

II. COUNTRY DEVELOPMENT PROGRAM

34. **Romania's overarching objective is to achieve convergence with the EU in terms of income and living standards.** With a GDP per capita of slightly over 40 percent of the EU 27 average, Romania has a large unfinished development agenda. The approach to pursuing the convergence agenda has been consolidated in the National Reform Program (NRP) for promoting sustainable and equitable economic growth in the context of the European Lisbon Strategy. The NRP, updated annually and reviewed by the European Commission, complements the four themes of the Lisbon Agenda – investing in people and modernizing labor markets, unlocking the business potential, especially of SMEs, investing in knowledge and innovation, and energy and climate change – with the need to improve the quality and management of administrative capacity and government expenditure in the context of prudent macroeconomic policies.

35. **The May 2009 Convergence Program of the Government reaffirms Romania's objective of joining the Eurozone in 2014.** The document emphasizes the importance of promoting sound macroeconomic management and coordination of policies to gradually correct the existing imbalances. The Convergence Program aims to reduce the budget deficit to less than 3 percent of GDP, in line with the provisions of the EU Growth and Stability Pact, and inflation to 3.2 percent by 2011 to allow Romania to join the Exchange Rate Mechanism in 2012.

36. **The political agenda of the governing coalition is articulated in the Government Program for the period 2009-2012.** The objectives of the Program are two-fold:

- **dealing with the effects of crisis** by stimulating the confidence in the economy and mitigating its adverse impact, especially on the poor and vulnerable; and
- **anchoring these short term measures in a medium-term structural reform agenda** that would support economic growth and resume progress towards convergence with EU living standards, social cohesion and eventual entry into the Euro-zone.

37. **The Government program recognizes the need to re-focus the policy attention on the large unfinished structural reform agenda laid out in the National Reform Program to pull Romania out of the crisis and converge sustainably with the EU.** The measures proposed by the Government are organized into three broad categories: (i) reforming the public sector; (ii) rebalancing the foundations of growth and enhancing competitiveness; and (iii) promoting social and spatial inclusion.

A. Public Sector Reforms

38. **The Government has taken steps to develop its public financial management system to optimize resource mobilization and generate fiscal savings within a more transparent, predictable and accountable framework.** In the short term, the Government has adopted a series of policy decisions which led to a sizeable fiscal consolidation (see paragraph 26). The authorities recognize that weaknesses in managing public spending have been at the core of the fiscal deficits and the poor delivery of public services. Therefore, they have initiated key fiscal reforms which are structural benchmarks under the IMF program: (i) the approval of a Fiscal Responsibility Law (FRL). The FRL would provide a framework for improved multi-year

budgeting, fiscal rules on expenditures, public debt and the primary deficit, and for managing guarantees and other contingent liabilities. The FRL would also set limits on the frequency of intra-year budget rectifications, and create an independent Fiscal Council; (ii) the adoption of legislation for the introduction of unified, simplified public compensation, which would consolidate most payments under the base salary; and (iii) the adoption of legislation for a revised pension system which would index benefits to inflation, raise and eventually equalize retirement age between men and women, and restore projected increases in contributions to the second pension pillar. These measures will test the commitment of the authorities to address key sources of economic vulnerabilities.

39. **The medium-term expenditure framework (MTEF) process will be strengthened so that it guides strategic planning in line ministries and prioritization of expenditures.** As an intermediate step towards performance-based budgeting, the MTEF would provide line ministries with incentives to prioritize expenditures within their policy agenda, better plan capital investment projects, arbitrate trade-offs between personnel costs and capital expenditures, and allow *a priori* agreements between the Government and the Parliament on the budget priorities in the case of unexpected changes in revenues. In the short-term, the MTEF should facilitate the mobilization of the significant EU Funds available to Romania; in the medium-term, the MTEF should enhance the strategic allocation of resources and fiscal discipline. The challenge is, however, to aggressively implement the MTEF agenda, whose main elements have already been drawn up in the context of the program with the IFIs.

40. **To remove disparities in pay and promote performance, a unitary public sector pay system will be gradually introduced,** using analytical work provided by the Bank as a basis for reform. The Government has already taken steps to reduce non-wage compensation and integrate allowances into base salaries and has engaged trade unions in consultations. Beyond the establishment of the unitary pay system, there is also scope to rationalize the public administration in line with current priorities and needs, and strengthen its capacity to perform. Functional reviews of central government institutions will be undertaken to improve performance and resource allocation across public sector entities, reduce bureaucracy, cut administrative costs and lead to savings which can be used to, for example, implement the unitary pay system and advance decentralization.

41. **The Government has maintained the flat 16 percent income and profit tax, and recognizes the need for sustained reform of tax administration to improve revenue collection, reduce administrative costs and tax burden for tax-payers.** As a share of GDP tax revenue collection remains low compared to other EU members, while costs are high in spite of improved tax administration management in recent years, indicating that there is still substantial room to enhance tax compliance and reduce costs. The Government has taken steps to reduce the number of taxes and simplify submissions to improve tax revenue collection, reduce the bureaucratic burden for the tax-payers as well as administrative costs of tax collection. More remains to be done, however, to reduce the administrative burden for the business environment and improve the interaction of the business sector with the administration.

42. **The Government has begun implementing a rapid decentralization of public services.** Efforts to decentralize have so far been partial and have not resolved the key issues affecting sub-national public administration. The new Government appears strongly committed

to move forward the decentralization agenda rapidly. A strategy for health decentralization has been drafted and presented to the Government. The approach to decentralization of education is also in an advanced design phase. The changes pursued seek to improve the efficiency of service delivery at local level and enhance sub-national investments quality. One key challenge would be for the Government to advance the process of decentralization at a pace which is commensurate with the establishment of an appropriate accountability framework and capacity-building for local governments to warrant the transparent and effective use of the public resources at sub-national level.

43. **The reform of the judiciary is led by the commitments assumed by Romania in the EU accession process.** The framework for reforms is defined by four benchmarks established within the Co-operation and Verification Mechanism agreed with the EU. One benchmark requires measures aimed at enhancing the capacity and accountability of the Superior Council of Magistrates, and three other benchmarks cover integrity and anti-corruption matters. The judiciary still faces systemic problems to courts' efficiency, magistrates' accountability and corruption. To address these key challenges, the Government has set a bold agenda, which needs to be implemented: (i) the adoption of the new Civil and Criminal Codes and Civil and Criminal Procedure Codes; (ii) the adoption of a human resources policy in the judicial system, together with a new salary policy; and (iii) the adoption of a reformed court management system. The four draft Codes are currently under Parliamentary debate and expected to be adopted in 2009. Regulatory impact assessments are planned to be undertaken after their adoption. The reform of the court system requires, however, renewed attention by the Government.

B. Growth and Competitiveness

44. **The Government recognizes that sound macroeconomic management is more critical than ever to address the financial crisis and make progress towards the medium-term objectives of resuming growth and joining the Euro-zone.** To reduce macroeconomic vulnerabilities, fiscal discipline is being strengthened and coordination between fiscal (including debt management) and monetary policies is improving in the context of the program with international partners. The 2009 budget has been rectified to reflect the more constrained economic and financial environment, and redirects expenditure to priority areas – especially critical investments funded from EU funds and social protection - and seeks to contain the deficit. In line with the recommendations of the European Economic Recovery Plan (EERP), short-term prudent fiscal policies will be anchored in a medium-term program of reform, supported by the adoption of the Fiscal Responsibility Law and the gradual introduction of the MTEF.

45. **In the financial sector, the priorities of the Government include the management of liquidity and addressing eventual solvency problems, access to finance, improved financial sector supervision, and contingency planning.** Maintaining credit for private enterprises, especially SMEs and agro-businesses is critical to stem the economic and social impacts of the crisis. Contingency planning would require stronger coordination between regulatory agencies, the Ministry of Finance and similar agencies in home countries of parent banks, and a more flexible framework for bank intervention and resolution. Regulatory and supervisory authorities in the financial sector will be strengthened by introducing a merit-based appointment process for

prospective Board members. In the medium term, the Government seeks to support further deepening of the financial sector.

46. **Improving the business environment is also on the agenda of the Government.** The business environment is affected by uncertainty about regulatory policies, excessive number and rates of taxes including high non-wage labor taxation, excessive and inefficient government bureaucracy, and slow and unpredictable settlement of business disputes. The Government has initiated a program to cut or eliminate 179 taxes and tariffs out of 489 and envisages further measures to reduce bureaucracy. While this is a good start, reforms need to continue. The implementation of the “Better regulation strategy for 2008-2013”, prepared as part of the EU accession commitment, provides the appropriate framework for advancing the reform agenda. The implementation of the Service Directive, which requires a firm though feasible schedule, is also expected to be a challenge.

47. **A National Pact on Education concluded in 2008 between all major stakeholders sets ambitious objectives for 2015 to increase the quality and relevance of education, access by vulnerable groups, and expansion of adult education.** In pre-university education, proposed measures include legislation in 2009 of a new structure better aligned on European standards; reform of school curricula and associate training of teachers and school managers; updating of student evaluation norms and procedures; accelerated decentralization of financial and human resources, and of administration and curricula; and a comprehensive program to upgrade teaching staff and school management. In university education, measures include external evaluation of public and private institutions and study programs, full autonomy of universities in managing human resources, improved access and quality of student services and students’ voice in decisions, introduction of student loans, etc. Finally, continuous learning would be promoted through the adoption of appropriate legislation, government financial support, and information and communication campaigns.

48. **The policy in agriculture is driven by the EU Common Agricultural Policy (CAP).** Under the Common Agricultural Policy (CAP), Romania has now access to significant financial resources, totaling EUR 14.5 billion for 2007-2013, to support the development of its agriculture and rural areas. Romanian farmers can therefore benefit from the opportunities offered by market integration and enhanced stability and predictability of the CAP policy, and its significant financial support framework. This would allow Romania to address the significant restructuring and competitiveness challenges resulting from the dual farm structure and missing markets (commodity, inputs, credit, land, credit) that characterize its agriculture. Since adopting the National Rural Development Program, Romania is making clear progress towards accessing CAP funds, but the actual absorption of funds by farmers and their impact on effective sector restructuring and rural economic development remain to be measured and assessed carefully.

49. **The Government is focused on the development of transport and communication to enhance competitiveness and increase mobility.** The policy agenda in infrastructure includes developing a medium-term strategy for transport, a program and financing plan and the restructuring of state-owned companies. The Government aims to mobilize the important amounts of resources available for Romania from the Structural and Cohesion Funds, largely untapped to date, together with private funding where feasible, to boost investment in

infrastructure as a means of mitigating the effects of the crisis and boosting growth. This would require significant reforms of sectoral policies and institutions, which remain to be firmed up.

50. **The 2007 Energy Strategy for 2007-2020 provides a basis for action in improving energy efficiency and climate change mitigation.** The Government plans to mobilize resources from the EU Structural Funds and by selling surplus CO₂ emission rights under the Kyoto Protocol Mechanism to finance improved energy efficiency and the development of the considerable potential for renewable energy generation. Gas supply sources could be diversified within a regional, possibly European, approach, and Romania is a strong supporter of this. The continuation of mining sector reform is still a challenge for Romania due to the large state subsidies provided to the sector. The Government is looking into finding suitable solutions for adjusting the size of the mining sector in alignment with the energy sector development.

C. *Social and Spatial Inclusion*

51. **In the short-term, the Government's focus is on containing and mitigating the increase in transient and core poverty caused by the crisis.** The policy focus is on a more cost-efficient mix of social assistance programs, and better targeting of benefits, within the fiscal constraints. The relatively well-targeted Guaranteed Minimum Income (GMI) is a priority for expansion, but it has suffered from limited and declining funding, while the income-tested family benefits program is also underfunded. A recent Government decision to grant all retirees a minimum pension of just under USD100/month is expected to have a positive impact on poverty. The Government has increased the resources allocated to social assistance programs through the recent budget rectification. In addition, the level of the unemployment benefit has been increased and the duration extended.

52. **In the medium-term, the aim of the Government is to strengthen the safety net measures and make them more inclusive, while also promoting more active policies.** There have been efforts to bring social assistance benefits under a single body – the National Agency for Social Benefits (NASB) - under the Ministry of Labor, Family and Social Protection, with a single form for all benefits, a single payment system and a single beneficiary registry. However, this system is not fully operational yet. It will be important to improve the social safety net for those disadvantaged and vulnerable categories or people who have not benefitted from economic growth, and to improve the monitoring and evaluation of the impact of these social assistance programs. To increase economic opportunities, it will also be important to strengthen linkages between social assistance, education, and labor policies, with particular attention to education, skills upgrading and employment generation.

53. **The Government has launched an ambitious reform program in health,** aimed at improving the access to quality health services at all levels of service in a more cost effective manner. The main measures promoted include: (i) the improvement of the drugs pricing mechanisms and adoption of the generic drugs prescription; (ii) redressing the balance from the costly hospital based services towards the less costly outpatient and primary care services; (iii) definition of a realistic package of health services covered by the social health insurance system; (iv) introduction of co-payment with exceptions targeted to those unable to pay; (v) improvement of the provider payment mechanisms and (vi) the introduction of the voluntary supplementary health insurance.

54. **The Government is contemplating further reforms of the pension system to improve the fiscal sustainability of the public pillar and enhance the equity of the multi-pillar system.** To improve the balance of the public pension fund, the social assistance contributions have been increased by 3.3 percent in 2009. Parametric reforms for the consolidation of the first pillar are envisaged in the context of the program with the IFIs, such as switching to inflation-based indexation and gradually increasing and equalizing the retirement age. Policy changes to restore the level of contributions to the second pillar, in which about 3.5 million workers participate, are also contemplated. The special non-contributory pensions, from which a number of public sector categories benefits, are expected to be integrated into the standard system, while the establishment of private occupational pension schemes is also envisaged. These measures are key for addressing the aging of the population, the imbalance between pension contributors and beneficiaries, and containing the budget deficits in both short and long term.

55. **The Government is implementing the Strategy for the Improvement of the Roma Situation, adopted in 2001 and updated in 2006.** Roma policies are aimed at increasing the accountability of central and local authorities in order to address Roma issues, promote an intellectual and economic Roma elite expected to facilitate social inclusion initiatives, eliminate discrimination, and induce a positive change in the public opinion regarding Roma. At the same time, efforts are being made in order to promote tolerance and social solidarity, stimulate the participation of Roma in economic, social, education, cultural and political life through sector assistance and community development programs, prevent social discrimination and ensure equal opportunities for Roma and a decent living standard. However, the Roma continue to be in a marginalized and vulnerable situation as evidenced by important indicators such as poverty rates, infant mortality, and school enrollment.

56. **Some population groups have not benefitted from economic growth. Rural dwellers, in particular, were left behind during the period of national economic growth.** Out of the four million farms which provide the main source of livelihood for 90 percent of the people living in rural areas, three million survive at the margin of subsistence on less than a hectare. Many of them are past or fast approaching the retirement age, and not appropriately covered by pensions or social assistance schemes, suggesting the need to explore social assistance policy options to address their needs. A recent Government decision to grant all retirees a minimum pension of just under USD100/month is expected to provide some relief in this area.

57. **Romania guarantees gender equity and equality opportunities in law, but women are more likely to be poor.** The Romanian Constitution guarantees equal opportunities for men and women and a special law on equal opportunities for women and men was passed in 2002 ensuring equal pay for equal work, measures for employees' protection against dismissal in case of gender discrimination, and employers' responsibility to inform employees about legal provisions in this area. A National Action Plan for Equal Opportunities was adopted in 2000 to implement the legislation. EU accession and the adoption of the *acquis* legislation for equal opportunities have strengthened the rights of individuals and improved their protection. In practice, however, wages of women remain though below those of men for equal qualifications. Women are concentrated in low paid sectors and are under-represented in managerial positions and in politics. Poverty among households with women head of families is higher, according to the Bank's Poverty Update (2007). Trafficking of women still exists, but the Government and

NGOs are actively engaged in preventing and fighting against it. Another challenge is to translate equal gender opportunity policies into practice to raise the labor force participation of women in a way that reconciles their professional and family lives, such as through accessible social care facilities for the elderly and children, and flexible work arrangements.

58. **The Government relies substantially on the EU Structural and Cohesion Funds to pursue its regional policy agenda.** Regional development is supported by large net inflows of EU funds during 2007–2013. The Regional Operational Program is specifically targeted towards regional and municipal development, but most sector operational programmes, especially the Environment Operational Programme and the National Rural Development Plan, have territorial development dimensions that affect regional and municipal development, and axes and measures that rely heavily on local public authorities for success. These programs finance a range of social services and provide key infrastructure services, including water, wastewater, and solid waste, particularly critical, as Romania has to comply with standards specified in the EU environmental acquis. However, the EU funds cover only a small part of the required investments and the Government, municipalities and other beneficiaries will need to mobilize significant counterpart and private sector funding in order for Romania to comply with EU directives. A key challenge for the Government is to address the existing institutional weaknesses, including by better defining the regional development model it wants to pursue.