3.1	-3.1	-3.1	-3.2
Transfers balance	3.5	2.9	2.5	2.6	2.6	2.6	2.5	2.5	2.3	2.3
Real Effective Exchange Rate Index (base 100=2000)	171.8	173.5	175.1	166.5	177.9	…	…	…	…	…
6. Financial Sector, % of GDP										
Deposits	62.5	65.6	64.6	62.2	57.3	…	…	…	…	…
Loans (households and non-financial corporations)	39.2	39.5	39.4	38.1	34.4	…	…	…	…	…
Credit to private sectors, annual percent change	0.9	4.7	6.6	1.3	-3.3	1.3	5.2	4.9	6.1	6.6
Assets quality										
NPLs ratio	7.9	11.9	14.3	18.2	21.9	…	…	…	…	…
Stock market capitalization	18.4	21.6	14.5	18.2	22.5	…	…	…	…	…

Source: Ministry of Public Finance; National Bank of Romania; IMF; Eurostat; National Commission for Prognosis, JP Morgan and the World Bank staff estimates.
1/ Projections are based on HICP (Harmonised Indices of Consumer Prices) weights.
*Actual: 2009-2010, Estimate: 2011-2012, Projection (WB staff): 2013-2018

13. **After a rapid expansion of the financial sector up to 2008, the banking sector has been contracting and non-performing loans (NPL) are rising.** As deleveraging accelerated, credit growth stalled. Since 2009, foreign parent banks have reduced funding by 20 percent, but domestic funding has not picked up the slack. The quality of the loan portfolio has deteriorated: by December 2013 the share of NPLs had risen to 22 percent, one of the highest rates in the region although portfolio audits and closing of provision gaps have helped keep provisioning high. The central bank is working on a plan to reduce NPLs, including providing incentives for write-offs of unrecoverable loans. Because a large share of lending is in foreign currency, banks are also vulnerable to currency depreciation shocks. The mostly foreign-owned banking system is also vulnerable to a further withdrawal of parent bank funding.

14. **Recent reforms have helped rebuild capital buffers and provisioning and improved the resolution of problem banks**. Stress tests found that Romanian banks would remain resilient even in the severe scenario of a deep depreciation of the currency and a prolonged recession, though a number of banks would have to raise additional capital. The capital adequacy ratio at about 14 percent is comfortable and provisioning covers over 90 percent of NPLs. The authorities continue to reinforce the bank resolution framework to deal with large systemic banks as well as smaller banks and include least-cost tests and bailing-in clauses to protect taxpayer resources. The authorities also plan to ensure that the deposit guarantee fund complies with the draft EU Banking Resolution and Recovery Directive.

Table 2: Romania - Fiscal Developments and Prospects, 2009–18

YEAR*	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue, % of GDP	31.2	32.2	32.6	32.9	31.7	32.6	32.7	32.6	32.4	32.2
Taxes, of which:	27.2	26.5	27.9	28.2	27.5	27.6	27.5	27.4	27.4	27.3
VAT	6.8	7.5	8.6	8.6	8.2	8.2	8.2	8.3	8.3	8.3
Social security contributions	9.5	8.7	9.1	8.8	8.6	8.7	8.6	8.6	8.5	8.4
Nontax revenue	2.9	3.8	3.3	3.1	2.7	2.6	2.6	2.6	2.6	2.6
Capital revenue	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Grants, including EU disbursements	1.0	1.8	1.2	1.4	1.4	2.2	2.4	2.5	2.4	2.3
Expenditures, % of GDP	38.5	38.6	36.8	35.4	34.2	34.8	34.0	34.0	33.7	33.6
Current expenditure, of which:	34.6	35.0	32.8	32.3	31.5	32.1	32.6	33.3	33.2	33.1
Compensation of employees	9.3	8.2	6.9	7.0	7.3	7.2	7.1	7.2	7.1	7.0
Goods and services	5.6	5.6	5.7	5.9	6.1	5.9	5.9	5.9	5.9	5.9
Interest	1.2	1.4	1.6	1.8	1.7	1.7	1.7	1.7	1.7	1.8
Subsidies	1.4	1.3	1.1	1.0	0.8	0.9	0.8	0.8	0.8	0.8
Transfers, of which:[1/]	16.6	18.2	17.1	16.3	15.4	16.3	16.8	17.5	17.4	17.4
Pensions	8.0	8.0	8.5	8.2	7.8	7.7	7.7	7.8	7.7	7.6
Capital expenditure [2/]	4.4	3.7	4.1	3.3	2.8	2.6	1.4	0.7	0.5	0.5
Net lending and expense refunds	-0.5	-0.1	-0.1	-0.1	-0.2	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Total capital spending, % of GDP [3/]	5.2	7.2	7.7	6.5	5.7	6.2	5.5	5.8	5.8	5.8
Fiscal balance, % of GDP	-7.3	-6.4	-4.3	-2.5	-2.5	-2.2	-1.4	-1.4	-1.3	-1.4
Primary balance	-6.2	-5.1	-2.8	-0.7	-0.8	-0.6	0.3	0.3	0.4	0.4
Structural fiscal balance [4/]	-7.9	-5.8	-3.5	-1.8	-1.8	-1.3	-0.5	-0.8	-1.1	-1.5
Fiscal balance (ESA95 basis)	-9.0	-6.8	-5.6	-3.0	-2.6	-2.2	-1.4	…	…	…
Financing, % of GDP, of which:	7.3	6.4	4.3	2.5	2.5	2.2	1.4	1.4	1.3	1.4
External borrowing (net)	2.6	2.8	2.7	3.3	2.1	1.3	0.6	0.2	0.2	0.2
Domestic borrowing (net)	5.8	4.0	2.2	0.9	1.4	1.1	0.8	1.1	1.1	1.1

Source: Ministry of Public Finance; IMF; and the World Bank staff estimates.
1/ Includes EU financed capital projects.
2/ Includes only the capital spending that is financed from budget and investment loans.
3/ Includes EU-financed capital projects.
4/ Actual fiscal balance adjusted for the automatic effects of the business cycle (IMF methodology).
*Actual: 2009-2012, Estimate: 2013, Projection (by World Bank staff): 2014-2018

15. **To promote wider sources of finance and investments, the authorities are also working to deepen the capital markets**. The government's decision to list state-owned enterprises (SOEs) in the stock exchange has generated domestic and foreign interest in the equity market. Market participants are eager to support development of capital markets, but the regulatory framework needs to be modernized and streamlined to remove obstacles, and there are concerns about governance of the regulator. The government has consolidated the regulation and supervision of insurance, pensions, and securities into a single Financial Supervisory Authority (ASF), and ASF and local stakeholders are drafting a new capital markets law.

MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

16. **Romania prospects for growth over the medium-term are moderate.** Private economic activity is likely to stay subdued because of sluggish demand both in the Eurozone and domestically. Inefficiencies and inadequate institutions constrain productive public spending and the effective delivery and targeting of public services. Assuming a gradual pick up in both private consumption and investment over the forecast horizon (2014-15), real GDP is expected to expand by 2.2 percent in 2014 and rise to 2.5 percent in 2015 (Table 1). Implemented vigorously, structural reforms to improve fiscal effectiveness, productivity, and market functioning will earn a long-term growth dividend.

17. **Prudent monetary and fiscal policies are expected to anchor inflation expectations, maintain fiscal buffers, and reduce public debt.** CPI inflation is expected to stay low and within the NBR's target of 2.5±1 percent for the first half of 2014. The planned liberalization of electricity and gas prices for commercial and public sector users is not expected to add much inflationary pressures. The government targets a 2014 fiscal deficit of 2.2 percent of GDP (cash and ESA), which would be an

improvement of 0.3 percent of GDP. The budget also envisages holding the wage bill to about 7.2 percent of GDP and public pensions to about 7.7 percent. Total capital spending (including EU funds) is expected to rise from 5.7 percent of GDP in 2013 to 6.1 percent in 2015 through careful prioritization, mainly by reducing non-EU-funded (and old) projects. Better absorption of EU funds, however, implies that more will be spent on infrastructure. Romania's Medium-Term Objective is a structural fiscal deficit of 1 percent of GDP by 2015, an additional structural effort of 0.8 percent compared to the expected 2014 headline deficit of 2.2 percent of GDP. Consistent with the Stability and Growth Pact, this objective has been institutionalized in Romania's Fiscal Responsibility Law.

18. **The external position is expected to remain comfortable.** As domestic demand recovers, the CAD will widen slightly, to 1.5 percent of GDP in 2014 and 1.9 percent in 2015. FDI is likely to pick up to cover 80 percent of the CAD in 2014 and at least 60 percent in 2015. But with international capital flows subdued, FDI will remain below the pre-crisis levels of 5–6 percent of GDP in the medium term. Export volumes are expected to rise by 6–7 percent in 2014–15 as conditions improve in the Eurozone, especially Germany.

19. **Though external debt is high, it is declining** having peaked in 2012 at 75.7 percent of GDP. It is projected to fall to less than 50 percent in 2018 as economic activity rebounds to its long-term potential. Short-term external debt is also expected to drop from a peak of 17.3 percent of GDP in 2011 to about 11 percent. This, and rising exports, will help bring down the external debt-to-export ratio from the 2009 peak of 224.5 percent to 134 percent by 2018. To achieve this, Romania will need to mobilize €35–40 billion (18-20 percent of GDP) annually to meet gross external financing requirements, of which about one-third to a half is for the public sector (Table 3).

20. **Romania's public debt, among the lowest in the EU, is expected to drop further over the medium term.** The gross public-debt-to-GDP ratio is expected to peak in 2014 at 39.7 percent of GDP (including guarantees) before easing down to 36.7 percent by 2018. Currently, public debt and debt service are well within the indicative thresholds of the EU Growth and Stability Pact Macro Imbalances Procedure. About 50 percent of public debt is external. This is also expected to decline as domestic capital markets deepen. Gross public sector financing needs—over the medium term about 7–10 percent of GDP a year, some €16–20 billion—are substantial but manageable (Table 4).

21. **Romania's debt remains sustainable in the medium term under a range of adverse shocks,** such as a combined permanent shock of 0.25 standard deviation in the real interest rate, the GDP growth rate, and the CAD. With these adverse assumptions, external debt continues to decline, though more moderately than in the baseline, reaching about 68 percent of GDP in 2018 compared to 59 percent in the baseline. However, an extreme shock of a one-time 30 percent real exchange rate depreciation—which could be caused by a reversal of prudent macroeconomic policies, large capital outflows, and a confidence shock—would escalate external debt to about 100 percent of GDP in the short run before it slides back to 87 percent by 2018 (Figure 2). This underscores the importance of continued monetary and fiscal prudence to keep macroeconomic vulnerabilities in check.

22. **The current macroeconomic policy framework is adequate.** Policies implemented during and after the global crisis facilitated the adjustment needed and laid the basis for healthier economic growth. Fiscal, monetary, and public sector wage policies have helped correct large external and internal imbalances. The financial system is capitalized and able to withstand new shocks, although cleaning of bank portfolios will extend into the medium term. Fiscal and external buffers against unforeseen shocks include government deposits of roughly six months of budgetary expenditures and debt financing (about €6 billion at the end of January), international reserves equivalent to seven months of current account payments, and resources worth €4 billion available under the precautionary IMF-EU agreement.

Table 3: Romania – Financing Requirements and Sources and External Debt, 2010-18

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Baseline external debt, % of GDP	68.7	74.3	75.1	75.7	67.5	61.1	56.1	53.7	50.9	47.5
Public sector	10.0	12.9	15.3	17.3	18.2	18.6	18.2	17.2	15.9	14.9
Other	58.7	61.4	59.8	58.4	49.3	42.5	37.9	36.5	35.0	32.6
Change in external debt, % of GDP	17.3	5.6	0.8	0.6	-8.2	-6.4	-5.0	-2.4	-2.8	-3.4
Total financing requirements, % of GDP	40.9	30.7	29.8	33.4	25.9	19.0	18.0	18.6	19.1	19.7
Current account deficit	4.2	4.4	4.5	4.4	1.1	1.5	1.9	2.1	2.3	2.6
Short term external debt	13.2	15.7	17.3	15.9	13.6	12.5	11.9	11.3	10.6	10.0

Source: Ministry of Public Finance; IMF; and the World Bank staff estimates.
*Actual: 2009-2012, Projection: 2013-2018.

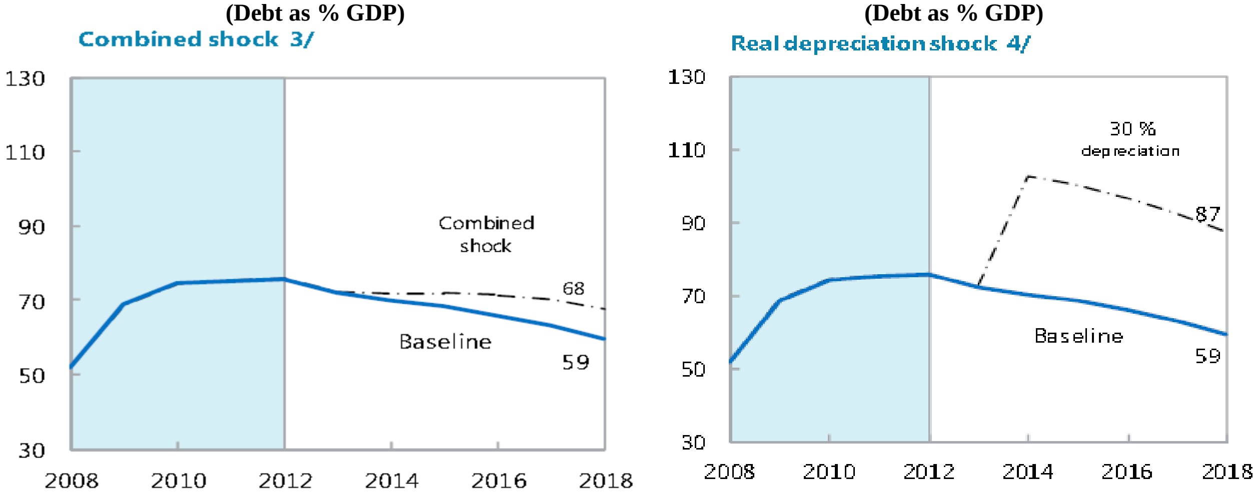
Table 4: Romania - Gross General Government Debt Dynamics, 2009–18

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Gross general government debt (including guarantees), % of GDP	23.8	31.1	34.3	38.2	39.3	39.7	39.0	38.3	37.4	36.7
Gross general government debt (direct debt only), % of GDP	21.7	28.1	32.2	35.8	36.9	37.5	36.9	36.3	35.5	34.9
External	10.0	12.9	15.3	17.3	18.2	18.6	18.2	17.2	15.9	14.9
Domestic	11.7	15.2	16.9	18.5	18.7	18.9	18.7	19.1	19.6	20.0
Change in general government debt, % of GDP	10.2	7.3	3.2	3.9	1.1	0.4	-0.7	-0.7	-0.9	-0.7
Primary deficit	6.1	5.0	2.8	0.7	0.8	0.6	-0.3	-0.3	-0.2	-0.2
Automatic debt dynamics	1.9	1.8	0.7	0.3	-0.8	0.1	-0.1	-0.2	-0.4	-0.5
Contribution from interest rate/growth differential	1.6	0.4	-0.1	0.2	-0.8	0.1	-0.1	-0.2	-0.4	-0.5
Of which: real interest rate	0.7	0.0	0.5	0.5	0.4	1.0	0.8	0.9	0.8	0.8
Of which: real GDP growth	0.9	0.4	-0.6	-0.2	-1.2	-0.8	-0.9	-1.1	-1.2	-1.2
Contribution from exchange rate depreciation	0.3	1.4	0.8	0.1	…	…	…	…	…	…
Residual, including asset change	2.2	0.5	-0.3	2.9	1.1	-0.3	-0.3	-0.2	-0.3	0.0
Public gross financing needs, % of GDP	18.4	13.9	13.0	11.6	11.8	9.4	8.6	7.9	6.7	7.3
Public sector debt to revenue ratio (%)	76.3	96.6	105.2	116.1	124.0	121.8	119.3	117.5	115.4	114.0

Source: Ministry of Public Finance; IMF; and the World Bank staff estimates
*Actual: 2009-2012, Projection: 2013-2018

Figure 2: Romania-External Debt Sustainability [1/ 2/]

Panel a: Combined Shock Scenarios (Debt as % GDP) | **Panel b: Real Exchange Shock Scenario (Debt as % GDP)**



1/ IMF staff estimates as of December 2013 (consistent with the recently approved IMF staff report for Romania).
2/ Data for 2013 correspond to IMF and World Bank staff projections.
3/ Permanent 1/4 standard deviation shocks applied to the interest rate, growth rate and current account balance.
4/ One-time real exchange rate depreciation of 30 percent in 2013.

23. **Nevertheless, there are substantial risks.** Externally, tightening global financial conditions could rapidly push up global interest rates and slow recovery in the Eurozone, which could depress Romanian exports, FDI, and growth and put pressure on the currency and domestic interest rates.

However, Romania is better prepared to absorb such shocks than it was before 2008. While nonresidents have little exposure to Romanian debt (21 percent of total domestic issuance at the end of 2013), the U.S. tapering of quantitative easing could trigger capital outflows, and the domestic rollover risk might intensify. Given that 62 percent of lending is in foreign currency, depreciation of the exchange rate would cause deterioration in bank and company balance sheets. The mostly foreign-owned banks also remain vulnerable to the withdrawal of parent funding, although reliance on domestic deposits is increasing. Finally, Romania might be affected by protracted or intensified regional instability. However, continued prudent macroeconomic policies supported by the fiscal responsibility legislation, EU monitoring safeguards, and the IMF, EC, and World Bank-supported programs provide effective mechanisms for mitigating these risks. Internally, the main risk stems from domestic politics. With presidential elections planned for the fall 2014, pre-election politics has intensified, which may slow structural reforms. Political uncertainty could also undermine investor confidence. The main mitigating mechanism is the broad commitment expressed by all political groups to the EU/IMF/WB-sponsored reform program and the macroeconomic framework.

IMF AND OTHER BALANCE OF PAYMENTS SUPPORT

24. **On September 27, 2013, the IMF Executive Board approved a successor pre-cautionary two-year stand-by arrangement for Romania**. It granted access of SDR 1,751.34 million (about €1.98 billion, 170 percent of quota). The first and second reviews were completed on March 26, 2014.

25. **Pre-cautionary EU balance-of-payments assistance of €2 billion is also available.** On July 4, 2013, Romania requested a third balance-of-payments program and the Council of the EU approved it on October 22, 2013. The first formal review is slated for June 2014.

26. **The authorities have withdrawn the proceeds of the DPL-DDO approved in June 2012 but kept them as a contingency buffer**. Consistent with their debt management strategy, the withdrawal helped build a larger liquidity cushion to mitigate refinancing risk. The cushion offers other advantages, such as below-market borrowing cost and a smoother and longer redemption profile than the Eurobond or domestic security markets. The program supported by the DPL-DDO has been implemented satisfactorily.

III. THE GOVERNMENT'S PROGRAM

27. **The government has drafted a 2013 National Reform Program (NRP), a Convergence Program (CP) for 2013–16, and an associated Government Program (GP) which was recently updated by the new governing coalition.** These programs are consistent with recommendations to Romania made by the EU Council of Ministers. The objectives are to (i) modernize public administration; (ii) increase the absorption of structural and cohesion funds; and (iii) improve the business environment. The GP also highlights as priorities (i) revenue and tax modernization reforms, including a return to a 19 percent VAT rate (from the current 24 percent) if GDP growth continues to exceed 3 percent and the budget allows it; (ii) stronger employment support policies, including incentives and support for hiring youth, workers aged 50-64, unskilled workers, workers with disabilities and ethnic minorities including Roma; (iii) adhering to merit-based recruitment for SOE boards; (iv) efficient public resource management; (v) improving public debt management; and (vi) enhancing investor confidence. It also stresses the importance of setting measurable results indicators consistent with budget allocations; helping those Romanians most affected by the crisis; accelerating structural reforms in SOEs and energy and capital markets; and putting in place sound cadaster and land registration systems.

28. **The CP, which details the government's macroeconomic strategy, is consistent with its commitment to achieve a structural deficit of 1 percent of GDP in ESA terms by 2015**. This is consistent with Romania's medium-term objective under the Stability and Growth Pact and its domestic fiscal rules. The EU considers the target and the CP realistic but emphasizes that there are political risks due to a lack of fiscal space for potential priority projects of the government and limited progress in SOE restructuring.

IV. THE PROPOSED OPERATION

OPERATION DESCRIPTION AND LINK TO THE GOVERNMENT PROGRAM

29. **The FEG-DPL is the first of two loans in support of the Romanian government's reform priorities**. The government has requested Bank support for its efforts to enhance Romania's growth potential by improving the efficiency and effectiveness of public resources and building up key markets. The FEG-DPL series is structured around two pillars: (A) strengthening fiscal management and SOE performance; and (B) improving the functioning of property, energy and capital markets.

30. **These pillars have powerful synergies.** Pillar A supports the government's efforts to keep the economy stable, improve the management of public debt, and manage public resources efficiently. Pillar B supports efforts to improve the business environment and enhance investor confidence. Among the synergies (i) the debt management strategy will support liquidity and price signals in capital markets; (ii) improvements in pro-poor spending will help mitigate the impact of energy sector liberalization; (iii) better governance and performance of SOEs should help build up capital markets; and (iv) reforms supported by both pillars will improve efficiency, investment, and growth.

31. **The FEG-DPL series takes into account lessons learned from previous development policy lending and IBRD support**. It builds on three lessons about what is essential for results: (i) strong government ownership; (ii) significant new supportive policy initiatives that are directed to high-priority issues; and (iii) a solid track record of Bank engagement. The government requested the FEG-DPL to support its institutional reforms to strengthen fiscal effectiveness, SOE performance, and market institutions, all of which are high-priority reform areas with deep Bank engagement.

PRIOR ACTIONS AND RESULTS

Pillar A: Strengthening Fiscal Management and SOE Performance

32. **Pillar A focuses on three policy areas**:

- **Strengthening debt management.** Fiscal management has been good, but weaknesses in debt management capacity have resulted in a shallow domestic government securities market that lacks basic instruments and long maturities. This raises Romania's vulnerability to external shocks and rollover risk and limits cost-effective government financing options. The measures supported are designed to result in a comprehensive medium-term debt strategy and annual borrowing plans that have longer maturities, deepening the government securities market.
- **Improving the quality of public spending.** While the government has exerted firm discipline on fiscal and aggregate expenditure, the quality of public spending is still low, and results from previous years do not influence budget formulation. As for investments, commitments are large, execution rates are low and there is a backlog of long-overdue, unfinished investments, including some that are EU-funded. Social protection spending is fragmented, resulting in unnecessary administrative burdens and other inefficiencies. Measures supported would introduce results-

informed budgeting, better prioritize public investments, and make social protection programs better targeted and more effective.

- **Improving SOE governance and performance.** Romanian SOEs perform poorly, resulting in sizeable fiscal and quasi-fiscal losses, in part because methods for their monitoring, control, and governance are antiquated. As a result, SOEs in aggregate have been operating at a loss since 2009 and their estimated payment arrears as of 2013 amount to about 2.0 percent of GDP (measured based on central and local SOEs that are not undergoing insolvency procedures). In response, the government has formulated measures to significantly tighten its oversight. Building on current efforts to professionalize the boards and management structures of all SOEs, measures supported would improve monitoring and accountability mechanisms for better governance, financial management and controls resulting in lower losses and greater value to taxpayers.

1. Strengthening Debt Management

DPL1 Prior Action #1: The Ministry of Public Finance (MOPF) has approved and published ***the rolling medium-term debt management strategy (DSM) for 2014–16 and the corresponding 2014 Annual Borrowing Plan (ABP)*** to build up the government securities market.

DPL1 Prior Action #2: The National Bank of Romania (NBR) has introduced ***an electronic auction facility for government securities in the primary market*** and started to hold auctions on March 2014.

DPL2 Trigger #1: MOPF has ***issued the legal and operational guidelines for managing liability operations*** and facilitated the ***establishment of a new electronic trading platform*** to improve the price disclosure, transparency and functioning of secondary markets.

33. **Since EU accession in 2007 the government debt market has developed rapidly, but the institutional framework needs to be further improved.** While the external debt market continues to be tapped successfully, the domestic securities market is underdeveloped. Because there are few liquid benchmark bonds, mostly of short and medium-term maturity, and relatively little trading in the secondary market, the yield curve is not yet a suitable pricing reference. Also, debt management risks are significant given the large share of foreign currency debt and the short average maturity of domestic debt—5.5 years for foreign currency debt, but only 2.7 years for domestic debt.

34. **The necessary reforms of the institutional framework for debt management have begun.** With accession, MOPF became the sole administrator of government debt and the General Directorate for Treasury and Public Debt (GDTPD) was reorganized into front, middle and back offices. The reform focus has now shifted to sharpening the Debt Management Strategy (DMS) and operationalizing it using Annual Borrowing Plans (ABP) to make debt management operations more predictable for the budget and markets. The previous DMS (for 2013–15) acknowledged that the portfolio was exposed to financial risks, but it was not linked to the 2013 ABP, which was formulated before the DMS. The DMS for 2014-16 and the 2014 ABP have been approved and are better connected and mutually consistent ***(Prior Action #1)***. In particular the 2014-16 DMS reassesses the share of local currency debt and the indicators for managing the interest rate and refinancing the exposure of local currency debt, while the 2014 ABP lays the foundations for building up benchmarks with targeted amounts and maturities and improving predictability and transparency in the primary market. This is expected to reduce the risk that GDTPD will deviate from the planned policies, including a sustained increase in local currency funding, and consolidate its credibility with market participants.

35. **MOPF and NBR are also modernizing platforms for both primary and secondary markets and other elements of the basic market infrastructure**. A fully electronic auction system was introduced at the NBR in March for the primary government securities market and is fully functional ***(Prior Action #2)***. The system's interface to the debt management system (FTI STAR) in MOPF is

advanced, allowing MOPF to have real-time access to primary market data and conduct necessary analysis. Plans are advancing to launch an electronic platform for the secondary market in the fourth quarter of 2014. The launch will require introducing a new framework for the primary dealership system based on primary dealers agreements; introducing legal, and procedural changes; and creating an operational framework to manage liabilities (buy-backs and bond exchanges) and for active cash management (repo/reverse repo) ***(Trigger #1)***. The electronic trading platforms will increase price disclosure and transparency.

36. **The institutional system will also be enhanced by creating a Policy Committee and a Technical Implementation Committee and revising the distribution of tasks within GDTPD along functional lines.** The Policy Committee will be responsible for harmonizing policies with the NBR and the Technical Implementation Committee for internal coordination of cash, debt and liability management (e.g., improving cash flow forecasting and introducing new cash management instruments). Analytical and execution functions are also being revised to reduce operational risk (e.g., unifying all market-based operations in the front office and ensuring seamless execution).

37. **These reforms are expected to improve debt risk management and reinforce government ability to meet financing needs cost-efficiently, which will help build up the capital market.** Along with a benchmark-building strategy, a more focused DMS and an ABP that is more transparent and makes DMS implementation more predictable should help make the secondary market more liquid. Cash and liability management will boost GDTPD's ability to manage refinancing risk and reduce carry-on cash balances. The electronic trading platform would enhance price discovery and support greater liquidity in the secondary market. In building up capital markets, these reforms will have multiple spillover benefits for the financial sector and the economy as a whole: deeper and more liquid government debt markets; new instruments and intermediaries to finance job-creating enterprises and critical public infrastructure; relatively risk-free investment opportunities for institutional and retail investors, stimulating the growth of savings, and additional tools for managing monetary policy through open market operations and repo facilities. Table 5 outlines how results will be measured.

Table 5: Indicator of Improved Debt Management

Indicator	Baseline	End-2014	End-2015	End-2016
Average maturity of domestic debt (years)	2.7 (2013)	2.9	3.5	3.7

Source: General Directorate of Treasury and Public Debt in the Ministry of Public Finance.

2. Improving the Quality and Effectiveness of Public Spending

38. **Management of aggregate expenditures has been solid and contributed to fiscal discipline, but the quality of public spending is still a major issue.** In the early 2000s the government took steps to introduce program and multiyear budgeting, but the effort was not sustained. Today's more realistic goal is to improve multiyear budgeting to enhance predictability, better align Romania's budget to the EU budget cycle, and gradually introduce results-orientation. To this end, the central government seeks to: (i) better measure results that can be used to inform budget allocations; (ii) better manage public investments; and (iii) improve basic spending policies. Better management and planning of the wage bill (aiming at implementing the 2011 Unitary Pay Law) is also part of the plans to improve multiyear budgeting.

Results-informed Budgeting

DPL1 Prior Action #3: Parliament has amended the Public Finance Law No. 500/2002 through Law 270/ 2013 and, based on these amendments, MOPF ***has issued a detailed action plan for preparing and executing results-informed budgets.***

DPL2 Trigger #2: The Government of Romania (GOR) has adopted ***the 2015 budget, which applies the results-informed framework*** **to two pilot ministries.**

39. **Introducing results-informed budgeting is a GOR priority.** Parliament recently amended the Public Finance Law to instruct MOPF to improve the preparation and execution of results-informed budget programs and MOPF has issued a detailed action plan ***(Prior Action #3)***. The plan requires early selection of two pilot ministries; issuance of methodological guidance on program budgeting to those ministries; appointment of focal persons; and circulation of letters and detailed budget proposals based on results of programs in the two pilot ministries and other diagnostic reviews of budget classifications and chart of accounts.

40. **The Ministry of Health and the Ministry of National Education have been selected as pilots to apply the results-informed budget methodology in their 2015 budgets (*Trigger #3*).** These two ministries are well-suited for this given their development challenges and because their key programs are amenable to a definition of outcome indicators and their monitoring and evaluation systems can be adjusted to reflect the results focus. The pilots are expected to be mainstreamed and extended to other ministries in the 2016 budget and then, gradually, to all budget entities.

Public Investment Management

DPL1 Prior Action #4: GOR has approved Emergency Ordinance No. 88/2013 ***setting up a system for prioritizing significant (over 100 million RON) public investments*** and has approved Decision No. 225/2014 on methodological norms for the implementation of such system.

DPL2 Trigger #3: GOR has prioritized large public investment projects using the new legal framework and adopted a ***Decision that only prioritized projects vetted by MOPF are included in the 2015 budget.***

41. **Romania does not have a government-wide system to manage and prioritize investments.** This is a major flaw in overall spending policy and fiscal management. While EU-funded projects follow established criteria, projects funded from national and local budgets do not. Also, projects are not prioritized within and across sectors at any point. Yet as a percent of GDP Romania's public investment budgets have been among the EU's largest for the past decade. As a result, in some sectors, such as transport or regional development, the public investment portfolio far exceeds available medium-term resources, even after accounting for EU funds. Also, implementation of almost a quarter of investments has been underway for over 10 years. The investment portfolio needs to be rationalized, and non-performing projects cancelled.

42. **The government is now moving to better manage public investment.** MOPF has set up a Public Investment Evaluation Unit to coordinate priorities. The government has also adopted an Emergency Ordinance (#88/2013) naming MOPF as the secretariat for prioritizing public investments considered significant (above Lei 100 million, or about €22 million), and the government has approved the methodology to operationalize investment priorities ***(Prior Action #4)***. Prioritization is in fact expected to be applied this year to all ongoing and new significant investment projects to ensure that such projects in the 2015 budget meet the criteria ***(Trigger #4).*** Projects that are co-financed from EU funds will be prioritized based on EU regulations.

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Pro-poor Spending

DPL1 Prior Action #5: GOR has approved a Memorandum on March 26, 2014 assigning to the inter-ministerial committee on the Minimum Social Insertion Program (MSIP) the ***preparation of specific legal and institutional steps to introduce MSIP in the first calendar quarter of 2016, including provisions to increase incentives for work***.

DPL2 Trigger #4: ***Parliament has adopted the Law on Introduction of the MSIP***, including addressing disincentives to work.

43. **The Ministry of Labor, Family, Social Protection and the Elderly (MLFSPE) has been building up the social assistance system**. The intent is to better cover the poor, enhance targeting (the percent of total resources spent on the poorest households), and improve generosity (whether the benefit is adequate to lift a family out of poverty). To this end, in October 2013 the MLFSPE simplified the eligibility criteria, in particular the assets filters, which were excluding a large share of poor households. This is part of a plan for a new flagship program, the ***Minimum Social Insertion Income Program (MSIP)*** *by* consolidating three existing means-tested programs: the heating benefits, the family benefit, and the guaranteed minimum income program. To ensure the introduction of the consolidated program by early-2016 proceeds smoothly, GOR has issued a Memorandum that assigns to an inter-ministerial committee preparation of the MSIP introduction (***Prior Action #5)***. Based on this, the MLFSPE has prepared the draft law on introduction of the MSIP and in the next several weeks will initiate extensive consultations with municipalities and beneficiaries. The time table envisages submission of the MSIP Law to Parliament in September 2014 for approval before year end **(Trigger #4)**.

44. **In addition to changing the law, the MSIP roll-out requires an integrated information system to manage the new benefit, including payments, cross-data checks and monitoring**. This requires coordination between the MLFSPE, the MoPF, the Ministry of Regional Development and territorial units responsible for key processes, such as assessments.

45. **The MSIP is expected to bring significant benefits to the poor at lower cost to the budget.** It is expected to ramp-up coverage, targeting and generosity of benefits for the bottom income quintile of the population and to provide adequate coverage to the second quintile. It is therefore expected to provide support to more than the 22 percent of the population who are below the EU poverty threshold of 60 percent of national median income. If the budget allocation for the MSIP is increased over time, the larger the benefit of this measure to the bottom 40 percent would be. Current expectations are that the budget allocated to the MSIP will increase from 1.1 billion RON in 2013 to about 2.5 billion at maturity in 2016 (from 0.2 to 0.3 percent of GDP). The PSIA section below elaborates on these points.

46. **The change in the benefit formula will give poor households incentives to move from assistance to a combination of assistance and employment.** When they take up employment, only a fraction of their formal earnings (50 percent of their formal wages or 25 percent of their presumed agricultural income instead of today's 100 percent) will be included in the administrative definition of income to be tested. This will increase the eligibility thresholds for households whose members find employment. A review of employment responses to similar reforms across the world suggests that due to this measure 7 to 17 percent of beneficiary adults who do not work are likely to switch to part- or full-time employment. The evidence suggests that this is particularly likely for households headed by single women. The expected results of these reforms are shown in Table 6.

Table 6: Indicators of Improved Public Spending

Indicator	Baseline	End-14	End-15	End-16
Results-informed budgeting: Share of total budgets of pilot ministries presented by programs linked to and informed by results indicators, percent.	0[a] (end-2013)	0	30	50
Large public investments: Average time to complete a significant project (after the completion, restructuring or cancellation of ongoing projects and the approval of new projects), years.	12[b] (Budget 2014)	10.5 (Budget 2015)	9.5 (Budget 2016)	8.0 (Budget 2017)
Pro-poor spending: Coverage of the poorest 20 percent of the population by the MSIP during the January to March season, percent.	62[c] (2012 data)	[40][c] (2013 data)	50[c] (2014 data)	65[c] (2015 data)

Sources: MOPF budget and investment units; and MOLFSPE and World Bank staff calculations based on the Romanian household surveys.

[a] Although part of the budgets of the pilot ministries are currently related to programs, at the presence none of them follow the new methodologies

[b] Calculated based on significant investments projects (over 100 million RON) included in the 2014 budget.

[c] Calculated as total coverage of the poorest 20 percent of the population by the three means-tested programs after correcting for their under-reporting in the survey. In 2012 total coverage of these programs was estimated at 35 percent for the bottom quintile (during the first quarter), increasing to 62 percent after correcting for true population coverage.

3. SOE Governance and Performance

DPL1 Prior Action #6: GOR has approved a Memorandum on April 2nd, 2014 ***on state ownership and oversight*** that clarifies the responsibilities of the line ministries and MOPF for monitoring, advocacy for good governance, transparency, and financial reporting.

DPL2 Trigger #5: Parliament has adopted the ***Law on corporate governance of SOEs*** based on the Emergency Ordinance 109/2011 and its evaluation.

DPL2 Trigger #6: GOR has ***launched* privatization proceedings, including *IPOs, for at least two SOEs*** in both Bucharest and/or international markets with enhanced transparency and accountability.

47. **Romania's SOEs are inefficient and poorly governed, contributing to fiscal and quasi-fiscal losses and payment indiscipline in the economy.** SOEs have dominant positions in energy (53 percent of sector turnover); and transport and storage (34 percent); and a large presence in mining and quarrying, as well as in roads and water. Some large SOEs may be insolvent. Many have both tax arrears and arrears to suppliers that while reduced over the past two years, are still above 2 percent of GDP. Their performance and governance practices have weakened SOEs so much that some cannot survive in a competitive environment. Besides their financial shortfalls, the services they provide, especially infrastructure, are considerably below EU norms. The root cause of these problems has been the inadequacy of governance, monitoring, and oversight of SOEs.

48. **In 2011 the authorities launched a comprehensive SOE reform program to** (1) improve pricing and the regulatory framework (particularly in energy and transport); (2) clarify public sector obligations and ensure they are budgeted for efficiently and effectively (e.g., subsidies for rail transportation more closely linked to utilization than to norms); (3) launch a privatization program (IPOs for energy SOEs, and there were attempts to privatize two commercial enterprises, in the chemical and transport industries, but both failed); and (4) improve the role of GOR as owner of SOEs. Depoliticization of board and management appointments began with enactment of Emergency Ordinance 109/2011 (EO109/2011). On privatization, five initial public offerings (IPOs) and two secondary public offerings (SPOs) were launched in the energy sector. Both SPOs and two IPOs have been completed. The other three IPOs are underway — scheduled for 2014 or 2015. Attempted majority privatizations that failed were for a petrochemical company, which is now in insolvency proceedings, and for a freight company. Also, one large energy generation company, Hidroelectrica, is being reorganized through

insolvency.[3] Finally, MOPF has started to systematically monitor SOEs budgets and arrears. A comprehensive arrears reduction program has been launched with support from the EU and the IMF.

49. **If SOE are to perform better, there must be improvements in how the government's functions as a shareholder that address gaps in SOEs policy, and continues IPOs and other privatization efforts.** The goal in all cases is better performance oversight and accountability for SOEs:

- ***The Memorandum approved on State Ownership and Oversight sharpens management of national SOE portfolio*** (***Prior Action #6)***. It clarifies the responsibilities of line ministries and MOPF for corporate governance, financial reporting, accountability, transparency, and monitoring and assessment of SOE management. It also promotes good practices, such as movement toward international financial reporting standards (IFRS)[4].
- ***The Law on Corporate Governance of SOEs will build upon the principles already embedded in EO109/2011 (Trigger #5)***. The objective of this Law is to upgrade the status of EO109/2011. It is also expected to introduce an accountability framework to line ministries and local government, complete with penalties. The government has commissioned an independent assessment of the implementation of EO109/2011 which would provide key inputs to the law.
- ***These actions will be complemented by increasing market and shareholder oversight as major SOEs are sold and listed in capital markets in and beyond Romania (Trigger #6)***: New privatizations will build on the IPOs launched in 2013, such as that in November 2013 for Romgaz, which sold 15 percent of its shares on the Bucharest Stock Exchange with Global Depository Receipts traded in London. The Romgaz IPO was oversubscribed and raised both foreign and domestic interest in the equity market. Work has started on a 15 percent IPO for Hidroelectrica, one of the largest electricity producers, a 51 percent IPO for the electricity supply and distribution company Electrica, and a 15 percent IPO for Oltenia, the third largest coal-fired electricity generation company in Romania. Expected results are summarized in Table 7.

Table 7: Indicators of Improvements in State-Owned Enterprises

Indicator	**Baseline**	**End-2014**	**End-2015**	**End-2016**
SOEs receiving unqualified audit opinion, number	8 (2013)	9	15	20
SOEs reporting under IFRS, number	5 (2013)	4	16	20

Source: Companies and SOE's oversight unit at the Ministry of Public Finance.

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

50. **To enhance growth prospects, Romania needs to build up its institutions and increase investor confidence and private investment, both of which require well-functioning markets**. This pillar, therefore, supports reforms to: (i) strengthen **institutions and safeguards for private property rights**; (ii) complete **liberalization of energy markets**; and (iii) improve the functioning of **capital markets.**

51. **These reforms are complementary to those supported by the first pillar; they are intended to re-invigorateg private investment and growth**. Critical and long-overdue reforms in the cadaster area can be expected to clarify and enhance trading of property rights and support greater investment and collateral-based lending to the private sector. Completing liberalization of electricity and gas markets and integrating them more closely with pan-European markets would enhance efficiency of supply and

[3] Hidroelectrica was successfully restructured through insolvency in June 2013, but in March 2014 the company had to return to the insolvency process because of a court decision to reopen litigations of claims by two creditors.
[4] EU's International Accounting Standards regulation 1606/2002 (IAS - IFRS) determines that member-states may permit or require non-publicly-traded companies to publish financial statements that comply with IFRS. Romania has not required unlisted SOEs to do so.

investments in energy infrastructure. Finally, reforms to build-up the non-bank financial sector and more efficient capital markets are needed to foster economic growth, especially since bank lending is expected to be constrained over the medium term.

Strengthening Institutions and Safeguards for Private Property Rights

DPL1 Prior Action #7: GOR has approved the Emergency Ordinance No. 8/2014 ***establishing the operational and financial independence of the National Agency of Cadastre and Land Registration*** for investments to increase coverage of rural and urban real estate registration.

DPL2 Trigger #7: ***Parliament has adopted a new Law on Cadastre and Real Estate Registration*** replacing Law 7/1996, which reflects European best practice of corporate governance and providing professional, inclusive and service-oriented land administration services.

52. **The lack of reliable information on real estate property rights in Romania is obstructing development of markets for property rights and discouraging private investments.** For instance the cost of first registration is prohibitive, especially in rural areas where only 10 percent of real estate, compared with 39 percent in urban areas, is registered. Further, the land restitution process begun in the early 1990s has not yet formally finished, causing further uncertainty about property rights. Finally, long settlement proceedings add even more uncertainty, which is an incentive to informality.

53. **The impact of these shortcomings on the bottom 40 percent of the population, especially farmers, other rural dwellers, and informal urban dwellers, is significant**. Shortcomings also deter EU-financed structural investments and cause inequalities in opportunities for farmers to absorb EU Common Agricultural Policy (CAP) funds. Broadening coverage of real estate registration is crucial to improve the functioning of land and other property markets, which could trigger new investments, increased farmer and investor participation in markets, and lead to greater absorption of EU funds.

54. **The government's strategy to address these issues is three-fold**:

- **The National Agency for Cadastre and Land Registration (ANCPI) has been granted greater financial autonomy to carry out investments related to registration *(Prior Action # 7).*** ANCPI was created in 20114 by unifying court-based land registers with the cadastre agency. Currently, ANCPI operates an electronic cadaster and a land registration system, eTerra, which is country-wide. Land and property restitution has been completed in Romania in terms of land allocation though not compensation, and most farmers and urban dwellers have land titles. However, registration of titles was left voluntary. ANCPI's goal is to register all the properties and land titles in eTerra, but currently it covers only 6.3 million properties (including apartments), constituting about 15 percent of the total number of real estate assets in Romania. In 2009, ANCPI lost its original autonomy and self-financing status reverting to central budget financing. This led to payroll restrictions, loss of key staff, and much slower progress on reform. Training and capacity building were underfunded, and the pace of registration slowed significantly. Finally, the Cabinet, via the Emergency Ordinance 8/2014 has granted ANCPI the ability to pursue reforms, jumpstart land registration, and improve operations in a financially sustainable, efficient, customer-oriented, and socially inclusive way. It did this by granting ANCPI the ability to retain registration fees and use them to finance the National Program, which aims to complete real estate registration nationwide. The ordinance also improves ANCPI's financial accountability. This represents a good first step toward better ANCPI governance and accountability, but a full governance framework would need to be part of the new law to cover, among other areas, more details on board composition, tenure and an accountability framework for more than financing aspects.
- **The GPR is working to alleviate legal constraints that hinder ANCPI operations (*Trigger #7)***. It

has begun to consolidate currently dispersed regulations related to real estate registration into a single comprehensive and harmonized law. Simply amending law 7/1996 on cadastre and real estate registration is no longer viable because numerous past amendments have made the law incoherent and illogical. The new law will enable ANCPI to operate a professional, inclusive and service-oriented land administration service. Also, the new Law on Cadastre and Real Estate Registration will need to refine governance and management structures of ANCPI, which have fallen behind European best practices

- **The Government has reactivated its systematic registration campaigns**. It will launch a campaign in rural areas with EU funding and accelerate urban land registration with co-financing agreements between municipalities and ANCPI. The campaign should make it possible to register over 20 million new properties in rural areas over the next eight years. In urban areas, real estate register coverage is expected to be complete by 2023 (Table 8).

Table 8: Real Estate Registration Indicator

Indicator	**Baseline**	**End-2014**	**End-2015**	**End-2016**
Coverage of urban real state registration (percent of all urban real estate).	39 (end-2013)	42	45	49

Source: ANCPI.

Liberalization of Energy Markets

DPL1 Prior Action #8: The National Energy Regulatory Authority (ANRE) has issued the Orders ***fully liberalizing the nonresidential electricity market.***

DPL2 Trigger #8: ANRE has issued the Orders to ***completely liberalize the nonresidential gas market***.

DPL2 Trigger #9: Transelectrica and the relevant authorities and stakeholders ***have completed ownership diversification of the energy market operator (OPCOM)*** and OPCOM *has coupled the* ***Romanian Day Ahead Market with electricity markets in Hungary, the Czech Republic, and Slovakia***.

55. **ANRE has been pursuing the liberalization of gas and electricity markets.** Romania's energy strategy since the late 1990's has been to: (1) transpose and implement the EU's energy acquis; and (2) attract private investments and professionalizing management of SOEs to secure energy supply and export to Europe. The 2003 energy strategy, "the Road Map for the Energy Field," guided restructuring, liberalization and Romania's accession to the EU in the area of energy reform. In 2011, the government again took up energy reform. In 2012, Parliament adopted a new electricity and gas law, which restored ANRE's operational and financial independence and empowered it to continue energy market reform. ANRE completed liberalization of the nonresidential electricity market in early 2014 ***(Prior Action #8)***, and expects to do the same for the nonresidential gas market in 2015 **(Trigger #8).** At the same time, wholesale electricity and gas prices for non-residential consumers will be fully determined by market forces in the energy market trading platforms.

56. **Meanwhile, Transelectrica, the electricity transmission company, authorities (including the Cabinet) and stakeholders plan to complete diversification of the ownership of OPCOM,** which operates Romania's power exchange and is currently ranked 8th in Europe in volume traded.[5] OPCOM

[5] For gas, ANRE licensed in mid-2013 and OPCOM and the Romanian Commodities Exchange later in 2013 both launched trading platforms initially targeting monthly contracts. Time will tell if there will be enough liquidity on two parallel gas exchanges. Romania's target is for trading on centralized markets to reach a volume of at least 2 billion cubic meters/annum by 2016.

is part of Transelectrica, which has been overseen by the Prime Minister's office since January 2014. Trading in OPCOM's day-ahead and centralized auctions of bilateral contracts has grown steadily since 2005 and reached about 26 percent of total electricity supply by 2011. With the electricity market liberalized, OPCOM's share increased to 35 percent in 2012 and 73 percent in 2013, accounting for most of the non-residential electricity supply. Meanwhile, negotiations are advancing to complete the coupling of OPCOM's day-ahead market with Hungarian, Czech, and Slovakian electricity markets by early 2015 (***Trigger #9***). Several decisions must still be made about possible merger with Poland's markets, though that is expected to take longer. Table 9 shows the expected results in this area.

Table 9: Results Indicators in Electricity

Indicator	**Baseline**	**2014**	**2015**	**2016**
Electricity contracted for the same-year delivery on the OPCOM market (Twh)	38.3 (2013)	40.8	42.0	45.0
Amount of natural gas traded at centralized platforms, billion cubic meters.	0.0	0.2	1.1	2.0
International trade in electricity, exports plus imports (Twh)	2.6 [a] (2012)	3.4	3.9	4.0

Note: For OPCOM trade, the indicator covers the Day Ahead Market, Intraday Market, and Centralized Market for Electricity Bilateral Contracts (the trading platform for non-standardized and Standardized Products: Weekly, Monthly, Quarterly, Yearly, Multi-Yearly Base, Peak and Off-Peak Products, including trade in public auctions and through continuous negotiations). In 2013 the volume represented 73 percent of Romania's consumption.

[a] Includes exports for 1.1 Twh and imports of 1.4 Twh. In 2012, however, trade volumes were low and the balance was negative for the first time. Average exports in the previous three years (2009-11) were 2.8 Twh and average imports 0.7 Twh. Physical border exchanges, as reported by ENTSO-E, are much higher due to balancing needs (8.8Twh in 2012 and 7.4 Twh in 2013).

Capital Markets

Prior Action # 9: GOR has approved Emergency Ordinance No. 94/2013 ***reducing the size of the Financial Supervisory Authority (ASF) board from 11 to 9 members and establishing minimum qualification requirements and conflict of interest principles for both board members and senior staff***, and Parliament has endorsed the revised composition of the ASF board through Decision 60/2013.

DPL2 Trigger #10: Parliament has adopted ***amendments to the Capital Markets Law*** to modernize the regulatory landscape, further enhance governance and accountability of ASF, and allow for secondary regulatory reforms to address key constraints hampering the development of capital markets.

57. **Romania's growth depends critically on a financial sector that is stable, resilient, and deep enough to efficiently intermediate savings and investments.** The banking system has made considerable progress in improving capital buffers and provisioning but balance sheets are still impaired and credit to the economy is limited. Also, with continued parent bank deleveraging and international capital flows subdued, it has become important to accelerate development of the nonbank financial sector and the institutional infrastructure for efficient domestic capital markets.

58. **Improving the functioning of capital markets will help to mobilize more domestic savings**. GOR's strategy for the development of the securities market focuses on non-government fixed income instruments (with long maturities), asset backed securities and collective investment schemes, and on establishing a framework (and capacity) to supervise and enforce market integrity in all these areas, taking into account macro-prudential considerations.

59. **Although supervision of capital markets has been integrated into the ASF, its credibility has been undermined by** (1) a large number of board members whose salaries are above reasonable benchmarks; (2) lack of a work plan for merging supervisory functions; (3) an outdated legal and

regulatory framework; and (4) concerns about governance. The government plans to address these issues as follows:

- **First, a basic framework for corporate governance was introduced by reducing ASF board size and setting qualification and conflict of interest criteria for both board members and staff *(Prior Action #9)***. After the recent ASF corporate governance reforms, a new chairman has been recruited on strict merit-based criteria. The changes represent the first of much-needed measures to improve the governance and accountability of the regulator; in this respect, a full governance review will need to be prepared this year to better define ASF's board and chairman hiring procedures, independence and accountabilities.
- **Second**, **ASF has also prepared its work program for 2014** to consolidate supervision and to better regulate collective investment schemes, securitization, and annuities plans.
- **Third, to address obstacles to market development, a group of public and private stakeholders have drafted a capital market plan.** The plan consists of short- and medium-term measures to remove barriers to capital market developments. The ASF is now reviewing and drafting a new capital markets law with comprehensive changes ***(Trigger #10).*** Among the recommendations are ways to reduce barriers to entry for new investors (particularly those from other EU countries and overseas) and ease the cost of listing on the stock market.

60. Table 10 shows the expected results of these reforms. The indicator aims to capture the potential increases in access to equity capital for private sector institutions, and the increased financial sector diversification.

Table 10: Capital Market Results Indicator

Indicator	**Baseline**	**2014**	**2015**	**2016**
Capital market procedures streamlined, number.	0 (2013)	10	18	18

Source: Financial Supervision Authority or Romania.

ANALYTICAL UNDERPINNINGS

61. **The FEG-DPL series is underpinned by extensive analytical work (**Table 11**),** such as the Country Economic Memorandum (CEM 2013) and several analytical Reimbursable Advisory Services (RAS) funded by the Romanian government. Work on the 11 newest EU member states (EU11) has complemented the country-specific work, particularly the EU11 Shared Prosperity Assessment and the EU11 Programmatic Energy Affordability Report. Finally, the Bank has prepared notes on financial and business environment issues.

Table 11: Prior Actions and Analytical Underpinnings

Prior Actions	**Analytical Underpinnings**
• **Prior Action #1**: The Ministry of Public Finance (MOPF) has approved and published the rolling medium-term debt management strategy (DSM) for 2014–16 and the corresponding 2014 Annual Borrowing Plan (ABP) to build up the government securities market. • **Prior Action #2**: The National Bank of Romania (NBR) has introduced an electronic auction facility for government securities in the primary market and started to hold auctions on March 2014.	• The functional Review of the Ministry of Finance, 2010 recommended measures for improvements in debt management functions. • WB technical assistance on debt management to MOPF (ongoing) specified key steps to improve liability management covering policy, operational procedures, legal and regulatory changes, and possible infrastructure upgrades.
• ***Prior* Action #3**: Parliament has amended the Public Finance Law No. 500/2002 through Law 270/ 2013 and, based on these amendments, MOPF has issued a detailed action plan for	• The 2013 CEM and DPL-DDO stressed the need for greater result-orientation of the budget. CEM motivated the need to improve public investment

Prior Actions	Analytical Underpinnings
preparing and executing results-informed budgets. • **Prior Action #4**: The Government of Romania (GOR) has approved ***Emergency*** Ordinance No. 88/2013 setting up a system for prioritizing significant (over 100 million RON) public investments and has approved Decision No. 225/2014 with methodological norms for the implementation of such system. • **Prior Action #5**: GOR has approved a Memorandum on March 26, 2014 assigning to the inter-ministerial committee on the Minimum Social Insertion Program (MSIP) the preparation of specific legal and institutional steps to introduce MSIP in the first calendar quarter of 2016, including provisions to increase incentives for work.	management systems. • The WB technical assistance report on public investment management in 2012 contrasted the significant gap between country systems and EU procedures (restarting in 2014). • The Romania Social Assistance system modernization project 2011 has been supporting gradual improvements in safety nets.
• **Prior Action #6**: GOR has approved a Memorandum on April 2nd, 2014 on state ownership and oversight that clarifies the responsibilities of the line ministries and MOPF for monitoring, advocacy for good governance, transparency, and financial reporting.	• The 2013 CEM highlighted the challenge of further reorganizing the ownership function in SOEs. • The World Bank Technical assistance on corporate governance for Transport Sector enterprises 2012 (ongoing). • The World Bank Functional Review of the Ministry of Economy and Energy, 2010 started the dialogue on the need to improve corporate governance for SOEs.
• **Prior action #7**: GOR has approved Emergency Ordinance No. 8/2014 establishing the operational and financial independence of the National Agency of Cadastre and Land Registration for investments covering both the rural and urban real estate registration.	• The World Bank Technical assistance on cadaster (ongoing) spelled out the institutional and operational strategy for properly rolling out registration in Romania
• **Prior Action #8**: The National Energy Regulatory Authority (ANRE) has issued the Orders fully liberalizing the nonresidential electricity market.	• The 2013 CEM and the 2010-11 Functional Review of the Ministry of Economy, the Energy Sector and Business Environment both emphasized the importance of liberalization of energy markets.
• **Prior action #9:** GOR has approved Emergency Ordinance No. 94/2013 reducing the size of the Financial Supervisory Authority (ASF) board from 11 to 9 members and establishing minimum qualification requirements and conflict of interest principles for both board members and senior staff, and Parliament has endorsed the revised composition of the ASF board through Decision No. 60/2013,.	• Financial and private sector policy note for CPS. • Capital markets rapid assessment (early 2014).

LINK TO THE CPS AND OTHER OPERATIONS

62. **The FEG-DPL series is a core activity of the 2014–17 Country Partnership Strategy (CPS),** which will be presented to the Board together with this operation. The CPS is built around three pillars: (i) further modernization of the public sector; (ii) growth and job creation; and (iii) social inclusion. This DPL series supports the first two pillars.

63. **By focusing on fiscal effectiveness, SOEs, and the private markets agenda, the FEG-DPL complements other Bank operations in Romania**. The FEG-DPL has been closely coordinated with and complements the following operations: (i) the ongoing DPL-DDO, which supports reforms in the public sector, health and energy; (ii) the Revenue Modernization Project (FY14); (iii) the Social Assistance System Modernization (FY12) Project; and (iv) the recently approved Health Modernization Program.

CONSULTATIONS AND COLLABORATION

64. **All Romanian legislative measures and reforms are subject to thorough consultation with social partners, civil society, and groups likely to be affected**. The Constitution guarantees public information and consultation on legislative initiatives by mandating parliamentary debate and approval.

Legislative policy initiatives must be posted on the internet for 30 days for consultations and feedback, with a background note justifying them and discussing their expected social and economic impact. Emergency ordinances introducing policies must be endorsed by the Parliament before they go into effect, and they must also comply with public consultation requirements.

65. **The Bank, jointly with the IMF and the EC, has consulted with a wide range of stakeholders on the specific measures supported by the DPL series**. These three agencies visit Romania every quarter and discuss the proposed reforms with social partners (e.g., unions, business associations, stock market participants), Parliament, and political parties. The latest consultations took place at the end of January 2014. There is a broad consensus among stakeholders on the main elements of the reform agenda. Many of the proposed reforms have been debated in conferences, workshops, and the media.

66. **The Bank is collaborating closely with development partners to ensure that the proposed measures are complementary.** While the arrangements focus on continued economic stabilization and financial sector resilience, they also include structural reforms of macro-systemic importance in health and the business environment (EU), and SOE arrears and privatization (IMF and EU). The Bank has also coordinated with the European Bank for Reconstruction and Development on SOE-related issues; and with the European Investment Bank on public investment management.

V. OTHER DESIGN AND APPRAISAL ISSUES

POVERTY, SOCIAL AND GENDER IMPACT

67. **Romanians are among the poorest citizens in the EU and even poorer than the populations of some non-EU European countries.** The US$5/day (PPP) poverty rate fell from 44.4 percent in 2006 to 37 percent in 2011. The official at-risk-of-poverty (AROP) rate was also high at 22.6 percent in 2012, and the risk of poverty or social exclusion rate (AROPE) was 41.7 percent.[6] Poverty remains closely associated with low levels of education, high levels of unemployment or inactivity, low job quality and gender gaps.

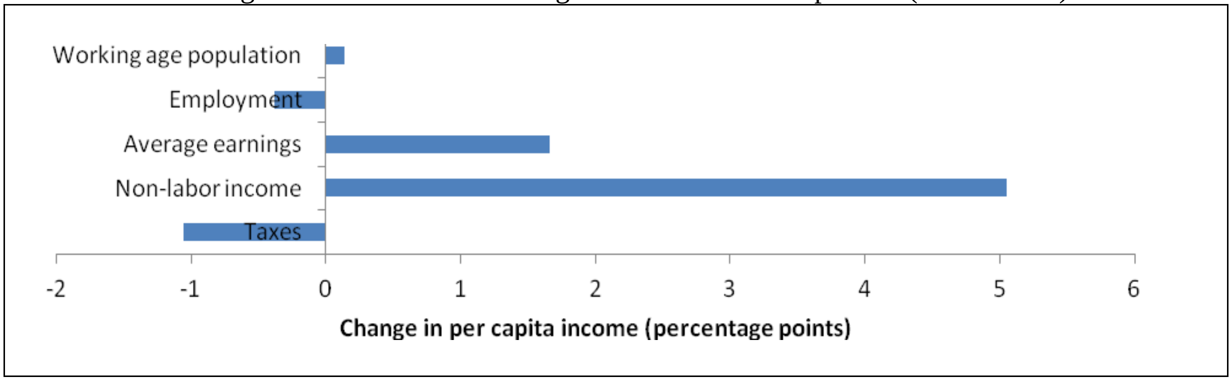
68. **Gender gaps persist**. The labor force participation rate for women aged 15–64 was 56 percent in 2011, compared to 71 percent for men, with similar numbers for employment rates. This is lower than the OECD average for women (62 percent). Women's salaries are 88 percent of men's, although the gender pay gap is below the EU average. Formal childcare arrangements are sparse: only 3 percent of children under 3 had formal childcare for at least 30 hours a week in 2010 (versus an average 14 percent in the EU). Finally, old age and inactivity are associated with higher poverty among women. For the 65+ age group the AROP rate for women (18 percent in 2011) was more than twice that of 65+ year old men (8 percent), although both were below the national average. Women living alone also had a much higher AROP rate (27 percent) than men (17 percent) in 2012.

69. **Roma exclusion is severe.** Only 12 percent of Roma men and 6 percent of women complete secondary school, the lowest rates in Europe. The early school leaving rate for Roma aged 18-25 is a staggering 95 percent. Because the Roma constitute 8 to 15 percent of the labor market entrants (a share that will continue to grow), exclusion affects both equity and national economic growth.

[6] AROP is the standard EU measure of relative poverty, based on a poverty threshold of 60 percent of median national income. AROPE is the poverty and social exclusion indicator for the Europe 2020 strategy, and combines AROP with indicators of material deprivation and low employment.

70. **Decomposition of income growth for the bottom 40 percent reveals that non-labor income – largely pensions but also social benefits – was the main driver during 2007-2010**. Transfers from pensions and untargeted social programs were the main source of improvements in income for the bottom 40 percent (Figure 3). These sources of income growth for the poor are fiscally unsustainable due to the demographic reality that Romania population is aging, which has been exacerbated by the out-migration of younger workers.

Figure 3: Sources of income growth for bottom 40 percent (2007 - 2010)



Source: Azevedo and Nguyen (forthcoming) using 2008 and 2011 EU-SILC files, accessed February 6, 2014
Notes: Shapley decomposition of income growth of the bottom 40 percent using income per capita (2005 USD PPP). All categories represent changes from the baseline year. Employment refers to the share of employed individuals with non-zero earnings.

71. **Poverty and social impacts of the DPL are expected to be neutral or positive.** The measures supported aim to help strengthen Romania's growth potential, make public spending more effective and, therefore, create the basis for sustained, poverty reduction and shared prosperity in the future. The DPL measures support better quality of public spending and better targeting of social spending (Pillar A) which is important for shared prosperity. It also aims to improve the functioning of property, energy and capital markets, which should improve the ability of individuals and businesses to mobilize human and physical capital and to mitigate risks (Pillar B). SOE restructuring reforms will result in some loss of employment, but the overall social impact will be limited because only 19 percent of SOE workers were found to belong to the bottom forty percent of the population and also because of compensating severance payments. Since severance payments are generous (at first fully covering the lost income of the bottom 40 percent), the long-term impact depends on whether those who are in the bottom 40 percent find employment once severance payments are exhausted after 12-14 months. If none of them find a job and cannot receive social benefits, the poverty rate (at US$5 PPP) can be expected to increase by between 0.2 and 0.3 percentage points. This scenario is unlikely however, given the envisaged expansion of safety nets supported by the operation (see Annex 4).

72. **The gender impact of the DPL is expected to be positive.** The majority of reforms will not affect men and women in different ways, though the planned revision of the benefit formula for the MSIP aimed at incentivizing work should be particularly beneficial to poor working women. As for the gender impact of the SOE reforms a detailed examination of the sectors where SOE dominates (transportation and energy) suggest female employment is relatively low: although 51 percent of the country's employees are male, according to the 2011 Household Budget Survey that is true of 79 percent of transportation and energy SOE employees. As for property registration reforms, the Bank and the European Union will encourage a gender-responsive expansion of property registration to further enhance the gender equality impact of the reforms supported by this DPL.

ENVIRONMENTAL ASPECTS

73. **The policies supported by the FEG-DPL series are not likely to have much impact on Romania's environment, forests, water resources, habitats, or other natural resources.** Scenarios for significant direct or indirect negative impacts appear very unlikely. Romania has adequate environmental controls, and its legislation and regulations are closely aligned with EU directives. Romania has adopted the EU guidelines for integrating environmental assessments into project planning and programming and the EU Environmental Liabilities Directive setting out liability for damage to properties and natural resources.

MONITORING AND EVALUATION

74. **The Bank is working closely with the Ministry of Public Finance, the Prime Minister's Office, and sector ministries to assess reform progress and impacts.** MOPF will facilitate the overall coordination and implementation of the DPL supported reforms, including monitoring results, through the committee chaired by the Minister Delegate for the Budget. The committee was established pursuant to Prime Minister's Decision no. 226/2012, as later amended (Prime Minister's Decision no. 122/2013). Baseline and updated data are provided by the relevant specialized agencies and tracked according to the indicators and outcome measures set out in the policy monitoring and results framework (Annex 1).

FIDUCIARY ASPECTS

75. **The Bank has a good understanding of the country's Public Financial Management (PFM) system and progress achieved**. A Country Financial Accountability Assessment (CFAA) was completed at the end of 2003, while a Country Procurement Assessment Report (CPAR) and a Public Expenditure and Institutional Review (PEIR) were published in 2005 and 2006. A Functional Review of the Ministry of Public Finance was carried out in 2010 and regular updates of the recent PFM reform activities have been carried out, and are reflected in the current PFM status. The annual budget and quarterly budget execution reports are available publicly in the web-site of the Ministry delegated for the budget.

76. **The Borrower`s PFM system, taken together with the Borrower`s commitment to acceptable PFM reforms, is adequate to support the operation**. The 2003 CFAA deemed the overall fiduciary risk associated with the PFM system moderate and it is assessed to remain as such with the recent PFM updates. In the areas of accounting, reporting and internal control, the fiduciary risk was considered significant, partly due to the heavy dependence on manual accounting and reporting processes, weak arrangements for management accountability and limited internal audit capabilities. The fiduciary risk was considered moderate in the areas of budgeting, treasury, cash management and external audit and parliamentary oversight. The fiduciary risk related to Bank's lending operations was considered low.

77. **Steady progress has been made in the development of PFM systems and institutions since the 2003 CFAA**. The recommendations of CFAA on improvement of treasury management, harmonization of accounting standards and practices, decentralization and rationalization of ex-ante financial control, and strengthening internal audit functions have been addressed by the Government. Fiscal discipline has been strengthened by amending and supplementing the 2010 Fiscal Responsibility Law in 2012 and 2013, respectively; and the 2002 Law of Public Finances in October 2013. New provisions: (i) clarify key terms such as commitment appropriations, budgetary credits, credit transfer, and credit redistribution; (ii) establish how various financing sources are presented in the budget accounts; and (iii) impose the obligation for spending units to inform suppliers, contractors and service providers about the allocated budget credits for public investment programs. Reporting and accounting functions are based on well-developed policies, including a unified budget classification and Chart of

Accounts, however manual intervention for collection, verification and validation of financial information is still practiced, limiting timely operational reporting and analysis. The quarterly in-year budget reports are reasonably accurate and detailed on economic and program level. To improve data collection, MOPF started in 2013 a project financed by the European Social Fund, which aims to develop an IT system for reporting of public sector financial statements. Key changes of this new reporting system are: (i) development of Treasury cash accounts of revenues and expenses at COFOG 3 level; (ii) control of payments vs. legal commitments in the Treasury; (iii) transmittal to MOPF by each public institution of a standard analytical trial balance; and (iv) elimination of consolidation of financial statements at the level of primary credit holders. Legislation has been passed in December 2013 to set up the framework for the new reporting system. The system is currently being tested, and it will become mandatory for all public institutions by June 30, 2015. The organization and effectiveness of the Court of Accounts has also improved.

78. **The Treasury Account in the National Bank of Romania (NBR) can be relied upon to hold proceeds from DPLs**. The June 2011 IMF safeguards assessment concluded that safeguards in place at NBR are generally adequate. The weaknesses identified by the previous (August 2009 and June 2005 safeguards) assessments have been addressed. Furthermore, the latest audit reports available had an unqualified (clean) opinion on NBR`s financial statements for 2011 and 2012. NBR can be therefore relied upon to account for the Banks loan proceeds from development policy operations, assuming that the arrangements are otherwise in accordance with the Banks policies and with specific mutually agreed terms for the operation. The Bank needs to take no further action in this area.

DISBURSEMENT AND AUDITING

79. **The proposed Loan will follow the World Bank`s disbursement procedures for development policy lending.** Loan proceeds will be disbursed in one single tranche to the foreign currency national budget account at the NBR, which forms part of the country's foreign currency reserves and budget management system. Disbursements will not be linked to specific purchases, and no evidence will therefore be needed to support disbursement, nor will procurement requirements be necessary. If loan proceeds are used for ineligible purposes as defined in the Loan Agreement, the Bank, upon notice, will require the Borrower to refund such amount promptly, and such amount shall be cancelled. Considering the Bank's knowledge of the public finance management systems, the ongoing improvements of these systems and the IMF assessment of the NBR, the Bank will not require an audit of the deposit account but will require the government to provide confirmation to the Bank on the amounts deposited in the foreign currency account within 30 days of receiving the funds, as detailed below. The front-end fee will be covered from the Borrower's own sources.

80. **As the borrower, MOPF will be responsible for the administration and accounting of loan proceeds.** The standard country rules will be followed by Treasury for administration and accounting. The proceeds of the loan deposited at the NBR will be used to cover the budget deficit and/or public debt refinancing. MOPF will be responsible for preparing withdrawal applications along with maintaining the deposit account as required. With the assistance of NBR it will maintain records of all transactions under the deposit account in accordance with sound accounting practices. The Borrower will report to the Bank within 30 days after receiving the loan amounts by sending a confirmation letter on the loan amounts deposited in the foreign currency deposit account.

VI. SUMMARY OF RISKS AND MITIGATION

81. **The risks related to the operation are substantial:**

- **Political and governance risks arise from domestic politics.** With parliamentary elections planned for May 2014, and presidential elections for November 2014, pre-election politics has intensified. Rearrangement of the coalition and ministerial posts in February 2014 exemplified these risks but this has so far not disrupted the pace of structural reforms. The government's updated reform program continues to emphasize macroeconomic prudence and structural reform. Nevertheless, risks remain. The main mitigating mechanism is the broad commitment by all political groups to the EU/IMF/WB supported reform program and the macroeconomic framework, as expressed during consultations in January. The broad consultations conducted so far and the government's strong electoral mandate from the 2013 parliamentary elections also mitigate this risk.
- **Macroeconomic risks stems from external and internal conditions.** Externally, tightening global financial conditions could push up global interest rates and slow recovery in the Eurozone, which could then depress Romanian exports, FDI, and growth and put pressure on the currency and domestic interest rates. However, Romania is better prepared to absorb such shocks than it was in 2008. While nonresidents have little exposure to Romanian debt (24 percent of total domestic issuance), the U.S. tapering of quantitative easing could trigger capital outflows, so that the domestic rollover risk might intensify. With 62 percent of lending is in foreign currency, a large depreciation of the exchange rate would cause deterioration in bank and company balance sheets. The mostly foreign-owned banks are also vulnerable to the withdrawal of parent funding although reliance on domestic deposits is increasing. Romania's economy might still be affected by a protracted/intensified regional instability in Europe, possibly through the impacts on the EU activity and trade. However, continued prudent macroeconomic policies, EU monitoring safeguards, and the IMF, EC, and World Bank-supported programs provide effective mechanisms for mitigating these risks.
- **Sector policies and institutional risks are also substantial.** Some of the supported measures aim at putting in place governance and accountability in institutions, such as the ANCPI and ASF. In a politicized environment where institutional capacity is weak, the reforms could be reversed. These risks are mitigated in a variety of ways: (i) the DPL series is supporting the government objective to develop its capital markets through supply (government securities, IPOs), demand (improved laws and regulation), and institutional (ASF) measures; (ii) the Bank's program and dialogue on property registration and financial sector development is broader than that supported by the DPL series; and (iii) the overall policy dialogue is supported by and closely coordinated with the EC and IMF.
- **The main risk in terms of operational design, implementation and sustainability is inadequate implementation capacity.** To mitigate this risk the authorities have mobilized technical assistance in almost all the reform areas supported.
- **As highlighted in the PSIA section, the impact on poverty and shared prosperity of the policy measures supported by this DPL is expected to be either positive or negligible**. There are no likely risks on Romania's environment, forests, water resources, habitats, or other natural resources. Finally, the fiduciary risks are moderate because Romania's PFM systems and central bank's management of foreign exchange are appropriate.

ANNEX 1 - POLICY AND RESULTS MATRIX

Objectives	Prior Actions under DPL 1 (FY14)	Triggers for DPL 2 (FY15)	Results
Pillar A--- Strengthening fiscal management and SOE performance			
A1. Strengthening **debt management.**	**Prior Action #1**: The Ministry of Public Finance (MOPF) has approved and published ***the rolling medium-term debt management strategy (DSM) for 2014–16*** and the corresponding ***2014 Annual Borrowing Plan (ABP)*** to build up the government securities market. **Prior Action #2**: The National Bank of Romania (NBR) has introduced an ***electronic auction facility for government securities in the primary market*** and started to hold auctions on March 2014.	**Trigger #1:** MOPF has ***issued the legal and operational guidelines for liability managing operations and has facilitated the establishment of a new electronic trading platform*** to improve the price disclosure, transparency and functioning of secondary markets.	Average maturity of domestic debt (years): • Baseline (end 2013): 2.7 • End-2016: 3.7
A2. Improving the **quality and effectiveness of public expenditures by:** (i) introducing **results-informed budgeting**.	**Prior Action #3:** Parliament has amended the Public Finance Law No. 500/2002 through Law 270/ 2013 and, based on these amendments, MOPF ***has issued a detailed action plan for preparing and executing results-informed budgets***.	**Trigger # 2** The Government of Romania (GOR) has adopted ***the 2015 budget, which applies the results-informed framework*** to two pilot ministries.	The share of total budgets of pilot ministries presented by programs linked to and informed by results indicators, percent: • Baseline (end 2013): 0 • End-2016: 50
(ii) Enhancing **public investment management.**	**Prior Action #4:** The Government of Romania (GOR) has approved Emergency Ordinance No. 88/2013 ***setting up a system for prioritizing significant (over 100 million RON) public investments*** and has approved Decision No. 225/2014 on methodological norms for the implementation of such system.	**Trigger #3:** GOR has prioritized large public investment projects using the new legal framework and adopted a ***Decision ensuring that only prioritized projects vetted by MOPF are included in the 2015 budget***.	The average time to complete a significant projects (after the completion, restructuring, cancellation of ongoing projects and the approval of new projects), years: • Baseline: 12 (2014 budget) • 2016: 8
(iii) Improving **effectiveness and targeting of pro-poor spending.**	**Prior Action #5:** GOR has approved a Memorandum on March 26, 2014 assigning to the inter-ministerial committee on the Minimum Social Insertion Program (MSIP) the ***preparation of specific legal and institutional steps to introduce MSIP in the first calendar quarter of 2016, including provisions to increase incentives for work***.	**Trigger #4: *Parliament has adopted the Law on the introduction of MSIP***, including addressing disincentives to work of beneficiaries.	The coverage of the poorest 20 percent of the population by the MSIP during the January to March season, percent: • Baseline: 62 (2012) • 2016: 70

Objectives	Prior Actions under DPL 1 (FY14)	Triggers for DPL 2 (FY15)	Results
A3. Improving the **governance and performance of State-Owned Enterprises (SOEs)**	**Prior Action #6:** GOR has approved a Memorandum on April 2nd, 2014 ***on state ownership and oversight*** that clarifies the responsibilities of the line ministries and MOPF for monitoring, advocacy for good governance, transparency, and financial reporting.	***Trigger #5***: Parliament has adopted the ***Law on corporate governance of SOEs*** based on Emergency Ordinance 109/2011 and its evaluation. **Trigger #6**: GOR has ***launched privatization proceedings, including IPOs, for at least two SOEs*** in Bucharest and/or international markets with enhanced transparency and accountability.	SOEs receiving unqualified audit opinion, number: • Baseline: 8 (2013) • 2016: 20 SOEs reporting under IFRS, number: • Baseline: 5 (2013) • 2016: 20
Pillar B--- Improving the functioning of property, energy and capital markets			
B1. Strengthen the **institutions and safeguards for private property rights**	**Prior Action #7:** GOR has approved Emergency Ordinance No. 8/2014 ***establishing the operational and financial independence of the National Agency of Cadastre and Land Registration*** for investments covering both the rural and urban real estate registration.	**Trigger #7: *Parliament has adopted a new Law on Cadastre and Real Estate Registration*** replacing Law 7/1996, which reflects European best practice of corporate governance and providing professional, inclusive and service oriented land administration services.	Coverage of urban real state registration (percent of all urban real estate): • Baseline: 39 (end 2013) • 2016: 49
B2. Completing **energy markets liberalization**	**Prior Action #8:** The National Energy Regulatory Authority (ANRE) has issued the Orders ***fully liberalizing the nonresidential electricity market***.	**Trigger # 8**. ANRE has issued the Orders to ***completely liberalize the nonresidential gas market.*** **Trigger #9:** Transelectrica and the relevant authority and stakeholders ***have completed ownership diversification of the energy market operator (OPCOM)*** and OPCOM *has coupled the* ***Romanian Day Ahead Market with electricity markets in Hungary, the Czech Republic, and Slovakia***.	Electricity contracted for the same-year delivery on the OPCOM market (Twh) • Baseline: 38.3 • 2016: 45.0 Amount of natural gas traded at centralized platforms • Baseline: 0 • 2016: 2 International trade in electricity, exports plus imports (Twh): • Baseline: 2.6 (end-2012) • 2016: 4.0
B3. Improving the **functioning of financial markets**	**Prior Action #9:** GOR has approved Emergency Ordinance No. 94/2013 ***reducing the size of the Financial Supervisory Authority (ASF) board from 11 to 9 members and establishing minimum qualification requirements and conflict of interest principles for both board members and senior staff,*** and Parliament has endorsed the revised composition of the ASF board, through Decision No. 60/2013.	**Trigger #10:** Parliament has adopted ***amendments to the Capital Markets Law*** to modernize the regulatory landscape, enhance the governance and accountability of ASF, and allow for secondary regulatory reforms to address key constraints hampering the development of capital markets.	Number of capital market procedures streamlined: • Baseline: 0 (2013) • 2016: 18

ANNEX 2: LETTER OF DEVELOPMENT POLICY

LETTER OF DEVELOPMENT POLICY

MINISTRY OF PUBLIC FINANCE

Mr. Jim Yong Kim
President
World Bank
Washington, DC. US

Dear Mr. Kim,

The Government of Romania has embarked on a comprehensive reform agenda to accelerate Romania's convergence towards EU incomes and living standards. This agenda aims to strengthen domestic and international investor's confidence in our economy via a continued strong macroeconomic management and a number of structural reforms to boost productivity and economic growth. We are confident that the successful implementation of this agenda will lead to further improvements in the living conditions of all Romania's citizens.

We welcome the support that the World Bank, jointly with the European Commission and the International Monetary Fund, have provided to our Government's reform agenda, in particular through the ongoing Development Policy Loan with a Deferred Drawdown Option that was approved in mid-2012. In this context, we request the Bank's continued support for the next stage of our reform program with a new Development Policy Loan (DPL) Programmatic Series. This letter outlines the main directions of macroeconomic policy and structural reforms underpinning the first DPL series.

Macroeconomic and Financial Framework

Romania weathered the global crisis well, thanks to the sound economic management and moderate public debt, and continued reforms with strong support of our international development partners. Economic growth last year accelerated to 3.5 percent. But given the uncertain international economic environment, especially in Europe, lower capital flows, and rising global interest rates, post-crisis economic growth in many countries, including Romania, will be moderate. We conservatively forecast our economy's medium-term growth at around 3 percent. This will slow Romania's convergence with the EU average compared to the pre-crisis period. It will also make it more difficult to ensure robust improvements of living standards of our citizens, especially the poor.

We understand that to reduce macroeconomic vulnerabilities in this uncertain environment, we must continue to strengthen our macroeconomic policies. To this end, we plan to reduce the ESA-based structural deficit in line with the adjustment path for the medium term objective under the EU's Stability and Growth Pact (SGP). For 2014, we have approved a budget consistent with a consolidated deficit target of 2.2 percent of GDP in cash terms. This target should allow us to increase the absorption of EU funds to ensure funding for key pro-growth investments. We will also safeguard health and education spending means-tested safety nets for improved well-being, opportunities, and support of all, including the poor.

Regarding inflation, Romania's annual headline inflation decelerated sharply last year and ended the year at 1.6 percent, at the bottom of our medium-term target band of 2.5±1 percentage point. This deceleration, in addition to the behavior of core inflation (around zero since October), and the persistent negative output gap allowed the National Bank of Romania to lower the policy rate during September 2013-January 2014 by a cumulative 75 basis points to 3.75 percent. As a result, average interest rates on new loans felt to a historic low of 8.2 percent in November. Later in January 2014, we reduced the high minimum reserve requirements with a view to gradually bringing them closer to those in the ECB and other EU countries. Looking ahead, to keep inflation expectations low and given the risks of volatile international capital flows and food and energy prices, our monetary policy stance will remain cautious, closely monitoring inflation developments and assessing risks in close consultation with the IMF and EC as part of the inflation and the overall policy consultation mechanism.

The Romanian banking sector maintains appropriate capital buffers, enhanced liquidity, and provisioning, but still faces pressures from asset quality, foreign bank deleveraging and, potentially, new external shocks. The capitalization of the banking sector remains strong at 15 percent at end-2013 with some differences across banks. However, credit growth in real terms to both corporates and households remains negative year-on-year at -6.5 and -2.7 percent, respectively, at the end of 2013. Non-performing loans (NPLs) ratio closed the year at 21.9 percent compared to 18.2 the previous year, reflecting the difficult economic environment, stagnant credit growth, and slow removal of fully provisioned NPLs from bank balance sheets. Total provisions cover 90 percent of NPLs while the narrower measure (IFRS provisioning ratio without prudential filters) increased to 67.6 percent at end-2013. The pace of foreign-owned bank deleveraging has accelerated in line with the rest of the region but remains orderly with a parent funding decline of 30 percent since end-2011. As a result, reliance on local funding has increased, especially on deposits. The risks from continuing parent funding retrenchment remain significant, especially if credit demand recovers, although these risks are mitigated by the lower prudential filters and minimum reserve requirements. The NBR will continue to closely monitor and supervise the banking system and take any necessary measures to ensure that banks maintain sufficient capital and liquidity, in light of the uncertain economic environment which could pose further challenges with respect to asset quality, profitability, and parent funding retrenchment for most banks. A recent top-down stress test performed by the NBR for the 2013 Financial Stability Report indicated that under an adverse scenario with a prolonged recession and 20 percent depreciation the overall banking system would remain resilient. We are also working to improve the laws on deposit insurance to transpose new EU directives.

Our macroeconomic management has been recognized by the markets: Romania's sovereign euro spread fell from 557 basis points in January 2012 to 241 by March 19, 2014. Credit rating agencies have reaffirmed our investment grade (e.g., Fitch Ratings, Moody's) or improved our outlook (Standard & Poor). In January 2014, we have successfully issued, on favorable terms, the first 30-year U.S. dollar denominated Eurobond.

The Reform Program

Our government is committed to continuing the strong reform program announced after the recent reconfiguration of our governing coalition in February 2014. This reform program marks the next stage of Romania's reforms focused on improving our debt management, enhancing the effectiveness of our fiscal management, increasing the performance of our state-owned enterprises, creating investment opportunities in key sectors (e.g., energy), and improving the functioning of property and financial intermediation markets to facilitate private investments and greater economic opportunities for all Romanian citizens. We are also supporting measures to improve our business environment and the conditions for healthy entry and exit of firms and firm innovation.

i. Debt Management

While the external debt market has been tapped successfully, the domestic government securities market needs further development. The secondary market trading is relatively low although growing while on the primary market and the issuance of long maturities is rather limited, all of which raise the vulnerability to external shocks and the rollover risk and limits cost-effective financing options to the government. The reform focus has now shifted towards sharpening and improving the Debt Management Strategy (DMS) and its operationalization via Annual Borrowing Plans (ABP) to make debt management operations more predictable for the budget and markets ***(Prior Action #1)***. The National Bank of Romania has introduced in March a fully electronic platform for the primary market while now efforts are channeled to connect this facility to the debt management system in the Ministry of Public Finance (MOPF) in order to ensure a real-time access to the primary market data (***Prior Action #2***). Following this, MOPF will arrange the launching a new electronic trading platform to improve the price disclosure and functioning of secondary markets and will issue legal and operational guidelines for liabilities management operations. In 2014, the MOPF will also create a policy committee and technical implementation committee and will revise tasks assignments in the General Directorate of Treasury and Public Debt (GDTPD) along functional lines. This new infrastructure framework will increase the pre-trade and post-trade information. and will enhance market liquidity by decreasing trading costs and thereby allowing increased trading volumes.

ii. Fiscal management

To strengthen fiscal management, the government intends to implement ambitious reform measures in tax policy and administration reforms, and public expenditure management.

On the revenue side, the objective is to broaden the tax base and, where possible, use the opportunity afforded by higher revenues to reduce tax rates on some of the most distorting taxes. For example, we would like to reduce the tax-wedge on labor income, which would help employment, incomes, and work incentives for the bottom 20 percent of the population. We are also aiming at modernizing our oil and gas taxation regime to attract investments that would contribute to sustainable development, improved infrastructure, and diversification. We are also working closely with the World Bank to modernize NAFA, our revenue collection institution.

On the expenditure side, we are undertaking a number of reforms to our systems to limit fiscal risks, improve expenditure management, enhance the quality of public spending and absorption of EU funds, and improve social spending for the poor and vulnerable. With the help of the European Commission and the IMF, we are introducing a firm commitment controls system, enhancing our consolidated fiscal reporting system, improving fiscal transparency and strengthening management of fiscal risks – including those arising from Public-Private Partnerships. We are also working on key pillars of our medium-term fiscal framework, including: (1) increasing the results-orientation of our budget; (2) enhancing our public investment management and EU funds absorption; and (3) improving the safety net policies underlying this key spending. We are also improving our budget planning tools to strengthen the medium-term fiscal framework.

We are concerned that the results achieved in previous years through the execution of public budgets do not always reflect the resources allocated, as efficiency of public spending remains low. To address this problem, we submitted amendments to our Parliament amending the Public Finance Law to empower us to improve results-informed budget programs (***Prior Action #3***). We have further prepared a detailed plan to start piloting this approach in the ministries of health and education and plan to adopt the 2015 budget applying the result based framework to the two pilot ministries.

We are also concerned that public investments are not prioritized following good international practice and appropriate technical screening processes before they are included in the budget. As a result, ongoing investment commitments exceed 30 percent of GDP and are expected to take close to 12 years to be completed. Our priority is, thus, to improve budgetary planning and project prioritization, which will also help to increase absorption of EU funds. To do this, we have established and staffed the Public Investment Evaluation Unit at the Ministry of Public Finance. The government has also adopted an Emergency Ordinance (#88/2013) naming MOPF as the secretariat for prioritizing public investment projects considered significant (above Lei 100 million) , and has also recently approved the methodology for appraising and prioritizing significant public investment projects. (***Prior Action #4***). We will reappraise the significant projects according to the approved investment prioritization norms for the preparation of the 2015 budget. For the projects co-financed from the EU funds, prioritization will be performed based on the EU regulations.

Further, despite improvements, our social assistance spending is still fragmented, insufficient targeted, resulting in unnecessary administrative burdens. The proportion of social assistance spending reaching the poorest 20 percent of the population can be further improved, as spending is dominated by categorically-targeted programs, while the share of means-tested programs in GDP shrunk (Household survey data suggest this share was 62 percent during the January-March period of 2012 after adjusting for the true population coverage of the means-tested programs). In this regard, we have started the consolidation of the all means-tested programs -- the Heating Benefits, Family Benefits, and Guaranteed Minimum Income program – into a single flagship anti-poverty program, the Minimum Social Insertion Income Program (MSIP). Last year we eliminated unnecessary asset filters from means-tested programs to increase their coverage of the poor, and increased their eligibility thresholds and/or benefit levels to mitigate the impact of the increase in energy tariffs on the household sector. This year we expect to complete the necessary legal framework and in 2015 the regulatory and technical work to allow the launch of the MSIP program during 2016. In this regard, the Cabinet has established, through a Memorandum, an inter-ministerial committee for the preparation of the MSIP program. The committee is tasked, *inter alia*, to finalize the legislation that will consolidate the means tested programs and introduce a benefit formula that will not penalize beneficiaries if they start to work (***Prior Action #5***). The committee, led by the Ministry of Labor, Family, Social Protection and Elderly, plans to submit the draft legislation for Cabinet's endorsement and further submission to Parliament in September 2014. To ensure the smooth implementation of the legislation and the achievement of the goals of the MSIP program – reducing income poverty among the poorest 20 percent of the population, while supporting the activation of work-able beneficiaries –the committee, inter-alia, is estimating the budgetary impact of the new program, covering both the transfers' component and its administrative costs. This will include the upgrade of the management information system for social assistance programs – hardware and software – which we expect to be ready during 2015. Spending on the three programs to be merged into MSIP has shrunk since 2010, in part due to parametric reforms and in part due to improved compliance with program rules. We are thus making efforts to allocate funding to the new program to expand its coverage of the poorest 20 percent as much as possible, especially during the winter season.

iii. State Owned Enterprises

We started major reforms to address the drag that state-owned enterprises (SOEs) pose to our economy and the burden they impose on our budget. In addition to aggressively addressing the issue of arrears build-up, we are making efforts to introduce governance principles based on good international practice for the appointment of the boards of directors and top management. In parallel we have attracted private investments in four energy enterprises via two secondary public offerings (SPOs) and two initial public offerings (IPOs), including a successful IPO for Romgaz in November 2013, the largest state-owned enterprise by revenue. We have also liquidated or restructured other SOEs resulting in a reduction of the total work force in SOEs from 245,253 in December 2011 to about 230,992 at the end of 2013. This has not been easy – for instance, with support of the World Bank's DPL-DDO, we placed into insolvency process one of the largest electricity producers (Hidroelectrica) to restructure it and commercialize its energy production in a transparent manner via the energy exchange platform OPCOM. To further improve the financial and economic performance of the SOE sector we consider it important to improve the accountability of the government as an owner. In this regard, we approved a Memorandum on State Ownership and Oversight sharpening the management of the SOE national portfolio (***Prior Action #6***). It clarifies the responsibilities of line ministries and MOPF for corporate governance, financial reporting, accountability and transparency, and monitoring and assessment of SOE management. It also promotes good practices, including movement toward international financial reporting standards (IFRS). This action would be followed up with the enactment of a full ownership policy, based on Emergency Ordinance 109/2011 and the evaluation we will be carrying out over the summer.

iv. Energy Sector Reforms

We have also substantially advanced reforms in the energy sector aiming at: (1) implementing the EU's energy acquis; and (2) attracting private sector investments and professionalizing management of SOEs to secure energy supply and to export to the rest of Europe. The 2003 energy strategy - Road Map for the Energy Field - guided the restructuring and liberalization process and Romania's accession to the EU in the area of energy reform. In 2011, we resumed energy reforms and, a year later, the Parliament passed new electricity and gas law and a law that restored the operational and financial independence of the energy regulatory authority (ANRE) and empowered it to continue the energy market reform. ANRE completed the liberalization of the nonresidential electricity market in early 2014 (***Prior Action #8***), and expects to do the same for the nonresidential gas market by 2015. This means that wholesale electricity and gas prices for non-residential consumers will be determined by market participants on the energy market. We are also committed to support ANRE in the implementation of the gas Road Map and in particular in fully liberalizing gas markets for non-residential consumers. We see this as a crucial step to attract new investments in this important sector for our economy and for Europe. To further foster electricity trading with Europe, our transmission company, Transelectrica together with the relevant authorities/entities will take the necessary actions to complete the ownership diversification of the energy market operator (OPCOM) and to reach an agreement with the foreign partners for coupling *the* ***Romanian*** electricity ***Day Ahead Market*** with the markets in Hungary, Czech Republic, and Slovakia in early 2015. These policies will be outlined in our forthcoming Energy Strategy, which also spells out the important investments that our gas and electricity transmission companies are undertaken to ensure proper connection of our gas and electricity grids with neighboring countries.

v. Property Markets

Livelihoods of our rural poor and marginalized communities in urban areas are impaired partly because of our citizens and companies inability to mobilize their assets for investments. This is due to a lack of reliable information on real estate property rights. The cost of first registration is prohibitive, especially in rural areas where only 10 percent of real estate, compared with about **39** percent in urban areas, is registered in the integrated information system for cadastre and land registration. Further, the land restitution process begun in the early 1990s has not formally finished, causing further uncertainty about property rights. Finally, long settlement proceedings for land restitution add even more uncertainty to the property market, which leads to informality of the property transaction. Broadening the coverage of real estate registration is crucial to improving the functioning of the property markets. To restart this process, we have granted greater financial autonomy to our National Agency for Cadastre and Land Registration (ANCPI) for carrying out the investments related to systematic registration of the property in the integrated information system for cadastre land registration (***Prior Action # 7***). We have also started to draft a new Land Registration Law and ancillary regulations to address the legal constraints that hinder systematic registration properties and expect to complete it by early 2015. In this new framework, we would further develop an appropriate governance and accountability framework of ANCPI, its management and its board. We are committed to ensure that the sole focus of ANCPI is on extending the coverage of property registration, and will do so with a special focus on territories with vulnerable population and in a gender-responsive manner in close consultation with the World Bank and the European Commission. We would also avoid diverting registration resources of ANCPI to territorial government or local units. We will fund our land restitution commitments from other revenue sources.

vi. Deepening Financial Intermediation

Romania's growth depends critically on a financial sector that is stable, resilient, and deep enough to efficiently intermediate savings and investments. To deepen financial intermediation we are focusing, in addition to the issues mentioned under the banking sector remarks above, on removing obstacles for the further development of our capital markets. Our strategy in this respect is three-fold: (i) promoting privatization and investment financing of SOEs through the stock exchange and we are, as previously discussed, revamping our domestic government securities market to provide key benchmarks for investors; (ii) revising our regulations to remove barriers to increasing market participation in the equity and non-government bond markets; and (iii) improving the governance of the recently unified regulator of pensions, insurance and capital markets.

We are aware that improving the functioning of capital markets will allow the growth of our economy to rely more on domestic savings and foster the development of tradable sectors. Government's strategy to development the securities market focuses on the non-government fixed income market (with long maturities), asset backed securities and collective investment schemes, and on establishing at the same time a framework (and capacity) to supervise and enforce market integrity in all these areas taking into account macro prudential considerations.

The Financial Supervisory Authority (ASF) is facing institutional challenges in swiftly completing the integration of the former three supervisory authorities. The corporate governance of this agency was not set up properly from the start, and this has required strong corrective action by the government and Parliament. In this regard, we introduced a basic framework for corporate governance in the ASF, by reducing its board size and establishing qualification and conflict of interest criteria for both board members and staff (***Prior Action #9***). In parallel, in accordance with the conditions laid out by the Memorandum of Understanding concluded with EC the selected consultant will deliver in April 2014 a report containing recommendations on the ASF internal organization. Based on these recommendations, ASF will decide on the adjustments to the organizational chart and on the assessment process for the rest of the staff. A new chairman has been recruited following strict merit-based criteria. The chairman, his management team, and the Board will be tasked with three strategic objectives: (1) further improving the governance and accountability framework of the agency including: clarifying the broad agency objectives; board and management accountabilities; enhancing transparency and public disclosure in general; and bringing all fees and charges to supervised entities and market participants in line with international best practices; (2) developing a blueprint for the full integration of the three previous supervision agency (including overall staff reductions as well as reassignment of post with emphasis on off-site consolidated supervision); and (3) developing our country's official strategy for developing the capital markets. The development of the securities market should include, among others, the non-government fixed income market (with long maturities), asset backed securities and collective investment schemes and, at the same time, should establish a framework (and capacity) to supervise and enforce market integrity in all these areas. It should also take into account macro prudential consideration. In the meantime, we are working closely with stakeholders towards the modernization of the Capital Markets Law and other pieces of legislation as might be appropriate to address constraints that are hampering the development of capital markets.

vii Business Environment and Competition

We recognize that enhancing competition and harmonizing the institutional framework for competition with EU principles will reignite productivity growth in Romania. Although our country provides significant investment opportunities, our business environment is still challenging for small and large firms alike. To improve the business environment, we will reduce a number of small "nuisance" taxes and fees and ease the compliance process and are committed to improve the quality of the regulatory environment, by moving towards systematic evidence-based policy-making, aligned with the EU Smart Regulation strategies. The use of Impact Assessment (IA) has been highlighted as one of the key topics of focus and reducing the administrative burden for the private sector is a key goal of reflected both in the Partnership Agreement with the EU for the period 2014 -2020 as well as in the National Reform Program of Romania. In parallel our Competition Council has embarked on an institutional reform program to increase its effectiveness on promoting and enforcing market competition, including the elimination of anticompetitive sectoral regulation. The Government plans to enact a revised competition policy legal framework in the areas of unfair competition, state aid and competition law.

Program Management, Monitoring and Evaluation

The Ministry of Public Finance, as representative of the Borrower will facilitate the overall coordination of policies through the coordination committee established pursuant to the Prime Minister Decision and chaired by the Minister Delegate for the Budget.

In closing, I strongly believe that the World Bank can provide valuable support to the Romanian Government's reform program for improved growth prospects and standards of living for our citizens. The World Bank's financial assistance in the form of the proposed DPL loan series and technical expertise will critically help fulfillment of the program's objectives. Our program has also been extensively described in the Letter of Intent and associated Memorandum of Economic and Financial Policies signed with the International Monetary Fund and in the Memorandum of Understanding signed with the European Commission.

Signed in Bucharest on ………..…, 2014

By ______________________________

Liviu Voinea
Minister Delegate for Budget
World Bank Governor

ANNEX 3: IMF PRESS RELEASE

IMF Executive Board Completes First and Second Reviews Under the Stand-By Arrangement and Ex-Post Evaluation of Exceptional Access for Romania

Press Release No.14/130
March 26, 2014

The Executive Board of the International Monetary Fund (IMF) today completed the first and second reviews of Romania's performance under its economic program supported by a 24-month Stand-By Arrangement (SBA). The authorities are treating the arrangement as precautionary and do not intend to draw under it. Completion of the reviews makes an additional amount equivalent to SDR 389.4 million (about €436.3 million) available for disbursement, bringing the total resources currently available to Romania under the SBA to an amount equivalent to SDR 584.1 million (about 654.4 million). The SBA with access of SDR 1,751.34 million (about €1.96 billion, 170 percent of quota) was approved on September 27, 2013 (see Press Release No. 13/376).

In completing the reviews, the Executive Board approved a waiver of nonobservance of the performance criterion on the general government overall fiscal balance, which was missed by a small margin, and modifications to program conditionality. The Executive Board also approved the Romanian authorities' request to add a review based on end-June 2014 performance. The additional review would coincide with the planned Article IV consultation and the mid-year budget rectification.

The Executive Board also discussed an ex post evaluation (EPE) of the SBA with Romania approved in March 2011. Romania treated the arrangement as precautionary and completed all the reviews. The EPE finds that the program objectives were largely met, although progress on the structural reform agenda was uneven and vulnerabilities remain.

Following the Executive Board's discussion on Romania, Mr. David Lipton, Deputy Managing Director and Acting Chair, said:

"Romania is making good progress under the precautionary SBA. Economic growth reached a post-crisis high in 2013, the current account narrowed significantly, and inflation has fallen to historic lows. However, the economy and the financial sector remain vulnerable to shocks. Steadfast program implementation is essential to preserve macroeconomic stability and policy buffers in this election year. "The budget deficit target for 2014 provides for further fiscal adjustment, while also supporting greater absorption of European Union funds. Improved capital spending, better revenue collection, and implementation of an expenditure control system are key priorities. Additional action is required to reform the health care sector and shield vulnerable households from deregulated energy prices. "Efforts are needed to strengthen monetary policy transmission. The banking system remains well capitalized, but the authorities need to accelerate the resolution of non-performing loans and closely monitor risks from parent bank deleveraging. The non-bank financial regulator needs to be reformed in line with best international practices. "Structural reforms in the energy and transportation sectors have progressed. Electricity prices for commercial users have been liberalized and initial public offerings were held in two major energy companies. Sustained progress in state-owned enterprise reform, including a restructuring of the freight railway company and a reduction of arrears will continue to be critical components of the program.

"The EPE concluded that the program objectives were largely met, although progress on structural reforms was uneven and vulnerabilities remain. The evaluation draws several lessons for Fund engagement with Romania. First, program conditionality, particularly as regards complex structural reforms, is no substitute for country ownership. Second, addressing financial sector risks requires strong coordination between home and host supervisors, appropriate macro-prudential policies, and data transparency."

ANNEX 4: POVERTY AND SOCIAL IMPACT ANALYSIS

Pillar A: Strengthening fiscal management and SOE performance

1. **The poverty and social impact of debt management and budget reforms are expected to be neutral overall but potentially beneficial to poverty reduction and shared prosperity over the medium term.** The DPL series supports the Government's adoption of a comprehensive medium-term debt strategy and annual borrowing plans, which aims at better managing risks while extending average maturities and reducing average costs. The impact of these measures is expected to eventually reach the bottom 40 percent in the form of reduced volatility and lower cost of capital. The DPL series also supports introduction of budget management tools, such as results-oriented budgeting (with pilots in health and education), that are expected to cover about 10 percent of recurrent spending by 2016 and the introduction of criteria to better prioritize public investments. These reforms will lead to better measurement of the impact of spending and over the medium term improve service delivery for all, including the bottom 20 percent and those socially excluded.[7]

2. **Consolidation of means-tested programs is expected to benefit mainly the bottom 20 percent of households through better targeting, coverage, and generosity.** The current three sets of eligibility criteria, beneficiary registries, and payment systems will be replaced by unified eligibility criteria, registry, and benefit distribution process. The benefits of this reform to the poor will come from efficiency gains from replacing small programs benefiting partially overlapping target groups with a single program that has a larger but clearer target group and reinvesting financial savings from reduced administrative costs, errors, fraud, and corruption. The coverage, targeting, generosity, and reactivation incentives are all expected to benefit particularly the bottom 40 percent (Table 12).

- ***Coverage***: The consolidated program is expected to cover 70 percent of those Romanians in the bottom income quintile, up from an estimated combined coverage of 62 percent in 2012—both measured in the first quarter of the year to capture the winter season and after adjusting the household budget data for the true population in the programs. The consolidated program is also expected to cover about one-third of the population in the second income quintile, a slight reduction from current coverage. The calculations assume that the budget allocation for the new program is increased moderately over time (as expected in the results framework of the DPL). Appendix 1 to this annex describes the calculations on coverage of these programs.

- ***Targeting***: Consolidation is expected to result in about 81 percent of benefits going to the bottom income quintile compared to 69 percent at present. This will mainly come from trimming benefits currently paid to the richest households, though some would also come out of benefits currently paid to the second quintile, which is expected to receive only about 12 percent of the benefits.

- ***Relative incidence***: Relative incidence measures the share of transfer to a particular quintile out of the total income of that quintile. For the poorest 20 percent of the population this is expected to increase from 6 to 9 percent between 2013 and 2016.

[7] The literature suggest that the impact of introducing results-informed budgets for social programs (health, education, and social protection) is positive, especially when performance reporting is well-established and when appropriate facilitation is provided to the implementing agencies. This is, however, only a tool and it can deliver on poverty reduction only if the government has good pro-poor policies in the first place. The "channels of transmission" from budget reforms to shared prosperity are likely to be (i) accountability (governments become accountable for their uses of public funds) and (ii) awareness (governments improve efficiency and effectiveness by feeding the lessons of performance assessments back into strategies and plans). See, for instance, Overseas Development Institute Briefing Paper (April 2003), *Results-Oriented Public Expenditure Management: Will It Reduce Poverty Faster?* (www.odi.org.uk). If accompanied by a strong medium-term fiscal framework, which is not yet the case in Romania, budget reforms could also be a useful tool in implementing "dash-for-growth" policies that squeeze untargeted transfers in favor of economic infrastructure.

- ***Reactivation incentives***. Finally, reduction of the implicit tax on earnings in the benefit formula (currently any earnings reduce the benefits by a corresponding amount, which adds up to a marginal implicit tax of 100 percent) will incentivize poor households to move from assistance to combined assistance and employment. Studies for the U.S. have found that this reform is most likely to have positive impacts among households headed by single women.

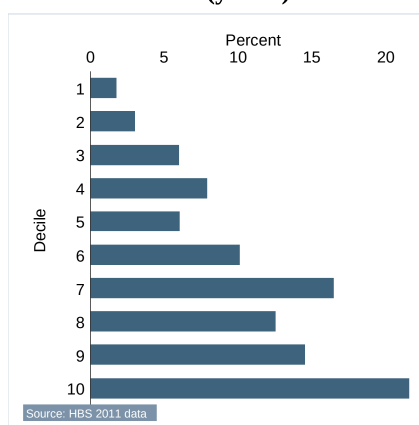
Table 12: Impact of the New MSIP on the Bottom 40 percent of Households
(2012-2017)

Assumption			Total budget		1st quintile*		2nd quintile*	
			Mln RON	% GDP	Targeting of benefits	Relative incidence**	Targeting of benefits	Relative incidence**
GMI+FA+HB 2012		2012	1001		66	5	19	1
GMI+FA+HB 2013		2013	1120	0.2	69	6	18	1
Insertion Minimum Income	Diff between the budget and the budget from 2013 goes entirely to the GMI component	2014	1500	0.2	74	9	15	1
		2015	2000	0.3	79	12	13	1
		2016	2500	0.3	81	15	12	1
		2017	2735	0.3	82	16	12	1
Insertion Minimum Income	Diff between the budget and the budget from 2013 goes proportionally to the GMI and FA	2014	1500	0.2	72	8	16	1
		2015	2000	0.3	75	11	15	1
		2016	2500	0.3	77	14	15	2
		2017	2735	0.3	77	15	15	2

** Quintiles of income per AE net of all SA*
*** Relative incidence is transfer amount received by a quintile as a share of total income of that quintile.*

3. **The SOE governance and performance-enhancing reforms supported by the DPL series can have a negative welfare effect on the newly unemployed if they cannot find alternative employment, but the estimated poverty and shared prosperity impacts are small.** This is partly because the share of the poor and the bottom 40 percent in public sector employment is small, and also because the affected employees will receive compensating severance payments. Improving the performance of SOEs may in some cases lead to additional employment, but in the short term labor shedding and cuts in compensation are a more likely outcome of reforms.

Figure 4: Distribution of SOE Employees (x-axis) by Consumption Decile (y-axis)



4. **The SOE sector in Romania currently employs some 330,000 workers (about 22 percent of consolidated public sector employment and 5 percent of total employment), of which more than half are in the energy and transport sectors.**[8] Benchmarks prepared by the government or minority investors for specific companies (e.g., the railway freight operating company and a hydropower company) suggest that overemployment is the norm, often by 60 to 80 percent; reforms should reduce employment by 30 to 40 percent in these companies).

5. **According to the 2011 household budget surveys (HBS), less than 1 percent of SOE employees were below the US$ 2.5/day poverty line (4 percent nationally) and 17 percent were below the US$ 5/day line (37 percent nationally).**[9] Most SOE

[8] The SOE restructuring reforms supported by the DPL series do not focus on any particular sector, but the PSIA focuses on SOEs in transport and energy because SOE employees in these two sectors can be identified in HBS and thus their income (and poverty) levels can be inferred.
[9] The sample includes 150,000 workers declaring that they work for transport or energy SOE, which is about half of the total SOE workers in the sample (the number of employees reported by the companies to the Ministry of Public Finance is currently about 330,000, but was closer to 380,000 two years ago).

employees were in the top four consumption deciles of the population in 2011, and 19 percent were in the bottom 40 percent (Figure 4). To assess the distributional impact of a possible loss of employment due to restructuring, the following assumptions were made:

- About 40,000 SOE employees are fired over a period of three years (27 percent of the total SOE employment pool, 15 percent a year for a period of three years).
- They all receive severance payments that replace incomes fully for those with incomes below the national average and up to the national average (about 73 percent of income) for those with higher incomes.
- There is either a full and or a partial (demand elasticity of 0.5) pass-through from income to consumption (i.e., the contraction of household consumption is proportional to the contraction of household income) at the time of the income shock.
- Either all fired workers are still unemployed at the end of the severance period, or some (one-third of the total) find alternative employment that pays the average wage in the economy.

6. **Analysis based on these assumptions indicates that there is no perceptible impact of the SOE restructuring on poverty and shared prosperity due to initial income replacement through severance payments, as well as the small share of SOE employees in the population and their prevalence in the upper deciles of the welfare distribution.**[10] The upper-bound effect on poverty, assuming no re-employment and full pass-through from the income loss to consumption levels, is about 0.15 percentage points at the US$2.5/day threshold and 0.3 percentage points at the US$5/day threshold. Allowing for either partial pass-through from income to consumption, partial reemployment, or both reduces this effect to less than 0.1 percentage points for the US$5/day line. In none of the simulations is the increase in poverty from the baseline statistically significant. However, the estimates consider only the loss of wages due to loss of employment and abstract from the loss of other benefits derived from employment. But at the same time the simulations also abstract from the fact that those unable to find employment when the severance package runs out could benefit from social assistance if eligible, which would cushion the welfare loss further. The SOE reform thus benefits from efforts to strengthen the social safety nets, supported by this DPL series.

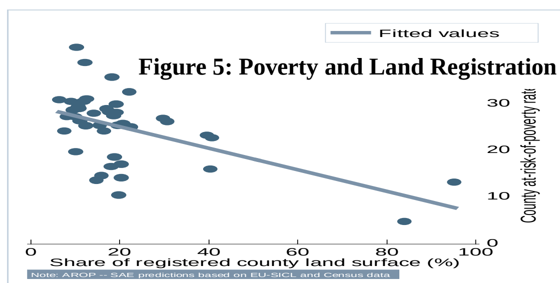


Figure 5: Poverty and Land Registration

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

7. **The cadastre reforms are expected to boost land registration, benefiting the entire population, especially those in the bottom 40 percent.** Only 17 percent of rural land and 26 percent of urban land is registered. In 6 of 42 counties the share of registered land falls below 10 percent. There is a negative relationship between the share of registered land at the county level and the county poverty rate,[11] which remains even if Bucharest and Ilfov—the outlier counties with registration rates above 80 percent—are excluded. Studies on other countries suggest that security of land tenure is associated with higher

[10] The group of affected employees is chosen randomly from the group of employees of energy and transportation SOEs in the HBS survey. These employees are assumed to receive a combination of severance payments and unemployment benefits as per regulations. Simulations look into (i) the impact of income loss due to severance payments being smaller than past income; and (ii) impact of income loss at the end of the severance benefit window.

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

productivity, greater agricultural investment, and participation in the rental market.[12] Restoring the operational and financial independence of ANCPI, supported by the DPL series, is expected to help streamline the registration process and reduce the cost of first registration, which is currently prohibitive. That should be beneficial to low-income households in particular.

8. **Reforms aimed at improving the functioning of property markets can also support gender equality in land registration if expansion of property registration is gender-responsive**. In Romania, as in most countries of Europe and Central Asia (ECA), women are allowed to own and inherit land and property equally to men. However, if titles and deeds to land are by default in the name of the head of household, who is usually male, that can preclude women from exercising any formal rights over the property. Tools and experience from rural Romania and other ECA countries are available to ensure that expansion of urban land registration is done in a gender-responsive manner. Gender-responsiveness is also likely to be embedded in the use of EU funds for the 2014–21 programming period. [13]

9. **Liberalization of nonresidential electricity and gas prices is not expected to have direct impact on households.** The liberalization of nonresidential electricity pricing, supported by the DPL series, was completed by January 1, 2014. According to ANRE, the regulator, this has resulted in no changes to final electricity tariffs. The liberalization of nonresidential gas prices is expected to be completed in 2015, which may result in a 20–30 percent increase in nonresidential gas tariffs. The government has announced a slower calendar of price adjustments for residential consumers. Given the weight of natural gas in the CPI in Romania (about 3.5 percent), even if the tariffs for households were to increase at the pace of nonresidential tariffs, the possible increase in the overall CPI due to higher energy costs should be marginal, particularly with inflation currently low. There can also be indirect channels, i.e., via other products and services, through which the increases in nonresidential gas prices affect residential consumers. Reliable estimates of this impact do not exist, but European Central Bank simulations of the inflation impact of oil shocks in the EU suggest the indirect effect is marginal: a 50 percent increase in the oil price is associated with a 0.3 percent increase in the harmonized CPI index, excluding unprocessed food and energy, after four years. Note, in this context, that consolidation of social assistance programs, supported by the DPL series, is expected to improve the ability of vulnerable households to cope with heating costs through better targeting and higher coverage.

10. **Reforms aimed at improving the institutional framework of capital markets are not expected to have adverse effects on shared prosperity.** Given that the jurisdiction of the ASF extends to areas that include insurance, pensions, and mortgages, consolidation of supervision of these areas should enhance the ability of individuals to mitigate various risks (disability, illness, natural disasters) and to provide for retirement. Those in the bottom 40 percent are generally in greater need of such risk mitigation mechanisms. According to EU-SILC 2011 data, only 31 percent report that they are able to meet unexpected expenses equivalent to €106 per household, compared to 62 percent among the top 60 percent.

[12] Deininger, K., Jin, S., 2003. "The impact of property rights on households' investment, risk coping, and policy preferences: Evidence from China." *Economic Development and Cultural Change*, 51 (4), 851-82.
Deininger, K., Jin, S., 2006. "Tenure security and land-related investment: Evidence from Ethiopia." *European Economic Review*, 50, 1245-1277.
Deininger, K., Ali, D. Alemu, T., (2011). "Impacts of land certification on tenure security, investment, and land market participation: Evidence from Ethiopia." *Land Economics*, 87 (2), 312-334.
[13] For example, training contractors and staff involved in systematic registration on how to be inclusive, such as by asking for both the husband and wife to be present for discussions on property rights when the staff visits the property. (Source: ECA Knowledge Brief on Gender and Land Administration)

Appendix 1 – Calculation of the 2012 Coverage of Means-Tested Programs

A two-step calculation was conducted to estimate coverage of the three means-tested programs for the first quarter of 2012 baseline:

- First, data on the total number of beneficiaries of the three programs was extracted from the first quarter Household Budget Survey (HBS) and an estimate of the coverage of the poorest quintile was computed. To avoid double counting, this coverage was split into the share of the poorest quintile that receives only the respective means-tested program, and the share of those who receive two or three means-tested programs; and
- Second, the extent of under-representation of these programs was estimated by dividing the number of beneficiary households from administrative data and the corresponding expanded numbers from HBS. This made it possible to estimate the corrected coverage of the three means-tested programs by increasing the program coverage with these factors—the coverage of the population covered only by one of the programs was adjusted with the program-specific correction factor, and the population receiving two or three programs by the average factor.

As illustrated in Tables 1 and 4 below, raw coverage of the bottom 20 percent is estimated at 35 percent in the first quarter of 2012, increasing to 62 percent after the corrections. In this context, increasing the coverage of the poorest quintile to a minimum of 70 percent by 2016 should be a feasible target. The improvements are likely to come from two sources: (i) the elimination of the asset filters that was begun in 2013, which will allow more households from the poorest quintile to qualify for means-tested programs; and (ii) a reduction of the threshold of the heating benefit component of the MSIP, which will reduce the leakage of funds to households from upper quintiles. Since between 2011 and 2012 the number of beneficiaries of the three means-tested programs fell, a larger budget for the MSIP will allow higher eligibility thresholds, which in turn will increase participation and coverage.

Appendix Table 1. Coverage of the poorest quintile with means-tested programs, Jan-Mar 2012

	Coverage (% population receiving)			
		Q1:	of which:	
	Total	Q1	Receives only this program	Receives 2 or 3 programs
Guaranteed Minimum Income	4.9	13.8	7.1	6.8
Income-tested Family Allowances	3.0	15.9	8.4	7.6
Heating Benefits	8.4	15.6	10.1	5.5
Any of the three above	13.7	**34.8**	**25.5**	**9.2**

Source: HBS 2012, 1st Quarter and World Bank staff estimates

Appendix Table 2. Coverage of the population with means-tested programs, administrative data (ANPIS)

	January	Febr	March	Average	Average 1stQ
GMI	199471	201288	188818	196526	196526
FA	350873	351721	315284	339293	339293
HB, thermal energy	211033	208852	206088	208658	1208175
HB, gas	206711	266045	268294	247017	
HB, other fuels	754760	753818	748924	752501	

Source: ANPIS

Appendix Table 3. Correction factors for the underestimation of means-tested programs in HBS

Program	Coverage		Correction factor
	HBS data	Admin data	Admin/HBS data
Guaranteed Minimum Income	159,073	196,526	**1.235**
Income-tested Family Allowances	203,390	339,293	**1.668**
Heating Benefits	525,198	1,208,175	**2.300**
Any of the three above	769,934		
Average correction factor for overlap*			**1.735**

**) correction factor for households receiving 2 or 3 programs*

Appendix Table 4. Coverage of the poorest quintile, adjusted for survey under-coverage

	Coverage			
		Q1:	of which:	
	Total	Q1	Receives only this program	Receives 2 or 3 programs
Guaranteed Minimum Income	4.9	13.8	8.7	
Income-tested Family Allowances	3.0	15.9	14.0	
Heating Benefits	8.4	15.6	23.2	
Any of the three above	13.7	**61.9**	**45.9**	**16.0**

Source: World Bank staff estimates