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**INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT**

**AND**

**INTERNATIONAL FINANCE CORPORATION**

**COUNTRY PARTNERSHIP STRATEGY**

**FOR**

**ROMANIA**

**FOR THE PERIOD July 2009-June 2013**

**June 12, 2009**

**Central Europe and the Baltic Countries Country Unit  
Europe and Central Asia Region**

**International Finance Corporation  
Southern Europe and Central Asia Department**

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## CURRENCY EQUIVALENTS

USD 1 = RON 2.9664

## FISCAL YEAR

January 1 – December 31

## ABBREVIATIONS AND ACRONYMS

AAA	Analytical and Advisory Activities	IFC	International Finance Corporation
CEM	Country Economic Memorandum	IFI	International Financial Institution
CP	Convergence Program	IMF	International Monetary Fund
CPS	Country Partnership Strategy	IL	Investment Loan
DPL	Development Policy Loan	IT	Information Technologies
EBRD	European Bank for Reconstruction and Development	LA	Lisbon Agenda
EC	European Commission	MIC	Middle Income Country
ECA	Europe and Central Asia	MSME	Micro, Small and Medium Enterprises
ECB	European Commission Board	MTEF	Medium-term expenditure framework
EERP	European Economic Recovery Plan	NATO	North Atlantic Treaty Organization
EIB	European Investment Bank	NBR	National Bank of Romania
EU	European Union	NHIF	National Health Insurance Fund
EU8	Member States that joined the EU on May 1, 2004, excluding Malta and Cyprus	NGO	Non-governmental organization
EU10	EU8 Member States that joined the EU on January 1, 2007, excluding Malta and Cyprus	NRDP	National Rural Development Plan
FDI	Foreign direct investment	NRP	National Reform Program
FIAS	Foreign Investment Advisory Service	OECD	Organization for Economic Cooperation and Development
FIRST	Financial Sector Reform and Strengthening Initiative	OP	Operational Program
FRL	Fiscal Responsibility Law	PAL	Programmatic Adjustment Loan
FSAP	Financial Sector Assessment Program	PEIR	Public Expenditure and Institutional Review
GDP	Gross Domestic Product	PISA	Programme for International Student Assessment
GEF	Global Environment Facility	PPP	Public Private Partnerships
GMI	Guaranteed Minimum Income	ROSC	Report on the Observance of Standards and Codes
IBRD	International Bank for Reconstruction and Development	SBA	Stand-By Arrangement
		SME	Small and medium enterprises
		TA	Technical assistance
		USD	United States dollar
		VAT	Value Added Tax

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# Country Partnership Strategy for Romania

## EXECUTIVE SUMMARY

1. After eight years of rapid economic growth and impressive gains in poverty reduction, the shockwave of the global economic and financial crisis has exposed the growing imbalances and economic vulnerabilities in Romania's economy, rooted in weak economic management and a large, unfinished agenda of public sector and governance reforms.
2. The new Government faces the difficult task of reconciling short-term fiscal consolidation with the need to mitigate the social costs of the crisis and restore the sources of sustainable and equitable growth. The new Government has moved rapidly to take fiscal measures aimed at containing the impact of the crisis, to mobilize an international financial package spearheaded by the IMF, the EU and the World Bank, and to resume the structural reform agenda that had faltered since EU accession on January 1, 2007.
3. The World Bank Group will complement and support this program by i) helping the Government to implement structural reforms to help mitigate the crisis by reducing social and economic vulnerabilities and ii) putting in place the basis for sustainable economic growth in the medium-term. In the first few years of the Country Partnership Strategy (CPS), the Bank program will center on a programmatic series of Development Policy Loans (DPLs), the existing investment portfolio, and Advisory and Analytical Activities (AAA). A mid-term CPS progress report would articulate the Bank program for the outer years of the CPS period. This CPS is fully consistent with a forthcoming Regional Framework that will set out the Bank's value-added and key areas of activity across Central and South Central Europe and the Baltics region. Notwithstanding the current economic crisis, Romania's EU accession is resulting in increased market access and commercial banking activity, with a gradually declining role for the IFC. IFC therefore, envisages a phased reduction of its involvement within a period of 5 years, subject to market conditions, offering support to selective sectors and activities in which IFC can still provide value addition and in which the commercial sector and market cannot fulfill. In the short term, IFC's investment strategy is to play a crisis response role by helping to recapitalize the major banks which are considered vital to the financial system and offering trade finance to financial institutions in Romania.

## **I. COUNTRY CONTEXT**

### **A. Political Environment**

4. **Between 2001 and 2006 stakeholders in Romania united behind the objectives of joining NATO and the EU, but since 2007 reform momentum has slowed sharply.** After EU accession on January 1, 2007 political differences escalated and reform fatigue set-in. This affected the consistency and coherence of public policies, and complicated the adoption and implementation of longer-term policies and programs. Coalition politics is expected to prevail over the period covered by this Partnership Strategy but the global economic and financial crisis may provide the necessary impetus for renewed political accommodation that has, prior to EU accession, enabled minority or coalition governments to undertake important reforms.

5. **In late December 2008 a coalition Government took office following parliamentary elections a month before.** The current Government, which enjoys a 70 percent majority in the Parliament, is formed by a coalition between democrat-liberals and the social-democrats/conservatives alliance under a political pact - Partnership for Romania. Given its large majority in the Parliament and the support of the President, the coalition Government in principle controls the important legislative initiatives needed to manage the crisis and renew reform. The breadth and depth of these legislative and policy measures will be necessarily limited to the areas of overlap between the respective agendas of the coalition members. At the same time, these measures will necessarily have cross-party support and therefore may be more likely to be sustainable. However, the Presidential elections scheduled for Fall 2009 could strain the coalition as candidates from the two main coalition parties are likely to compete for the Presidency.

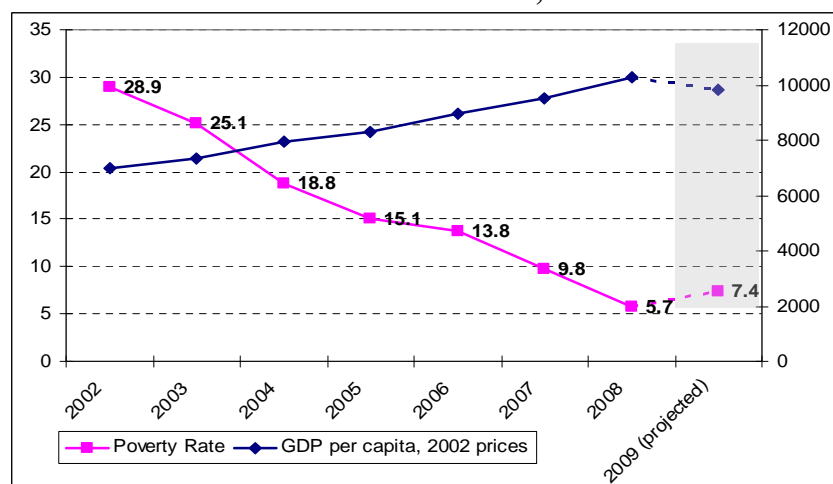
6. **The crisis provides stimulus for reform consensus.** The crisis has forced strong austerity measures and a re-evaluation of populist policies, including in public sector wages and pensions. Success in mitigating the impact of the crisis hinges on the commitment and capacity of political institutions to work together to enact bold reforms and to mobilize key stakeholders and the population behind them.

## B. Recent Economic Developments

### *Growing macro imbalances and the build-up of vulnerability*

7. **The Romanian economy experienced an economic boom during 2003-08, associated with the process of accession to the EU, leading to rapid gains in poverty reduction.** Growth averaged over 6.5 percent per year during that period, reaching over 7 percent in 2008. Absolute poverty declined from 35.9 percent in 2000 to 5.7 percent in 2008. A large part of the domestic absorption boom was driven by private investment: with EU accession prospects becoming more certain, capital flows, particularly foreign direct investment, were attracted by perceptions of lower investment risk that made Romania a favorable investment location. Sharp increases in asset prices and rising collateral values added a self-reinforcing momentum to the absorption boom.

**ECONOMIC GROWTH & POVERTY, ROMANIA 2002-2009**

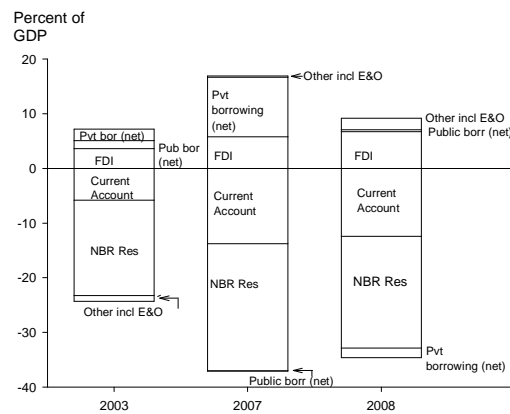


Source: Romania - Rapid assessment of the economic crisis on poverty. Joint note by UNICEF and the World Bank, April 2009

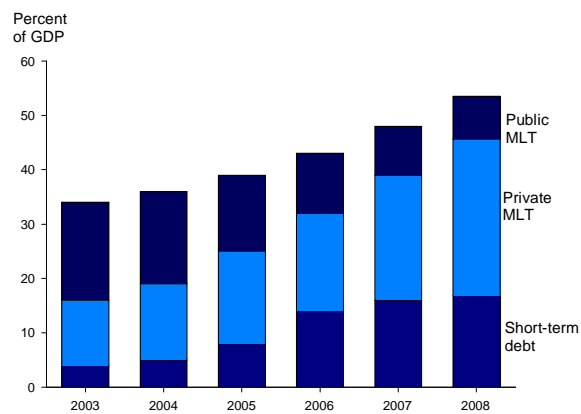
8. **The strong economic growth was accompanied by widening current account imbalances.** Although exports to the EU countries grew at a robust pace, domestic demand grew at an even faster rate, and the current account deficit rose from just over 5.0 percent of GDP in 2003 to 12.4 percent of GDP in 2008.

9. **At the same time, in the past two to three years, the composition of the capital inflows moved increasingly towards private debt flows**—in large part the result of borrowing by banks, often by subsidiaries of foreign banks from their parent banks but also as a result of direct borrowing by corporates.

**Figure 1.**  
Growing current account deficits were increasingly financed with private borrowing until 2008....

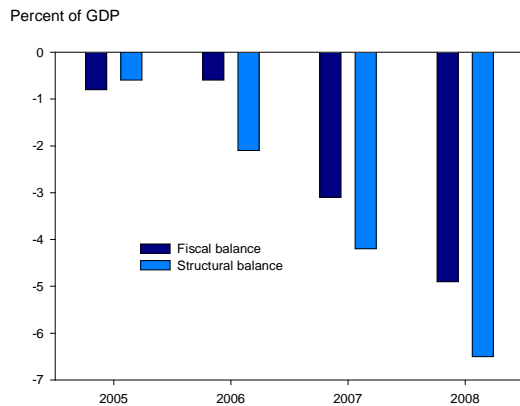


**Figure 2.**  
.. and the structure of private debt shifted toward shorter maturity

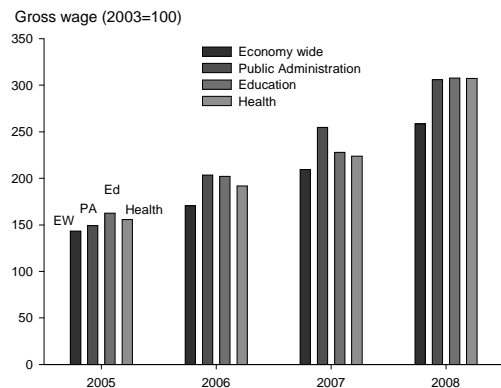


10. **The domestic overheating and external imbalance were exacerbated by the fiscal policy stance.** Fiscal policy in Romania has been highly pro-cyclical in recent years with fiscal management lacking in medium term orientation. Following efforts of fiscal consolidation during 2003-05 that led to a narrowing of the fiscal deficit to 0.8 percent of GDP in 2005, the fiscal deficit widened again progressively to reach 4.9 percent in 2008 (while the structural fiscal deficit increased from 0.7 percent of GDP in 2005 to 6.5 percent of GDP in 2008) as a result of excessive public spending policies. Government spending doubled between 2005 and 2008 pushing the public sector share of economic activity from 31 percent of GDP to 37.8 percent of GDP. The public sector wage bill more than doubled over these three years due to high wage increases combined with a huge increase in government employment. In the final months of 2008, further expenditure hikes in the run up to the November 2008 parliamentary elections left a legacy of precarious financing of the deficit. This doubling of government spending was not matched by a corresponding increase in the amount and quality of public services.

**Figure 3.**  
Fiscal policy was pro-cyclical and deficits grew..



**Figure 4.**  
..driven in large part by loose public pay policy



11. **The overheating and large capital inflows complicated monetary policy.** Monetary policy was relatively tight—with the National Bank of Romania (NBR) increasing reserve requirements and interest rates in an attempt to dampen inflationary pressures. In addition, a number of measures were undertaken to contain credit expansion, especially in foreign currency lending. Between 2004 and 2008, policy interest rates were raised, as were minimum reserve requirements (to 18 percent on local currency liabilities and 40 percent on foreign currency liabilities); measures were taken to limit household debt exposures, especially with regard to mortgage debt; prudential regulations were strengthened to limit lending to un-hedged borrowers of foreign exchange, and restrictions on household debt service ceilings were tightened. These measures contributed to the subsequent deceleration in household credit growth, but pressure from an expansionary fiscal policy and capital inflows caused the NBR to miss its inflation target in 2007 and 2008. At the same time, the interest rate differential between domestic and international rates and the restrictions on credit growth mentioned above, may have served to further encourage direct external borrowing and short term capital inflows. In particular, large firms began to borrow directly abroad as reflected in an increase in direct borrowing by firms from the equivalent of 4 percent (on a net basis) of GDP in 2005 to nearly 11 percent of GDP in 2007.

12. **Romania’s financial system—which is dominated by commercial banks—played an integral part in the domestic overheating.** Between 2003 and 2007, total financial system assets more than doubled from about 36 percent to 74 percent of GDP (with the banking sector accounting for 83 percent of total assets). At the end of 2007, foreign-owned banks (mostly subsidiaries) accounted for 88 percent of total banking sector assets. Growth in real private sector credit rose from 23 percent per year in 2003 to over to 60 percent in 2007 before slowing slightly to 54 percent in 2008. Much of banks’ lending was directed towards households, three quarters of which towards consumer credit. Between 2003 and 2007, claims on households rose from 12 to 28 percent of total banking sector assets (19.5 percent of GDP in mid-2008), while claims on companies declined from 37 to around 30 percent of banks’ assets.

13. **The proportion of banks' lending funded from non-deposit sources—particularly foreign borrowing—rose progressively.** While deposits grew relatively steadily, lending significantly outpaced the growth in deposits with the loan to deposit ratio increasing by over 43 percent during 2003-2008 to reach 130 percent at end 2008. The large resort of banks to external financing of lending is reflected in the rise in net foreign liabilities of banks from the equivalent of -2 percent of GDP in 2003 to around 18 percent at end 2008.

14. **The indebtedness of households and corporates also grew rapidly, with much of the borrowing denominated in foreign currency.** Total borrowing by the corporate sector grew at an annualized rate of 44 percent between 2004 to mid-June 2008 entailing a near doubling of indebtedness to 28 percent of GDP. Although the proportion of foreign currency (FX) borrowing declined slightly over the period, it was still over 70 percent in 2008. While household disposable income grew at an average annual rate of 20 percent, household debt increased at a rate of 77 percent, with FX denominated borrowing rising even more rapidly; by mid-2008, the share of FX borrowing in total household borrowing had risen to 56 percent (from 45 percent in 2005).

15. **In sum, the Romanian economy had become vulnerable to liquidity and foreign exchange risks by the time the global financial crisis unfolded.**

### **C. Impact of crisis**

16. **The economy has been hit hard by the global economic downturn.** Economic activity declined sharply in the last quarter of 2008 and has fallen further in early 2009. Real GDP growth shifted from an average of 9 percent (quarter on quarter annualized) during the first three quarters of 2008 to a 13 percent decline in the fourth quarter. The decline was driven primarily by a drop in domestic demand. Export growth also slowed. With imports dropping even more sharply, the correction in the current account deficit began towards the end of 2008. For the first quarter of 2009, early indicators (confidence, industrial production, retail sales and tax revenues) all point to a continued sharp drop in GDP, along with rising unemployment as well as poverty incidence.

17. **Asset and financial markets have been severely affected by the effects of the global crisis and economic downturn.** The stock market has lost 65 percent of its value since the peak in August 2008. The inter-bank market was disrupted in October 2008 by rumors of liquidity problems at a commercial bank, leading to a spiking of rates; these rates remained relatively high thereafter due to lingering concerns about counterparty risk, high risk aversion, and market segmentation due to an uneven distribution of assets (T-bills) eligible for discount with the NBR. Balance of payment pressures drove a 15 percent depreciation of the leu against the Euro from October 2008, putting pressures on household, corporate and bank balance sheets. To dampen currency volatility, the central bank intervened in the spot market, with some EUR4½ billion in reserves since end-October. Despite the depreciation, financial conditions tightened significantly on increased sovereign credit default swap premium and monetary policy tightening. Romania's international credit rating was cut in late 2008 by a larger margin than those of other countries in the region, reflecting market concerns about the sustainability of Romania's large current account deficit, uncertainties surrounding the outlook for fiscal and incomes policies, and the

financial health of banks with subsidiaries or branches in Romania. This has translated into significantly higher external borrowing costs for Romanian banks and corporates.

18. **As conditions in the financial markets have worsened, the financing of the fiscal deficit has been increasingly concentrated at very short maturities.** This has exposed the Government to roll-over risks in the current environment of de-leveraging.

19. **Romania's deteriorating macro-financial environment has created risks for financial stability.** Over the last few months, liquidity risk has become substantial in view of the difficulties in parent banks and the downgrading of Romania's sovereign rating to below investment grade by major international ratings agencies in late 2008 leading to a decline in the capital account flows. A sharp contraction or reversal of inflows could threaten macroeconomic and financial stability through a drying up of credit to the private sector, resulting in an even sharper slump in economic activity and larger increases in loan defaults. In addition, a reversal of capital inflows would put additional downward pressures on the exchange rate. While banks' direct exposures to foreign exchange risk reflected in their net open positions are low, as noted above, many households and businesses are exposed to un-hedged foreign exchange risks. Banks, therefore, have substantial indirect foreign exchange risk exposures, in the form of credit risk.

20. **The rapid deterioration in economic conditions and depreciation of the leu will place strains on bank capital positions.** The banking system entered the crisis well capitalized and with high liquidity buffers. Stress testing has already been performed by the National Bank of Romania. A strengthening of capital positions may be warranted and, in line with commitments made in Vienna and in Brussels, parents of most foreign owned banks have agreed to maintain lines of credit to their subsidiaries and borrowers in Romania and to increase their capital in order to comply with the minimum agreed level of solvency. In addition, banks will need to be proactive in enhancing loan quality by developing and implementing effective debt restructuring or workout procedures for household and corporate clients.

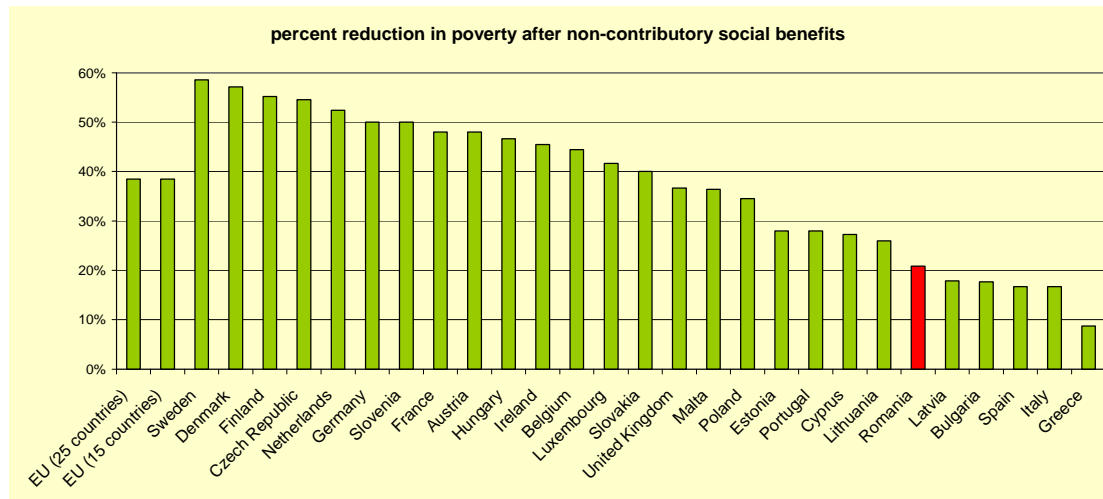
#### **D. Social Outcomes**

21. **Growth was highly successful in reducing poverty for the large majority of the population.** The rapid growth witnessed over most of this decade has led to a dramatic decline in absolute poverty to 5.7 percent in 2008. The number of absolute poor fell from 2.1 million in 2007 to about 1.2 million in 2008. Poverty remains concentrated among vulnerable groups, in particular in rural areas where 75 percent of the poor are found. Besides rural areas, children, in particular those of large families, the youth, the Roma, the unemployed and the self-employed (especially in agriculture), are at higher risk of poverty.

22. **Poverty reduction gains are at risk, with both core and transient poverty expected to increase.** The onset of the crisis is expected to partially reverse the important gains in overall poverty reduction derived from past economic growth. Poverty is expected to rise to 7.4 percent of the population in 2009, and the proportion of children living in absolute poverty is projected to increase from 7.8 percent in 2008 to 10.7 percent in 2009. Although most of poor continue to reside in rural areas, poverty is expected to increase faster in urban than in rural areas (by 40 and 30 percent, respectively), and the self-employed (outside of agriculture) where the impact of the

crisis is expected to be most pronounced. The budget transfers needed to finance increased demands on social assistance from the chronically poor, the unemployed and those vulnerable to transient poverty will be a challenging task given the reduced fiscal space.

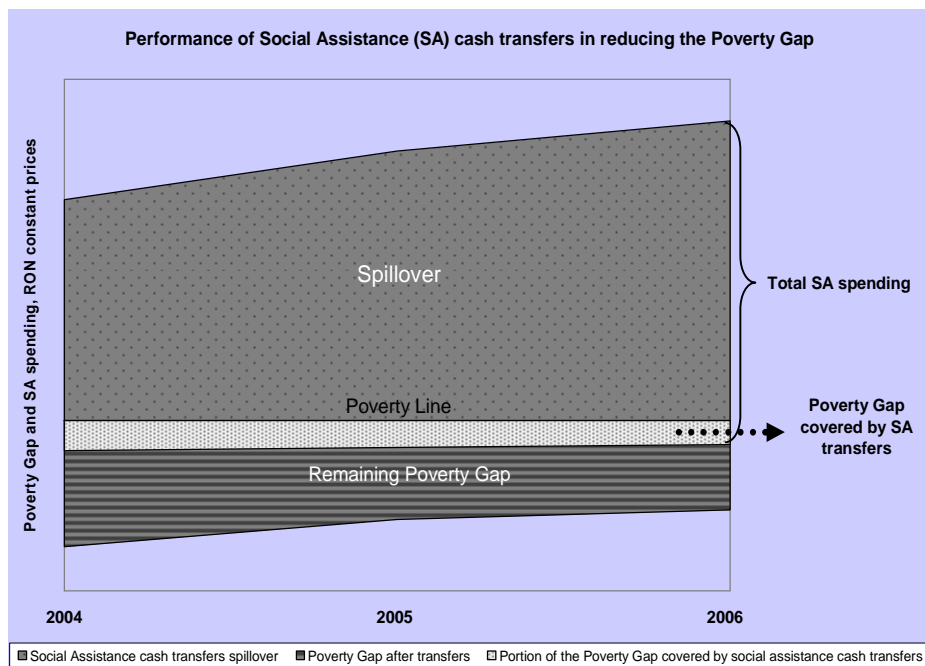
**Figure 5. Effectiveness of Social Assistance Programs across EU member states**



Source: World Bank Policy Briefs, 2009

23. **Social protection schemes do not address poverty well.** Romania’s social protection expenditure per capita is the lowest in the EU, and spending on poverty-targeted programs is low in proportion to GDP and to needs; it has actually declined in recent years. Only a few safety net programs perform well, while the overall system of social assistance cash benefits performs less well than in other EU countries in reaching the vulnerable and in providing them with adequate protection (figure 5). Most of the social assistance benefits have a low adequacy, representing only 10-20 percent of the minimum wage, and cover less than 30 percent of the household consumption of the poorest beneficiaries. The total social assistance benefits are not cost-effective from a poverty reduction perspective: 13 RON are spent for 1 RON reduction in the poverty gap (not taking into account administrative costs). Leakages and inequity in social assistance programs are high (figure 6): only 17 percent of the social assistance benefits reach the poorest quintile, 29 percent of the poor are excluded from the system (“remaining poverty gap” in figure 6), and half of the funds spill to the wealthier quintiles. Spending on poverty-targeted programs has decreased relative to GDP in recent years. Well-targeted programs such as the Guaranteed Minimum Income Program (GMI) or income-tested family allowances are underfunded, leaving out 60 percent of the rural poor and 77 percent of the urban poor.

**Figure 6. Effectiveness of Social Assistance Programs in Romania**



Source: World Bank Policy Briefs, 2009

## **E. Economic Outlook**

24. **The economy is expected to contract by about 4 percent in 2009** (Table 1). Domestic demand will contract as foreign direct investment and capital inflows, which previously helped finance high consumption and investment growth, will drop sharply. With no fiscal space and tight financing conditions, an easing of fiscal policy to cushion the downturn will not be possible.

25. **The Government has already initiated substantial measures to address the fiscal deficit.** The 2009 approved budget contains important spending cuts and revenue increases yielding around 3 percent of GDP in total. These measures include i) an increase of 3.3 percentage points in social contributions; ii) higher property taxes due to an overdue increase in appraisals; iii) removal of a reduced VAT rate for the purchase of a first house; iv) significant cuts in the public wage bill by reducing bonuses and other benefits and by eliminating 137,000 vacancies (previously used to grant higher allowances to existing staff); and v) substantial cuts in spending on goods and services as well as subsidies. It is estimated that the fiscal measures already approved in the budget would reduce the fiscal deficit to about 5.2 percent of GDP and the structural deficit would fall by about 1.7 percent of GDP.

26. **The Government has sought multilateral support, including from the IMF, the EC and the World Bank Group.** The Fund's program of support seeks to i) strengthen fiscal policy further to reduce the Government's financing needs and improve long term fiscal sustainability; ii) maintain adequate capitalization of banks and liquidity in domestic financial

markets; iii) sustainably reduce inflation; and iv) secure external financing and improve confidence.

**Table 1: Selected macro indicators**

	Actual					Projected	
	2005	2006	2007	2008	2009	2010	2011
	Annual percentage change						
<b>Output and prices</b>							
Real GDP	4.1	7.9	6.2	7.1	-4.1	0.0	5.0
Domestic demand	8.3	12.8	14.3	8.9	-8.2	-3.3	6.0
Consumer price index (CPI av)	9.0	6.6	4.8	7.8	5.9	3.9	3.5
Unemployment rate	5.8	5.8	4.3	4.0	8.9	9.7	7.7
Nominal wages	17.0	18.9	22.6	23.6	5.9	3.8	5.2
Public sector wages	25.9	27.3	18.5	31.0	5.1	3.9	3.5
Private sector wages	14.7	16.5	23.2	21.2	6.2	3.8	5.7
	In percent of GDP						
<b>Savings and investment</b>							
Gross domestic savings	23.3	26.5	31.1	31.4	30.8	29.9	31.9
Gross national savings	14.4	16.1	17.3	19.0	23.2	23.4	25.7
<b>General government</b>							
Revenue	30.1	31.0	32.5	32.6	33.0	33.4	33.1
Expenditure	30.9	31.6	35.6	37.5	37.5	37.0	35.8
<b>Fiscal balance</b>	-0.8	-0.6	-3.1	-4.9	-4.6	-3.6	-2.7
Privatization proceeds	1.3	0.4	0.1	0.1	0.0	0.0	0.0
External financing	0.5	0.1	0.1	0.5	2.8	1.1	0.2
Domestic financing	-1.0	0.1	2.9	4.4	1.8	2.4	2.5
Structural balance <sup>1/</sup>	-0.6	-2.1	-4.2	-6.5	-3.8	-1.7	-1.2
Gross public debt (direct debt only)	15.6	15.4	17.5	20.1	23.6	25.7	25.7
	Annual percentage change						
<b>Money and credit</b>							
Broad money (M3)	36.5	28.1	33.7	17.6	6.6	6.5	11.5
Credit to the private sector	-	54.5	60.4	33.7	15.9	5.1	3.2
	In percent						
<b>Interest rates</b>							
Euribor six months	2.8	3.2	4.8	3.5	-	-	-
NBR policy rate	7.5	8.7	7.5	10.2	-	-	-
NBR lending rate (Lombard)	14.0	14.0	12	14.2	-	-	-
Interbank offer rate (1 week)	7.0	7.4	7.8	15.9	-	-	-
	In percent of GDP						
<b>Balance of payments</b>							
Current account balance	-8.9	-10.4	-13.8	-12.4	-7.5	-6.5	-6.2
Merchandise trade balance	-9.9	-12.0	-14.4	-13.5	-7.5	-6.6	-6.8
Capital and financial account	15.6	15.7	17.3	13.9	-2.4	3.3	7.8
FDI	6.6	8.9	5.8	6.7	3.1	3.7	3.7
International investment position	-29.9	-35.3	-40.9	-52.9	-56.8	-55.8	-54.1
Gross official reserves	22.0	23.4	22.1	20.5	23.4	26.1	25.6
Gross external debt	39.0	42.9	47.1	53.4	64.2	68.5	64.0
<b>Exchange rates</b>							
RON per euro (eop)	3.7	3.4	3.5	4.0	-	-	-
Real effective exchange rate							
CPI based (depreciation -)	17.9	7.6	9.0	-4.2	-10.3	-2.1	1.3
Nominal GDP (bn RON)	289.0	344.7	412.8	504.0	531.3	568.5	634.1
Nominal GDP (bn Euro)	79.7	97.8	123.6	136.8	119.7	118.8	130.7

<sup>1/</sup> Actual fiscal balance adjusted for automatic effects of internal imbalance (output gap) and external imbalance (absorption gap). Source: IMF.

27. **Under the Fund's program, the fiscal deficit is expected to further narrow to 4.6 percent of GDP in 2009 from 4.9 percent of GDP in 2008.** Fiscal measures yielding an additional 1.1 percent of GDP are to be implemented in 2009 as prior actions for the IMF program, concentrating on expenditure reductions. The fiscal deficit for 2009 is thus expected to be 0.3 percentage points lower than 2008, at 4.6 percent of GDP. In order to safeguard the targets, spending plans will be back-loaded and their execution will be conditional on revenue performance. The structural fiscal deficit would decline by nearly 3 percentage points of GDP (from 6.7 percent to 3.8 percent of GDP). The authorities envisage additional adjustment efforts in 2010 to bring the deficit down to around 3.7 percent in that year, and to bring it to well below 3 percent of GDP in 2011 to meet the Maastricht deficit criterion.

28. **The current account deficit is projected to decline from 12.5 percent of GDP in 2008 to 7.5 percent in 2009 and further to 6.5 percent in 2010.** This adjustment process is expected to be driven primarily by a sharp import decline arising from the drop in domestic demand and the depreciation in the real exchange rate.

29. **The balance in the capital and financial account is expected to fall from a surplus of EUR18.8 billion in 2008 to a EUR2.7 billion deficit in 2009.** FDI is expected to decline considerably in 2009, and trade credit contracts will fall in line with import compression, consistent with developments in recent months. The capital and financial account is projected to reach a EUR3.8 billion surplus in 2010, on the back of a slight recovery in FDI and reduced capital outflows.

30. **Romania faces considerable balance of payments financing needs over the next 24 months.** Based on the projected current account deficit and stock of short term and maturing medium and long-term debt, Romania's gross financing needs would amount to EUR44 billion in 2009. Under the assumptions of average rollover rates for amortizing debt in 2009 of around 90 percent for banks and 70 percent for corporates, a financing gap of approximately EUR11¾ billion would emerge. For 2010 and the first quarter of 2011, the Fund's macro framework assumes that a strong adjustment program will reduce the financing gap to about EUR8¾ billion, bringing total financing gap under the program to EUR20 billion, as the current account is expected to continue to adjust and rollover rates and FDI to improve due to higher confidence in economic policies and the expected incipient recovery in the world economy. The financing gap for 2010 includes a build up in gross international reserves of about EUR3 billion, increasing reserves coverage to about 100 percent of short-term external debt at end-2010 from about 75 percent at end-March 2008, significantly reducing external vulnerabilities.

31. **Over the medium term, a gradual economic recovery is expected, whose pace and strength will reflect the restoration and broadening of the economic reform agenda initiated before EU accession.** Output is projected to follow a U-shaped adjustment pattern, and while positive growth is expected to resume by the second quarter of 2010, it would remain near zero in 2010. Beyond the economic stabilization and fiscal consolidation efforts under way, economic reforms will decide the evolution of the economy after the crisis, in particular how quickly and strong the economic recovery will be. In the *short-term*, Government priorities are to stimulate confidence in the economy, protect the poor and vulnerable from the effects of the crisis, protect employment, and contain the slowdown in demand, with focus on the financial system and fiscal policy.

32. **Consistent with the European Economic Recovery Plan, short-term actions are anchored on a longer term strategy aimed at fostering sustainable growth and employment by addressing the development challenges facing Romania.** The quality of the fiscal adjustment in reducing economic vulnerabilities and depth of the crisis would hinge on public sector reforms in the areas of public financial management, public administration, and macroeconomic management, complemented by governance and sector reforms to increase the efficiency of public spending and quality of public service delivery (notably in health, education, transport). The lack of sustainability of recent growth underscores the need for Romania to diversify its sources of growth in line with the recommendations of the Lisbon Agenda on enhanced competitiveness and business environment, better skills through education and innovation, and better infrastructure in transport, communication and energy; particularly important is capturing the growth potential of agriculture, a sector largely by-passed by growth over the past two decades. Finally, because the crisis will boost transient poverty, and the already significant core poverty will swell, economic growth must be accompanied by social policies to ensure social and spatial equity, through access to gainful employment and public services, and through well-targeted social assistance and sustainable social insurance programs. The severity of the crisis and the political support of the coalition Government offer a rare opportunity to address these structural and institutional reforms.

33. **The outlook is, however, subject to exceptional uncertainties and risks.** The recovery depends on global events, and on addressing structural challenges through a credible and sustained reform effort. In the near term, output could be further compressed through balance-sheet effects arising from a further RON depreciation and higher-than-expected inflation, especially if capital outflows are larger than anticipated. It would also be affected by a further worsening of global growth prospects, notably in Europe.

## **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 CO<sub>2</sub> 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.

### **III. THE WORLD BANK GROUP PROGRAM**

#### **A. Implementation of 2006 CPS and Lessons Learned**

59. **The FY06-09 CPS Bank program failed to establish a partnership with Romania,** despite being well aligned on Romania's priorities prior to and after EU accession and well coordinated with the EU at both policy and technical levels. The result was that while Romania made significant progress against its development goals, the CPS did not achieve many of the outcomes it sought. The CPS did not anticipate the pressure of populist policies stemming from the high expectations of the population following EU accession. It also underestimated the rapid inflow of other lower cost sources of finance and the desire of the Ministry of Finance to diversify its financing sources. The CPS did not identify areas of the Bank's value-added vis-à-vis other external partners and was perceived as being inflexible and having high transaction costs in comparison.

60. **IFC's portfolio has performed well.** IFC was relatively less affected than the Bank by the change in Government financing preferences and the shift towards EU institutions as preferred partners. During the CPS period IFC invested a total of \$383 million of its own fund and help mobilized \$191 million in 15 projects. These included 8 projects in the financial sector, a project to support the modernization of refinery, a project to improve river transportation, a project to support the first private hospital chain and a project in transportation and warehousing. Additionally IFC invested in regional projects in private equity funds, which allowed investments in smaller competitive companies as well as in oil and gas exploration. IFC-Bank cooperation throughout the period was strong. The CPS envisaged some links, for example with IFC supporting privatizations in infrastructure and energy proposed through the Programmatic Adjustment Loan (PAL) series, but these were stopped when the policy loan series was dropped and a halt in privatization of utilities by the Government.

61. **The Bank program was too optimistic and highly dependent on the anchor which was to be provided by policy-based lending.** The program was highly integrated, which worked well when the whole agenda moved forward as planned. However, when the PAL series was dropped, the associated investment loans also suffered, the program lost focus and coherence. Other financing sources replaced and exceeded Bank lending, but the associated technical assistance to line Ministries remained in demand. The Bank lending program was reduced to 40 percent of the indicative amount projected by the CPS and technical assistance was curtailed.

62. **The implementation of the portfolio was affected by the deterioration of the country dialogue.** As the dialogue around the PAL series weakened, implementation problems in the associated investment loans multiplied, commitments at risk increased and disbursement performance deteriorated. Commitments at risk rose from zero in FY05 to 36 percent in mid-FY09, twice the average rate Bank-wide. Disbursements declined from a peak of 27 percent in FY03 to 10.9 percent in FY07, well below Bank-wide performance. Disbursement performance recovered to 18 percent in FY08 owing to more pro-active portfolio management and a new generation of faster disbursing projects.

63. **Portfolio implementation problems notwithstanding, the Bank maintained a dialogue with many stakeholders, based on a solid body of analytical work.** Analytical work on policy issues positioned the Bank to take an effective role in advising the new Government on the reform agenda in the short- to medium-term. This includes the 2006 Public Expenditure and Institutional Review; the 2008 Public Sector Pay Practices; the 2007 Notes on Pensions, Health Sector Policy, and Education Policy; the 2007 report on Private Sector Development Strategy; the 2008 Notes on Municipal Finance and on Regional Development; the 2007-08 Programmatic Poverty Assessments; the 2008 report on Financial Sector Literacy and Consumer Protection, the 2008 Discussion Paper on a Student Loan Scheme; the Policy Briefs issued in January 2009; the 2009 joint IMF-WB Financial Sector Assessment Program; the 2009 ROSC on accounting and auditing; and the ongoing Public Expenditure Review Update. The recommendations of these reports have inspired some of the decisions made by the new Government in response to the crisis. The proposed new DPL series resumes structural reforms launched under the 2003-2007 PAL program, which supported reforms in public finance management, education, health, social assistance, pensions, judiciary, and private sector development.

64. **The following lessons can be drawn:**

- **Identify the Bank’s comparative advantage vis-à-vis other external partners and design the program around these areas.** The Bank did not heed sufficiently the need for a different approach towards a MIC client no longer dependent on Bank financing. The program continued to emphasize large investment loans when other larger, faster, cheaper and more flexible financing sources were available. The Bank did not re-focus its role as a knowledge-provider or technical adviser. More could also have been done to experiment with more flexible, outcome-oriented investment loans that would support performance based budgeting and allow for lower non-financial transaction costs, by taking advantage of new opportunities and innovations –such as country systems pilots— that arose during the CPS programming period. As a result, the dissonance between the desire of line ministries for Bank projects to secure programs and predictable budgetary resources as well as knowledge on the one hand, and the desire of the Ministry of Economy and Finance to diversify its sources of financing to increase flexibility and reduce financing costs on the other, was not resolved. Bottlenecks in project financing due to budgetary constraints and limited fiscal space hindered successful implementation of several projects. The Bank should focus on its areas comparative advantage in some key reform areas, and on lowering its non-financial transaction costs (see Section B below).
- **Allow flexibility in a CPS to manage changing circumstances and the prevailing needs.** Given the fact that the program spanned such an important historical moment for Romania, the CPS program was somewhat over-determined with a program of loans outlined for all four years of the CPS. The Bank appeared to have a pre-set agenda and was unable to adjust with sufficient flexibility in line with the Government’s revised priorities. While Investment Loans (ILs) and Advisory and Analytical Activities (AAA) can reinforce a Development Policy Loan series, they should not be so inextricably linked as to create an ‘all-or-nothing’ program. Likewise, investment projects should not be overly complex (in technical and financing terms), which results in implementation delays and the need for restructuring or capacity building during implementation. The program should be designed so it can be scaled up or down according to the Government’s demand. As the lack of interest in lending

manifested itself, the Bank could have stepped-up its AAA program to demonstrate its value-added and develop a new knowledge partnership, but instead AAA declined in line with the lending program.

- **Anticipate and manage political transitions.** The CPS acknowledged that much of the commitment to reforms had been due to EU accession aspirations, but anticipated this reform commitment would continue to achieve convergence. In doing so, it underestimated an understandable reform fatigue after years of reforms in preparation for accession. At times, the Bank heard only the voices it chose to or sought agreement to its plans from other parts of Romania's governance structure. Such dialogue was counter-productive. The Bank should maintain dialogue with a wide range of stakeholders across the political spectrum, at all levels of the civil service and with a wide range of public stakeholders, including businesses, special interest groups and other non-governmental organizations.

65. **This CPS has been designed to reflect these lessons**, although the circumstances under which it is presented are very different to those prevailing at the time of the last CPS. The Bank is focusing on a series of budget support operations, presented alongside the CPS, with lower non-financial transaction costs for the Romanian authorities. However, unlike the last CPS, the other operations are not so intricately linked to the DPL as to make the whole program hostage to the success of this operation. Instead, the DPL is underpinned by analytical work that can be used to take forward Romania's objectives in a variety of ways, when needed. The program could be scaled up in the near-term only with significant cancellations within the current investment portfolio; in the absence of reform or ownership it could be scaled back to a limited portfolio of activities in areas of greatest need and ownership. A revitalized communications and outreach program is being implemented.

## **B. External Partners and the Bank's Value Added**

66. **The EU and EU-related institutions have become Romania's main external partner.** The EU has committed more than EUR 32 billion in grants to Romania over the period 2007-13, equivalent to about 25 percent of Romania's GDP in 2009, to further the EU's objectives of convergence and cohesion, support for SMEs, environmental sustainability, innovation, development of trans-European transport and energy networks, and sustainable and secure energy.

67. **EIB and EBRD are key supporters of Romania's development objectives.** EIB is the largest institutional investor in Romania with a portfolio of EUR 6.2 billion and planned activities of EUR 1.5 billion for 2009 and 2010. The EIB plays an important role in providing required co-financing for the EU structural and cohesion funds and also technical assistance to support the convergence, infrastructure, environment and energy goals. The EIB lending focuses on industry, transport, and energy. The EIB lends at both national and sub-national lending levels. EBRD invests in both the private and public sectors in areas such as power, transport, municipal infrastructure, financial institutions and the corporate sector. EBRD is supporting Romania's efforts to decrease the intensity of its carbon fuel consumption and is promoting energy efficiency projects and energy efficiency loans via the banks.

68. **As the crisis unfolded, the Government requested an international support package of EUR19.95 billion for the 2009-10 period.** The IMF would contribute EUR12.95 billion, the EU EUR5 billion, the World Bank EUR1 billion, IFC EUR100M in 2009-2010 and EUR100M in 2010-11 (subject to market conditions) and EBRD and EIB the remainder. The programs supported by the various partners are complementary. The IMF Stand-By Arrangement (SBA) envisages a new Fiscal Responsibility Law that will, among others, set up procedures for improved multi-year budgeting supported by DPLs; similarly, the SBA envisages a reform in key parameters of the pension system and financial sector reforms coordinated with DPL actions. The EU funds would support fiscal consolidation and fiscal governance reform, strengthening of monetary and financial sector policies, and structural reforms in public administration, quality of public services, and business environment. EBRD intends to double its investment in the private sector in Romania to EUR1 billion during the 2009-10 period. Approximately half of this amount would support the financial sector. EIB's additional resources (total amount of lending envisaged for 2009 is EUR 1.5 billion) will be targeted to investments both in the public sector (e.g. infrastructure) and the private sector (e.g. industry, energy, and support of SMEs lending).

For the 2007-13 period, Romania has been allocated EUR 19,67 billion: EUR 19,21 billion under the Convergence objective and EUR 0,46 billion under the European Territorial Cooperation objective. Together with the national contribution of EUR 5,53 billion, total financing for Cohesion policy activities would amount to EUR 25,2 billion over the seven-year period. Romania's contribution to the EU budget will amount to EUR 10.2 billion.

<b>Operational Program</b>	<b>EU allocation EUR mln</b>
Development of Human Resources Operational Programme	3476.14
Administrative Capacity Development Operational Programme	208.00
Regional Operational Programme	3726.02
Increase of Economic Competitiveness Operational Programme	2554.22
Transport Operational Programme	4565.94
Environment Operational Programme	4512.47
Technical Assistance Operational Programme	170.24
European territorial cooperation Objective	454.56
<b>TOTAL OPs</b>	<b>19.667.60</b>
CAP - Pillar 1	6127.50
CAP - Pillar 2 (NRDP)	8022.50
<b>TOTAL CAP</b>	<b>14150.00</b>
<i>Source: European Commission, staff calculations</i>	

69. **The World Bank can contribute significant value-added to Romania's development policy agenda, especially in structural reforms.** Building on past support to reform and analytical work, it can play an important role in supporting crisis management and reform in the

areas of public finance management in general and public expenditure in particular, public sector pay, education, health, social protection, and the financial sector. These specific areas were chosen as a focus for the DPL series in consultation with the Government and external partners, based on two main considerations: the Bank's knowledge through past sector involvement, analytical work, and regional experience; and the competence available from other sources. The Bank's role in supporting social sector reform is particularly critical, given that this area is largely excluded from the EU *acquis* and EU-supported programs.

**The Bank can provide value-added in four ways:**

- **Substance:** The Bank can be a strategic partner in sectors for which there is limited or no coverage in the EU *acquis communautaire*, i.e. health, education, social protection, pensions and public administration.
- **Approach:** The *acquis* sets the goals and standards to be achieved by Member States, but usually leaves the choice of implementation path to achievement of those goals to the individual countries. The Bank can assist with a diagnosis of the degree of readiness to achieve European goals, present options, and provide capacity building for implementation, i.e., to help with the 'how to' of complex policy and reform issues. For example, all member states need to achieve the 20-20-20 climate change targets, but may not know whether it is most efficient and effective to do so by changing the mix of power generation sources or by reducing the demand for energy. The Bank can help design implementation plans, identify costs, benefits and areas of vulnerability, build capacity and – with other partners – assist in the implementation of the plans.
- **Cross-sector integration:** Some topics demand a holistic, cross-sector response, which the Bank is well-placed to provide. For example, the demographic shifts currently taking place in EU10 countries will require solutions that incorporate a range of structural reforms, including in health, education and pensions.
- **Global perspective:** The Bank can both draw on experience in other countries to bring innovative ideas, examples and lessons, as well as learn from EU-10 countries to enhance programs across the range of the Bank's client countries. One example of sharing global ideas is the conditional cash transfer programs that were initially developed in Latin America and are now being applied in the US and in Europe.

**C. The Proposed Bank Strategy**

**70. The dual objective of the Bank is to support Romania deal with the economic and financial crisis, and to broaden and deepen the reform program for sustainable and equitable growth.**

**71. The proposed Bank program is largely defined for the first two years, and outlined for the outer years.** Learning from the earlier CPS, the approach of this CPS seeks flexibility and ability to respond to evolving circumstances and demand by adopting a results-based program centered on development outcomes and objectives that, on the one hand, reflect the

Government priorities and, on the other, are aligned with the Bank's comparative advantage and value-added.

72. **The main thrust of the engagement program is three-pronged, drawing on: existing projects, the DPL program, and opportunities for lending and AAA engagement depending on supply and demand factors.** In the first two years, the Bank program consists of the following activities: the portfolio of on-going projects, the proposed DPL program, and analytical and advisory activities (AAA) centered around the implementation of the reform program supported by the DPL. To the extent possible, the Bank will tap additional resources, e.g., through Trust Funds such as the Financial Sector Reforms and Strengthening Initiative (FIRST), and partnership opportunities with the EU and other IFIs. A mid-term review of the CPS with Government would define the program for outer years and could also include new lending activities (subject to available lending headroom) that would need to be defined in terms of objectives and modalities (general budget support, or sector specific budget support), and a program of new analytical and advisory activities.

73. **In the first two years of the CPS, the Bank's lending program in Romania would be dominated by a EUR 1 billion programmatic series of three DPLs as part of a joint program with the IMF and the EC.** In line with the respective mandates of other partners, the Bank's engagement would focus on the financial sector, social sector reforms and public sector reforms. Selective investment lending outside the DPL program could be considered provided there is ownership, with priority given to areas which have the required absorption capacity and aligned with the Bank's comparative advantage which are outlined below. A substantial portfolio restructuring exercise is underway to free up resources from existing loans that no longer match the Government's priorities and to create headroom for such operations.

74. **Lending would be complemented by a substantive AAA program to inform and help guide the implementation of individual reforms.** Special emphasis will be placed on peer-learning and dissemination, including sharing best practice in project design and implementation. AAA work is anticipated around the core reform topics supported by the DPL including education, health and pensions as well as public financial management issues with an emphasis on decentralization, tax and civil service reform. AAA will also be used to maintain a dialogue with strategically important sectors not covered by the DPL, including agriculture, infrastructure and the environment.

75. **The program is characterized by uncertainties.** If the pace of global and European economic recovery is slower than currently anticipated and/or the Government's interest to pursue reforms is sustained, lending may continue into the outer years of the CPS beyond the DPL series (subject to available lending headroom). If, however, the pace of economic recovery is rapid and/or the Government's commitment to reform weakens, the focus of the program may shift towards a knowledge-sharing agenda based on AAA and a cost-sharing relationship. While the early years of the program are reasonably well defined, the outer years are not and will be defined following a mid-term review and consultations with the Government.

76. **As of end of April 2009, IFC's portfolio in Romania stood at about \$470 million which represents IFC's 3<sup>rd</sup> largest portfolio in Europe and Central Asia after Russia and Turkey.** However, IFC envisages a phased reduction of involvement in Romania within a period of 5 years (subject to market conditions), offering support to selective sectors and activities in

which IFC can still provide value addition and in which the commercial sector and market cannot fulfill. In addition, IFC's activities will maintain their focus on managing its existing portfolio of investments. IFC has begun withdrawing from sectors and lines of business in Romania where the private sector is ready to take over. For example, IFC does not participate in FDI in projects below US\$50 million where commercial banks are willing to finance and also IFC does not offer credit lines to large banks, with the exception of special types of financing (energy efficiency, long term local currency, agriculture lending and MSMEs financing). In the short term, IFC's investment strategy is to play a crisis response role by helping to recapitalize the major banks which are considered vital to the financial system and offering trade finance to financial institutions in Romania. IFC's effort will contribute to speed up economic recovery and boost job creation while reducing the impact of the financial crisis. Also, IFC will consider investments, on a very selective basis, in banks and sectors that have a very strong development impact in frontier regions or in the areas of agriculture, climate change, infrastructure and health and education.

**Table 3. Proposed IBRD Lending Program<sup>1</sup> and Selected AAA Services**

<b>Proposed IBRD Base-Case Lending Program</b>	<b>Calendar Year</b>	<b>Amount Euro (M)</b>
DPL 1	2009	300
DPL 2	2009	360
DPL 3	2010	340
<b>TOTAL</b>		<b>1,000</b>

<b>Recent/Proposed AAA Services</b>	<b>Completion Calendar Year</b>
Public Expenditure and Institutional Review Programmatic	2009-10
Pensions for the Elderly Poor	2009
Macro Monitoring	2009-10
DPL Education Reform TA	2009-10
DPL Health Reform TA	2009-10
DPL Civil Service – Public Financial Management TA	2009-10
DPL Financial Sector TA	2009-10
Tax Administration TA	2009-10
Poverty Monitoring Programmatic Series	2009-10
Student Loans TA	2009-10
IT Assessment at NBR TA	2009
Pension Annuities TA	2010-11

<sup>1</sup> Subject to IBRD financial capacity

## **D. Strategic Pillars of the Proposed Program**

77. **The Bank's envisaged strategic partnership with Romania would be based on three pillars:** (i) public sector reform; (ii) growth and competitiveness; and (iii) social and spatial inclusion.

### **Pillar 1: Public Sector Reform**

*Goals: in the short-term to secure fiscal savings without adversely affecting priority services and social assistance; and in the medium-term to modernize the public administration to improve the accountability and responsiveness of its staff and predictability and efficiency in public resource management.*

**Public financial management - Objective:** reduce fiscal vulnerabilities by restoring budget discipline, improving the effectiveness and efficiency of public expenditures, and improved resource mobilization.

78. The IMF's SBA program supports a Fiscal Responsibility Law which aims to streamline the budget process and ensure fiscal sustainability over the medium term. As a complement, the World Bank will work with the authorities through the DPL program to improve the quality of annual budget planning by anchoring it more firmly in a credible medium-term expenditure framework and then to start to implement this process with selected line ministries. Through this process, the Bank will aim to strengthen national policy formulation; better link budget allocations with outcomes and performance; build capacities for economic analysis and forecasting; and improve the capacity of the Parliament and civil society for economic analysis. As a result, it is expected that the efficiency and effectiveness of Romanian public expenditure will be improved in the medium-term.

79. A programmatic series of Public Expenditure Review updates will complement the DPL series with the first in the series focusing on identifying opportunities for short-term savings and efficiency gains in major expenditure categories of the public budget, including education and health, transport and agriculture. Later updates will also cover issues around the systemic and institutional aspects of budget formulation and execution. In parallel to the Public Expenditure Review, the World Bank would also focus its analytical and advisory services on fiscal decentralization and tax administration where the needs are large.

80. In the outer-years of the CPS, output-based investment operations could be considered in support of decentralization, tax administration and performance-based budget support in selected sectors (for example, providing financing for the implementation of the per capita education scheme).

**Public administration reform - Objective:** improve the public pay system to enhance transparency and predictability, motivate performance among public sector employees, attract and retain critical skills.

81. The DPL program will support changes to Romania's public pay system to enhance capacity to attract and retain critical skills in the public administration. The reforms would aim

to keep personnel costs in line with GDP growth, improve the delivery of public services and limit discretion within the system. AAA work on civil service reform will be considered as a complement to the DPL. Overall, the program hopes to upgrade the Romanian public administration to align it better with European practices. Functional reviews and institutional reforms in selected public sector entities could be supported by DPLs; the former could be addressed by Advisory and Analytical Activities on a fee for services basis if so requested by Government.

**Governance - Objective:** strengthen the efficiency and accountability of the justice system.

82. Improved governance is implicit in many of the Bank-supported operations, and will be an important objective of the DPL-sponsored public sector reforms and supporting technical assistance and analytical work. A Judicial Reform project already in the portfolio will continue to increase the efficiency of the Romanian courts and improve accountability of the judiciary, in support of Romanian and EU objectives in this area.

## **Pillar 2: Growth and Competitiveness**

*Goals: in the short-run to put in place crisis-management measures in the financial sector; and in the medium-term to establish the building blocks for a resumption of growth for sustainable convergence to EU-average living standards through improved business environment, enhanced skills, upgrades in the infrastructure network and more efficient agriculture.*

**Financial sector - Objective:** deepen and strengthen the resilience of the financial sector.

83. The DPL series will include measures across the series drawn from a recent Financial Sector Assessment Program (FSAP) update. Some aspects of contingency planning have begun under the IMF program. The Bank's program will support adoption of a Strategic Action Plan to further this process to guide the response to a potential financial crisis, dealing particularly with potential future interventions in the financial sector, guidelines for mortgage and corporate debt restructuring, and amendments to the Insolvency Law. The DPL program will also seek to strengthen consolidated supervision of the financial sector and ensure the political and financial independence of financial sector regulators, and support the implementation of Basel II. Analytical work on the financial sector is up-to-date, but more may be needed in the outer years of the CPS, especially if external conditions or regulations change. The overall aim of the Bank is to help the authorities to strengthen their financial sector to underpin a resumption of growth and become more resilient to future shocks. IFC will selectively and in the short-run enhance its crisis response initiative by helping restore liquidity and confidence by working with other partners to provide appropriate funding to banks and by supporting trade finance. IFC's role in Romania in this context, is to: a) work together with other IFIs to develop and implement support programs for main banks in the country, subject also to further support from the parent banks and from the Romanian authorities (where applicable); and b) signal IFC's confidence and strong support for the Romanian banking sector through investments in systemic banks.

84. The degree of financial intermediation, remains at one of the lowest levels in Central and Eastern Europe and the system continues to offer limited products and services. Moreover, the global liquidity crisis has weakened the access to finance to underserved segments such as

MSMEs and the agriculture sector especially in rural areas of the country. In light of this, IFC strategy in the financial sector is to support existing clients, particularly those that are deemed systemic in their respective countries, to continue to strengthen financial intermediation to MSMEs, to facilitate trade and to introduce new financial products and services, such as local currency products, agriculture finance and energy efficiency lending. Success of the MSMEs sector is critical to the health of the Romanian economy as MSMEs represent more than 90 percent of registered companies, 70 percent of GDP and an important share of employment. IFC will also continue to finance private equity funds which are targeting SMEs. These funds will help local enterprises expand and improve their competitiveness.

**Business environment - Objective:** improve the business environment, including institutional and policy framework for R&D and innovation, and the development of a knowledge-based society and economy.

85. A Knowledge Economy project in the portfolio supports the Government in improving e-government services, including for small and medium enterprises. Advisory work is being considered on tax administration to reduce the tax (and tax processing) burden on businesses in Romania and corporate financial reporting. The Bank-wide Doing Business report may provide the basis for further analytical work in the outer years of the CPS. The Bank could also consider support the Romanian authorities in implementation of their Better Regulation Strategy for 2008-2013, with particular emphasis on simplifying the top 10-15 regulations identified by business surveys as being most onerous. Additionally, after the recommendations of the 2008 Accounting and Auditing Report on the Observance of Standards and Codes (A&A ROSC), the Bank may assist Romania to further implement the EU *acquis communautaire* as it relates to corporate financial reporting, including by advising Romania on the set-up of the audit oversight system that is crucial to enhance external audit quality in Romania. This assistance could be financed under a Bank fee-for-service arrangement, similar to the ones that are already in place with several new EU Member States under the Swiss Enlargement Contribution. On June 26, 2008 Switzerland and the EC signed a political declaration of intent to extend the Swiss Enlargement Contribution to the 2007 new Member States, Bulgaria and Romania, adding CHF 257 million (approximately US\$255 million) to the existing funding of CHF 1 billion, subject to approval by the Swiss Parliament (which still needs to take place) and the negotiation of Bilateral Framework Agreements (expected by the end of 2009). The Swiss State Secretariat for Economic Affairs (SECO) has already indicated its wish that the Bank-managed TA program on corporate financial reporting should also be extended to these countries using a portion of the Contribution, a move which is facilitated by the active policy dialog associated with the A&A ROSC.

**Education, skills and knowledge - Objective:** support the Government in improve access to and quality of education in a fiscally sound manner.

86. The DPL takes education as a focus sector for implementation of key reforms measures to improve the efficiency of resource use while enhancing the quality and access of public services. The series of loans will support a reform of education financing in primary and secondary education, which will free up resources for improving quality, while an on-going Rural Education project in the portfolio focuses on quality and access issues through rehabilitation and innovation. Technical assistance work will support the careful design and implementation of the decentralization of primary and secondary education, while at the tertiary

level a technical assistance program will support the introduction of a Student Loans scheme, which will boost the revenue base of the education system and provide an alternative and complement to the existing grant (scholarship) system. A Knowledge Economy project in the portfolio helps to connect disadvantaged communities with public services, and also supports the Government to adjust the delivery of its services (e.g., primary education) or introduce e-government services, including for small and medium enterprises. The overall objectives are to enhance the transparency and accountability of public sector activities through full and timely access to public information. Further support in this sector could be considered in output-based investment operations and/or technical assistance. IFC will also consider investments in education provided that the private players become more transparent.

**Agriculture - Objective:** provide advisory, technical and financial assistance to support the market-based restructuring and competitiveness of Romanian agriculture.

87. The Bank remains active in the agriculture sector with three projects: one that supports the implementation of land tenure and titling reform and enables greater absorption of EU funds; another aims to improve the competitiveness of farmers and agro-processors through improved advisory services, to modernize the agricultural research apparatus, and to improve food safety, in line with EU requirements; and a third supports the rehabilitation and reform of irrigation systems to increase agricultural productivity. Complementary analytical work could include a review of the optimal mix of EU Common Agriculture Policy and national funds to maximize the impact on competitiveness. Analytical work (in the Public Expenditure and Institutional Review) and technical assistance may also be considered to strengthen the capacity of those Government departments responsible for agriculture and rural development to enhance their strategic planning and programming capacity as one of the key expenditure categories in the budget. The Romanian agriculture sector is often referred to as a significant beneficiary of European Union membership because EU integration can give Romanian farmers access to a market with more than 500 million consumers. Despite the comparative advantages of the country, namely, an abundance of arable land and a favorable climate, the Romanian agriculture sector suffers from fragmentation and obsolete production methods. Investments are needed to raise the sector's competitiveness and to help local farmers improve efficiency through upgraded technology. IFC will selectively support direct investments in agribusiness as well as financial institutions which provides financing to the agriculture sector, which has been largely ignored by the financial sector. IFC's support of this key sector can help to encourage additional investment from the financial community.

**Transport - Objective:** improve the efficiency of the roads and railways sub-sectors, help reduce the overall costs of transportation, improve road safety, and reduce the negative impacts of traffic congestion and pollution in selected cities.

88. The portfolio of transport projects in the current portfolio is expected to close in the first few months of the CPS. However, as a major expenditure category in the budget, the PER will consider opportunities for fiscal savings and efficiency gains drawing on the Bank's experience in this sector. While other institutions, particularly EIB and EC, remain the key counterparts on transport issues, a future Bank role in this sector could be envisaged in the areas of strategic planning, institutional and policy reforms, safety and development of PPP projects. IFC will closely coordinate with EBRD and EIB to finance PPPs with significant developmental impact.

**Energy and Environment - Objective:** assist Romania in meeting its commitments in respect to energy market liberalization and EU 20-20-20 targets, implementation of EU Water and Nitrate Directives, and in reducing environmental, social and economic vulnerabilities to natural and technological disasters.

89. The Bank's support in this area has been declining and now focuses on rehabilitation of a hydropower station and a guarantee operation of a privatization agreement for electricity distribution companies under a new regulatory framework, and the closing of mines in an environmental safe manner together with the regeneration of economic activities in the mining areas. Should the Government decide to resume the privatization process to include the remaining state-owned energy companies and mining companies, the Bank may consider supporting this process and/or the associated institutional and regulatory issues. The Bank has also recently supported lending (including a GEF grant), analytical and technical assistance to support companies' adoption of energy efficient technologies. It is hoped that this work may be furthered during the CPS period as Romania has to meet the EU's ambitious climate change targets and could draw significant revenues from the sale of surplus CO2 emission rights under the Kyoto Protocol.

90. An Integrated Nutrition Pollution Control loan and associated GEF grant in the portfolio will help Romania to meet the EU Nitrates Directive requirements by reducing pollution discharge into water bodies and strengthening institutional and regulatory capacity. The on-going Municipal Services projects is assisting Romania meets its commitments with respect to water quality, and also in the absorption of EU funds. In collaboration with the Bank, IFC may support new investors in the power sector (generation and distribution) and other network utilities (water, gas, district heating), where emerging regulatory frameworks are not yet well-tested and constitute an element of uncertainty and "political risk" which may otherwise constrain investor interest. IFC will also work with local financial institutions to provide energy efficiency lending and invest in renewable energy projects (wind and/or biomass).

91. The on-going Hazard Risk and Emergency Preparedness in Romania project aims to reduce environmental, social and economic vulnerabilities to natural and technological disasters by enhancing the Government's institutional and technical capacity for disaster risk management. This includes establishing an integrated disaster information management system, developing earthquake scenarios, conducting public awareness and preparedness programs. The Bank may also discuss Catastrophic Risk Insurance options with the Romanian Government.

### **Pillar 3: Social and Spatial Inclusion**

*Goals: in the short-term to protect the new and existing poor populations from the adverse effects of the crisis; in the medium-term to promote social inclusion and regional development.*

**Social assistance - Objective:** improve the cost effectiveness and targeting of social assistance programs to mitigate the impact of the crisis on the poor and vulnerable.

92. Social protection is a core theme of the DPL series, which will aim to improve the design and increase the coverage of the most efficient and well targeted social assistance program - the Guaranteed Minimum Income (GMI) – while progressively rationalizing the coverage of the less efficiently targeted programs. The Bank has some considerable analytical and advisory work

already in place on this topic, but will continue to deepen this through a programmatic poverty monitoring series to help in particular with the monitoring and evaluation, and the design of future improvements. Further lending or technical assistance work to support implementation of the measures could be considered in the outer years of the CPS, notably in helping the development of activation policies and programs.

**Social Inclusion - Objective:** improve the social inclusion and living conditions of the most disadvantaged and vulnerable people in the Romanian society.

93. The Bank's program already has a Social Inclusion operation that aims to improve the living conditions and social inclusion of the most disadvantaged in society, which in Romania include the Roma, persons with disabilities, children at risk and victims of domestic violence. The programmatic poverty monitoring program will provide further analytical coverage of these issues. Three other programs in the current portfolio also have a strong inclusion focus: the Knowledge Economy project specifically targets remote and disadvantaged communities to link them electronically to broader society; the Rural Education project supports school-based innovations in remote regions; and a Mine Closure project provides socio-economic regeneration opportunities to mining communities and local authorities. Further work in transport or communications would continue to focus on connectivity and inclusion.

**Health sector - Objective:** support the design and implementation of health sector reform program to improve health outcomes.

94. As with education, the DPL takes health as a focus sector for implementation of key reforms measures to improve the efficiency of resource use while enhancing the quality and access of public services. Specific reforms to be supported include those that would support the Government's decisions on drug pricing and adoption of legislation to promote the prescription of generic drugs; improve the design of the benefits package and in particular introducing a co-payment system with exemptions for the poor; promoting the development of supplementary insurance rationalizing hospitals and shifting to a focus on primary care services which would be supported by provider payment reforms. This program will be supported by analytical work and further lending for health could be considered in the outer years of the CPS given the extensive reform agenda. An on-going health project is supporting the modernization of maternity and emergency services. IFC will seek to help stimulate the growth of the private healthcare sector in Romania, as well as support the delivery of higher quality and better reach of services by offering advisory services within the World Bank programs and promoting private sector participation. IFC will also help establish benchmarks for delivery of private health services in the country.

**Pension system - Objective:** strengthen the performance, financial viability, integrity and equity of pension system.

95. The DPL series will support reforms in the pension system to put it back onto a sustainable footing, including indexation of benefit adjustments to inflation, raising and gradually equalizing the retirement age and increasing the contribution rate to the second pillar. Other important aspects of the Bank's program include analytical work, which could be followed by implementation support, to provide better social protection for elderly poor (effectively a zero

pension pillar) and implementation of a capacity building program for the pension system administration. The Bank may also advise on strengthening pension annuities in anticipation of the time when the second, private pillar will start to pay out.

**Regional development - Objective:** address the disparities across regions by focusing on strengthening the administrative and financial management capacity with the view to improve the quality of public service delivery at sub-national level.

96. The Bank supports the regional development policy of the Government through investment lending in municipal infrastructure and advisory services. Under a Bank-financed project Master Plans for water and wastewater infrastructure are prepared for eleven (out of forty two) counties for financing by the EU funds. Another project provides TA to Roma communities to prepare projects (small roads, water, sanitation, small housing investments) for financing through EU funds and capacity building and training at local level for preparation of investment projects for EU financing. The Bank stands ready to continue to offer support in lending and analytical and advisory services for regional and municipal development. Areas for assistance could be envisaged in planning, institutional and policy reforms, including decentralization, capacity building at sub-national level and co-financing of EU funds.

#### **E. Consultations and Partnership with the Government and other Stakeholders**

97. **To be effective, the Bank will need to forge a true partnership with the Government, based on sharing of goals and mutual trust, and anchored on broad support among other stakeholders.** The Bank will seek to continue the practice of regular portfolio reviews with the authorities to ensure a good alignment of priorities and prompt follow-up where issues arise. Such reviews could take place every six months with officials, and at least once a year at Ministerial level.

98. **The FY10-13 World Bank Group CPS was prepared by drawing on intensive dialogue and feed-back mechanisms. The CPS teams used a variety of consultation mechanisms.** Stakeholder consultations were the main instrument for identifying key challenges and possible CPS themes in May 2009. These workshops involved national and local Governments, civil society, the business community/private sector, academia, unions, youth groups, and other development partners. Further live and online consultations are envisaged through CPS implementation. Other tools included a series of consultations on policy notes, issued in early 2009, dissemination and consultations of individual analytical or TA reports produced by the WB (e.g. social protection, regional development, municipal finance, students loan, civil service pay), and an on-line feedback mechanism via the website (See Annex E for more details).

99. **The consultations provided a venue for a meaningful exchange of views with various stakeholders on the critical challenges of current economic crisis affecting Romania and long-term prospects as well as policy options and programs that would address these challenges.** The key messages and implications for further Bank Group support are summarized in Box 1. The goal of these discussions was to listen to a wide spectrum of voices and to incorporate the most relevant opinions and comments in the CPS design. A detailed feed-back

report will be sent to all participants and posted on the Bank's Romanian website to inform the public about messages and recommendations.

### **Box 1. Key Messages from Stakeholder Consultations**

**Lessons learned from past and ongoing work of the World Bank in Romania.** Need to scale up successful experiences, including reforms piloted by Bank-financed projects. Need to bolster information and communication on policies and projects. Need for better coordination among donors/lenders.

**Consistency of proposed Bank program with needs and expectations.** The Bank program should consider sectoral strategies and not only 3 main national programmatic documents (GP2009, Lisbon Agenda, NRP 2007) Advice extended to the Bank on balancing flexibility with the need for firmness, especially concerning agreed reform objectives and specific project outcomes.

**Political and economic context, risks and opportunities.** Coalition politics create risks for sustainability of both reform and project implementation. General concern about the commitment and capacity to design and implement needed reforms. Reservations about the extent to which current cooperation of the Government with IFIs goes beyond financial needs and is driven by genuine acceptance of the need for reform.

**Scope for resuming reform.** Education was unanimously identified as the neediest area for reform. Teachers' pay must be linked to broader reform objectives and outcomes. Public Sector is seen as lacking professionalism and management skills. Perceived inefficiency of the bureaucracy, lacking communication and coordination, is hampering delivery of public services.

**Governance.** Concern with implementation capacities in both central and local administrations. Need for better inter-ministerial coordination and at local level. Virtual consensus on inability to address governance issues.

## **F. Measuring Results**

100. **The proposed Bank engagement is expected to support the achievement of key Government objectives.** The envisaged lending and AAA program would be supportive of key Government objectives in selected policy areas. The results framework (Annex C) largely reflects the results anticipated from the existing portfolio activities (lending, and analytical and advisory) and those new activities planned for the first years of the CPS. The Bank program would be small in the context of Romania's overall development program and the actions of other parties – Government or other outside agencies – will also play a part in contributing to these outcomes. Nevertheless, the specific outcomes identified in Annex C are those that the Bank will try to influence and those which can be attributed to the Bank's interventions.

## **IV. Risk Management**

101. **The proposed Bank strategy carries risks.**

102. *Institutional capacity risks* relate to policy formulation and coordination capacity, medium-term vision, implementation, and accountability. Capacity constraints could delay key elements of the reform program to be supported by the Bank. The Bank's program has a strong focus on capacity building in both the executive and legislative branches of the Government with emphasis on public financial management and public administration reforms. AAA could play an important role in addressing capacity constraints and building institutional capacity where needed.

103. *External economic and financial risks* relate to the uncertainty of the global economic outlook, the risk that financial markets may remain frozen over a prolonged period, the risk that the economic downturn in the EU may be more severe and protracted than currently envisaged, and that the perceptions of institutional investors and risk-assessment agencies may be more pessimistic than expected. Should that happen, Romania's growth could be further compressed, especially if capital outflows exceed expectations. This risk is exogenous and cannot be mitigated. The Bank has limited headroom to increase lending in the near-term.

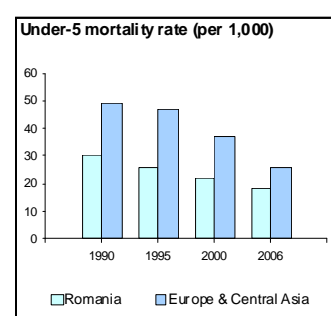
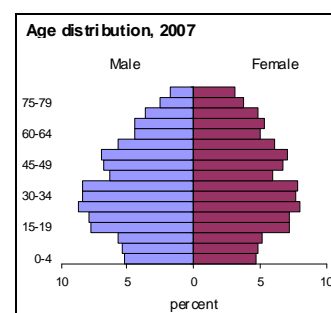
104. *Domestic economic risks* include the ability of Romania to withstand external shocks, the response of the economy to reforms, and the capacity to mobilize and absorb external funds. The relatively large size of the package may provide sufficient space for building up reserves, that would help deal with worse than expected capital outflows, and prolonged distress of the financial sector. The DPL program and associated analytical work aims to help Romania to identify efficiency savings and to maintain manageable fiscal balances.

105. *Social risks* stem from popular expectations, the persistence of core poverty relatively unaffected by economic growth, and the rise in transient poverty during the crisis. The Bank-supported DPL and other programs target assistance towards those in poverty or socially excluded.

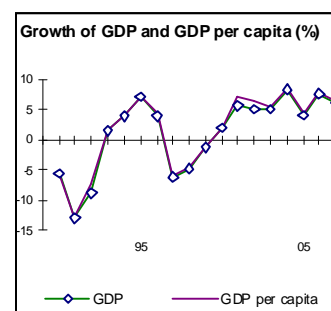
## Romania at a glance

9/24/08

Key Development Indicators (2007)	Romania	Europe & Central Asia	Upper middle income
	Population, mid-year (millions)	21.5	445
Surface area (thousand sq. km)	238	23,972	41,497
Population growth (%)	-0.2	0.0	0.6
Urban population (% of total population)	54	64	75
GNI (Atlas method, US\$ billions)	158.4	2,694	5,750
GNI per capita (Atlas method, US\$)	7,370	6,051	6,987
GNI per capita (PPP, international \$)	10,980	11,116	11,868
GDP growth (%)	6.6	6.8	5.8
GDP per capita growth (%)	6.5	6.7	5.1
<b>(most recent estimate, 2000–2007)</b>			
Poverty headcount ratio at \$1.25 a day (PPP, %)	10	5	..
Poverty headcount ratio at \$2.00 a day (PPP, %)	..	11	..
Life expectancy at birth (years)	72	69	70
Infant mortality (per 1,000 live births)	16	23	22
Child malnutrition (% of children under 5)	4	..	..
Adult literacy, male (% of ages 15 and older)	98	99	94
Adult literacy, female (% of ages 15 and older)	96	96	92
Gross primary enrollment, male (% of age group)	105	98	112
Gross primary enrollment, female (% of age group)	104	96	109
Access to an improved water source (% of population)	88	95	95
Access to improved sanitation facilities (% of population)	72	89	83



Net Aid Flows	1980	1990	2000	2007 <sup>a</sup>
<i>(US\$ millions)</i>				
Net ODA and official aid	..	243	432	914
<i>Top 3 donors (in 2006):</i>				
European Commission	..	62	264	695
Germany	..	68	25	51
France	..	0	17	42
Aid (% of GNI)	..	0.6	1.2	1.3
Aid per capita (US\$)	..	10	19	42
<b>Long-Term Economic Trends</b>				
Consumer prices (annual % change)	..	..	45.7	4.8
GDP implicit deflator (annual % change)	12.1	13.6	44.3	12.7
Exchange rate (annual average, local per US\$)	..	0.0	2.2	2.4
Terms of trade index (2000 = 100)	..	83	100	90
Population, mid-year (millions)	22.2	23.2	22.4	21.5
GDP (US\$ millions)	..	38,299	37,053	169,283
<i>(% of GDP)</i>				
Agriculture	16.4	23.7	12.5	6.4
Industry	56.6	49.9	36.4	37.1
Manufacturing	..	33.8	14.5	21.9
Services	27.0	26.3	51.1	56.5
Household final consumption expenditure	53.7	65.9	79.0	75.3
General govt final consumption expenditure	12.3	13.3	7.2	7.6
Gross capital formation	36.3	30.2	19.5	31.1
Exports of goods and services	..	16.7	32.9	29.5
Imports of goods and services	..	26.2	38.5	43.5
Gross savings	..	21.5	15.4	17.6



1980–90 1990–2000 2000–07  
(average annual growth %)

0.4	-0.3	-0.6
1.3	-0.6	6.1
1.9	-1.9	7.1
-1.0	-1.2	5.6
..	..	..
..	0.9	5.1
..	1.3	6.8
..	0.8	7.1
..	-5.1	9.4
..	8.1	10.4
..	6.0	12.4

Note: Figures in italics are for years other than those specified. 2007 data are preliminary. .. indicates data are not available.  
a. Aid data are for 2006.

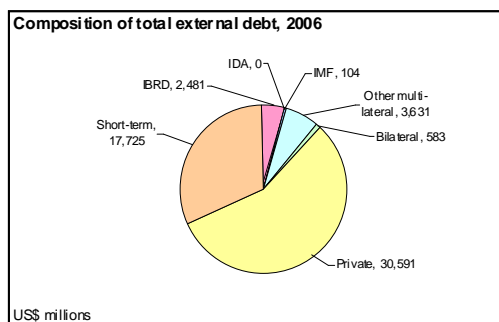
Development Economics, Development Data Group (DECDG).

Romania

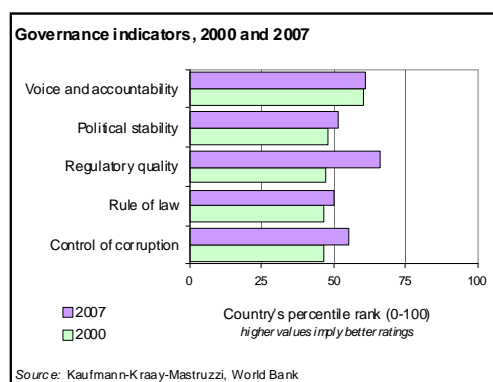
<b>Balance of Payments and Trade</b>	<b>2000</b>	<b>2007</b>
<i>(US\$ millions)</i>		
Total merchandise exports (fob)	10,366	40,445
Total merchandise imports (cif)	13,054	70,245
Net trade in goods and services	-1,930	-23,740
Workers' remittances and compensation of employees (receipts)	96	8,569
Current account balance as a % of GDP	-1,355	-22,826
	-3.7	-13.5
Reserves, including gold	3,396	37,211

<b>Central Government Finance</b>		
<i>(% of GDP)</i>		
Current revenue (including grants)	31.1	30.6
Tax revenue	29.2	28.5
Current expenditure	31.8	29.2
Overall surplus/deficit	-4.0	-2.8
Highest marginal tax rate (%)		
Individual	40	16
Corporate	25	16

<b>External Debt and Resource Flows</b>		
<i>(US\$ millions)</i>		
Total debt outstanding and disbursed	11,160	88,374
Total debt service	2,500	11,721
Debt relief (HIPC, MDRI)	-	-
Total debt (% of GDP)	30.1	47.1
Total debt service (% of exports)	20.1	19.0
Foreign direct investment (net inflows)	1,037	9,834
Portfolio equity (net inflows)	58	301



<b>Private Sector Development</b>	<b>2000</b>	<b>2008</b>
Time required to start a business (days)	-	10
Cost to start a business (% of GNI per capita)	-	3.6
Time required to register property (days)	-	83
Ranked as a major constraint to business (% of managers surveyed who agreed)	<b>2000</b>	<b>2007</b>
Tax administration	..	35.6
Tax rates	..	34.1
Stock market capitalization (% of GDP)	2.9	27.1
Bank capital to asset ratio (%)	8.6	8.9



<b>Technology and Infrastructure</b>	<b>2000</b>	<b>2007</b>
Paved roads (% of total)	49.5	30.2
Fixed line and mobile phone subscribers (per 1,000 people)	29	126
High technology exports (% of manufactured exports)	5.5	4.4

<b>Environment</b>		
Agricultural land (% of land area)	65	63
Forest area (% of land area)	27.7	27.7
Nationally protected areas (% of land area)	..	2.5
Freshwater resources per capita (cu. meters)	..	1,955
Freshwater withdrawal (% of internal resources)	54.8	..
CO2 emissions per capita (mt)	3.9	4.2
GDP per unit of energy use (2005 PPP \$ per kg of oil equivalent)	4.2	5.3
Energy use per capita (kg of oil equivalent)	1,616	1,772

<b>World Bank Group portfolio</b>	<b>2000</b>	<b>2007</b>
<i>(US\$ millions)</i>		
<b>IBRD</b>		
Total debt outstanding and disbursed	1,898	2,634
Disbursements	384	232
Principal repayments	91	211
Interest payments	104	132
<b>IDA</b>		
Total debt outstanding and disbursed	0	0
Disbursements	0	0
Total debt service	0	0
<b>IFC (fiscal year)</b>		
Total disbursed and outstanding portfolio of which IFC own account	284	438
Disbursements for IFC own account	112	391
Disbursements for IFC own account	17	47
Portfolio sales, prepayments and repayments for IFC own account	5	162
<b>MIGA</b>		
Gross exposure	20	138
New guarantees	0	0

Note: Figures in italics are for years other than those specified. 2007 data are preliminary.  
.. indicates data are not available. - indicates observation is not applicable.

9/24/08

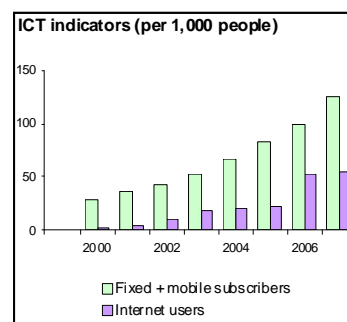
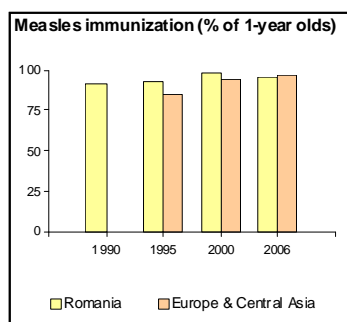
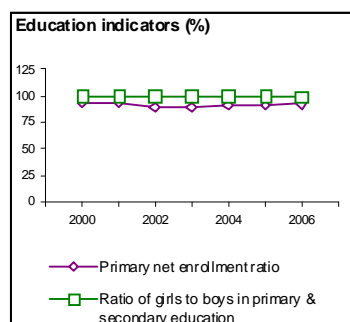
Development Economics, Development Data Group (DECDG).

## Millennium Development Goals

Romania

With selected targets to achieve between 1990 and 2015  
(estimate closest to date shown, +/- 2 years)

	Romania			
	1990	1995	2000	2007
<b>Goal 1: halve the rates for extreme poverty and malnutrition</b>				
Poverty headcount ratio at \$1.25 a day (PPP, % of population)	..	..	..	9.6
Poverty headcount ratio at national povertyline (% of population)	..	25.4	36*	13.9
Share of income or consumption to the poorest quintile (%)	9.9	8.9	8.2	8.2
Prevalence of malnutrition (% of children under 5)	..	..	3.7	..
<b>Goal 2: ensure that children are able to complete primary schooling</b>				
Primary school enrollment (net, %)	81	..	94	93
Primary completion rate (% of relevant age group)	96	86	102	101
Secondary school enrollment (gross, %)	92	..	81	86
Youth literacy rate (% of people ages 15-24)	99	..	98	..
<b>Goal 3: eliminate gender disparity in education and empower women</b>				
Ratio of girls to boys in primary and secondary education (%)	99	..	100	100
Women employed in the nonagricultural sector (% of nonagricultural employment)	..	42	46	46
Proportion of seats held by women in national parliament (%)	34	7	7	11
<b>Goal 4: reduce under-5 mortality by two-thirds</b>				
Under-5 mortality rate (per 1,000)	31	26	22	18
Infant mortality rate (per 1,000 live births)	27	21	19	16
Measles immunization (proportion of one-year olds immunized, %)	92	93	98	95
<b>Goal 5: reduce maternal mortality by three-fourths</b>				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	..	24
Births attended by skilled health staff (% of total)	..	99	98	98
Contraceptive prevalence (% of women ages 15-49)	..	57	64	70
<b>Goal 6: halt and begin to reverse the spread of HIV/AIDS and other major diseases</b>				
Prevalence of HIV (% of population ages 15-49)	..	..	0.1	0.1
Incidence of tuberculosis (per 100,000 people)	74	112	136	128
Tuberculosis cases detected under DOTS (%)	..	..	9	79
<b>Goal 7: halve the proportion of people without sustainable access to basic needs</b>				
Access to an improved water source (% of population)	76	80	85	88
Access to improved sanitation facilities (% of population)	72	72	73	72
Forest area (% of total land area)	27.8	..	27.7	27.7
Nationally protected areas (% of total land area)	..	..	..	2.5
CO2 emissions (metric tons per capita)	6.7	5.5	3.9	4.2
GDP per unit of energy use (constant 2005 PPP \$ per kg of oil equivalent)	2.9	3.5	4.2	5.3
<b>Goal 8: develop a global partnership for development</b>				
Telephone mainlines (per 100 people)	10.2	13.1	17.4	20.0
Mobile phone subscribers (per 100 people)	0.0	0.0	11.1	106.2
Internet users (per 100 people)	0.0	0.1	3.6	55.7
Personal computers (per 100 people)	0.2	1.3	3.2	14.8



Note: Figures in italics are for years other than those specified. .. indicates data are not available. \* national data

9/24/08

Development Economics, Development Data Group (DECDG).

**CAS Annex B2 - Romania**  
**Selected Indicators\* of Bank Portfolio Performance and Management**  
 As Of Date 06/08/2009

Indicator	2006	2007	2008	2009
<b>Portfolio Assessment</b>				
Number of Projects Under Implementation <sup>a</sup>	22	21	20	17
Average Implementation Period (years) <sup>b</sup>	3.2	3.3	3.7	4.3
Percent of Problem Projects by Number <sup>a, c</sup>	4.5	14.3	15.0	35.3
Percent of Problem Projects by Amount <sup>a, c</sup>	5.4	26.3	12.3	35.5
Percent of Projects at Risk by Number <sup>a, d</sup>	4.5	14.3	15.0	35.3
Percent of Projects at Risk by Amount <sup>a, d</sup>	5.4	26.3	12.3	35.5
Disbursement Ratio (%) <sup>e</sup>	12.0	10.9	18.2	10.6
<b>Portfolio Management</b>				
CPPR during the year: Joint Portfolio Review held in 2007, Q2, 3, 4, 2008, 2009				
Supervision Resources (total US\$)				
Average Supervision (US\$/project)				

Memorandum Item	Since FY 80	Last Five FYs
Proj Eval by OED by Number	65	14
Proj Eval by OED by Amt (US\$ millions)	5,395.7	1,007.1
% of OED Projects Rated U or HU by Number	18.5	0.0
% of OED Projects Rated U or HU by Amt	22.0	0.0

- a. As shown in the Annual Report on Portfolio Performance (except for current FY).
- b. Average age of projects in the Bank's country portfolio.
- c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
- d. As defined under the Portfolio Improvement Program.
- e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only.
- \* All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.

**CAS Annex B3 - IBRD/IDA Program Summary - Romania**

As Of Date 08/06/2009

**Proposed IBRD/IDA Base-Case Lending Program <sup>a</sup>**

<i>Fiscal year</i>	<i>Project ID</i>	<i>Euro(M)</i>	<i>Strategic Rewards b (H/M/L)</i>	<i>Implementation b Risks (H/M/L)</i>
2010	DPL 1	300.0		
	DPL 2	360.0		
	Sub-total	660.0		
2011	DPL 3	340.0		

**Annex B3**

**Romania: IFC Investment Operations Program**

	2006	2007	2008	2009*
<u>Commitments (US\$m)</u>				
Gross**	146.29	132.9	39.45	169.75
Net***	133.32	136.07	45.19	64.00
Net commitments by Sector (percent)				
Finance	61	63	39	88
Global Manufacturing	0	0	0	0
Health & Education	0	9	1	0
Infrastructure	13	28	60	12
Oil, Gas, Mining & Chemicals	26	0	0	0
	100	100	100	100
<u>Net Commitments by Investment (percent)</u>				
Equity	5	4	58	12
Loan	95	96	42	88
	100	100	100	100

\* as of April 30, 2009

\*\* IFC and Participants

\*\*\* IFC's account only

## CAS Annex B4 - Summary of Nonlending Services - Romania

As Of Date 06/08/2009

<i>Product</i>	<i>Completion FY</i>	<i>Cost (US\$000)</i>	<i>Audience<sup>a</sup></i>	<i>Objective<sup>b</sup></i>
<b>Recent completions</b>				
PEIR	06	537	G,D,B,P,D	KG, PS
PSD Policy Note	07	103	G,D,B	KG, PS
Rural Regional TA	07	176	G,D,B,P,D	KG, PS
Poverty Monitoring	07	57	G,D,B,P,D	KG, PS
Municipal Finance Policy Note	07	155	G,D,B,P,D	KG, PS
HD Sector Policy Notes	07	144	G,D,B,P,D	KG, PD
ROSC	08	167	G,D,B,P,D	KG, PS, PD
EU Convergence	08	146	G,P,D	
Poverty Monitoring 2	08	144	G,D,B,P,D	KG, PS, PD
Public Pay and Employment	08	55	G,D,B,P,D	KG, PS
National Rural Development Plan TA	08	53	G,D	KG, PS
FSAP Update	09	286	G,D,B	KG, PS
Reform of Higher Education Financing	09	127	G,D,B	KG, PS, PD
<b>Underway</b>				
IT Assessment at NBR TA	10	60	G,D,B,P,D	KG, PS
PEIR Update	10	62	G,D,B,P,D	KG, PD
Poverty Monitoring (III)	10	84	G,D,B,P,D	KG, PS, PD
Pensions for Elderly Poor	10	118	G,D,B,P,D	KG, PS, PD
<b>Planned</b>				
PEIR Programatic (I)	10	100		
Macro-Monitoring	10	150		
DPL Education Reform TA	10	100		
DPL Health Reform TA	10	100		
DPL Civil Service - PFM TA	10	100		
DPL Financial Sector TA	10	100		
TAX Administration TA	10	100		
Poverty Monitoring (IV)	10	75		
Student Loans TA	10	100		
PEIR Programatic (II)	11	100		
Macro-Monitoring	11	100		
DPL Education Reform TA (II)	11	100		
DPL Civil Service - PFM TA	11	100		
Poverty Monitoring (V)	11	75		

a. Government, donor, Bank, public dissemination.

b. Knowledge generation, public debate, problem-solving.

## Romania Social Indicators

	Latest single year			Same region/income group	
	1980-85	1990-95	2001-07	Europe & Central Asia	Upper-middle-income
<b>POPULATION</b>					
Total population, mid-year (millions)	22.7	22.7	21.5	445.1	822.9
Growth rate (% annual average for period)	0.5	-0.5	-0.4	0.0	0.7
Urban population (% of population)	49.6	54.0	54.1	63.6	75.2
Total fertility rate (births per woman)	2.3	1.3	1.3	1.6	2.0
<b>POVERTY</b>					
<i>(% of population)</i>					
National headcount index	..	25.4	..	..	..
Urban headcount index	..	20.4	..	..	..
Rural headcount index	..	27.9	..	..	..
<b>INCOME</b>					
GNI per capita (US\$)	..	1,470	6,150	6,051	6,987
Consumer price index (2000=100)	..	8	259	159	152
Food price index (2000=100)	0	11	184	..	..
<b>INCOME/CONSUMPTION DISTRIBUTION</b>					
Gini index	..	28.2	31.5	..	..
Lowest quintile (% of income or consumption)	..	8.9	8.2	..	..
Highest quintile (% of income or consumption)	..	37.2	40.0	..	..
<b>SOCIAL INDICATORS</b>					
<b>Public expenditure</b>					
Health (% of GDP)	..	..	3.9	4.1	3.6
Education (% of GDP)	..	3.5	3.5	4.6	4.7
<b>Net primary school enrollment rate</b>					
<i>(% of age group)</i>					
Total	..	81	93	91	94
Male	..	81	93	92	94
Female	..	81	93	90	94
<b>Access to an improved water source</b>					
<i>(% of population)</i>					
Total	..	80	88	95	95
Urban	..	95	99	99	98
Rural	..	62	76	88	83
<b>Immunization rate</b>					
<i>(% of children ages 12-23 months)</i>					
Measles	88	93	95	97	94
DPT	95	98	97	95	96
Child malnutrition (% under 5 years)	..	..	4	..	..
<b>Life expectancy at birth</b>					
<i>(years)</i>					
Total	70	69	72	69	70
Male	67	66	69	64	67
Female	73	73	76	74	74
<b>Mortality</b>					
Infant (per 1,000 live births)	26	21	16	23	22
Under 5 (per 1,000)	32	26	18	26	26
Adult (15-59)					
Male (per 1,000 population)	228	270	205	299	258
Female (per 1,000 population)	114	119	87	123	137
Maternal (modeled, per 100,000 live births)	..	..	24	44	97
Births attended by skilled health staff (%)	..	99	98	95	94

Note: 0 or 0.0 means zero or less than half the unit shown. Net enrollment rate: break in series between 1997 and 1998 due to change from ISCED76 to ISCED97. Immunization: refers to children ages 12-23 months who received vaccinations before one year of age or at any time before the survey.

World Development Indicators database, World Bank - 10 September 2008.

**Romania - Key Economic Indicators**

Indicator	2003	Actual			Estimate			Projected		
		2004	2005	2006	2007	2008	2009	2010	2011	2012
<b>National accounts (as % of GDP)</b>										
Gross domestic product		100	100	100	100	100	100	100	100	100
Agriculture		14	9	9	6	7	7	7	7	7
Industry		35	36	36	37	37	36	36	36	36
Services		51	55	55	57	55	57	57	57	57
Total Consumption		85	87	86	83	81	78	76	74	73
Gross domestic fixed investment		22	24	26	30	33	32	31	31	32
Government investment		3	4	5	6	5	6	7	7	0
Private investment		19	20	21	25	28	25	24	24	0
Exports (GNFS) <sup>b</sup>		36	33	32	30	31	28	28	27	27
Imports (GNFS)		45	43	44	44	44	36	34	33	32
Gross domestic savings		15	13	14	17	19	22	25	26	27
Gross national savings <sup>c</sup>		15	15	16	18	19	22	24	25	26
<i>Memorandum items</i>										
Gross domestic product (US \$ million at current prices)		75,795	99,173	122,695	169,283	200,079	172,500	187,007	202,649	225,322
GNI per capita (US \$, Atlas metho		2,950	3,830	4,830	7,370	8,610				
Real annual growth rates (% , calculated from 05 prices)										
Gross domestic product at										
market prices		8.4	4.1	7.7	6.6	7.8	1.0	2.5	5.0	5.0
Gross Domestic Income		8.2	2.3	7.3	6.5	8.4	1.0	2.3	5.6	5.9
Real annual per capita growth rates (% , calculated from 05 prices)										
Gross domestic product at										
market prices		8.8	4.4	8.1	6.5	7.2	-3.6	0.4	2.7	4.1
Total consumption		10.6	9.1	9.6	9.9	8.2	-5.0	-0.2	2.1	3.4
Private consumption		16.2	10.3	12.9	11.8	9.3	-3.7	-0.4	2.3	3.6
<b>Balance of Payments (US \$ millions)</b>										
Exports (GNFS) <sup>b</sup>		27,121	32,819	39,445	49,930	61,988	48,987	51,740	54,956	60,055
Merchandise FOB		23,515	27,711	32,434	40,445	49,165	39,188	41,378	43,909	48,043
Imports (GNFS) <sup>b</sup>		33,996	42,973	54,194	73,670	87,614	61,680	63,484	66,692	72,093
Merchandise FOB		30,126	37,431	47,189	64,837	76,025	53,539	55,125	57,717	62,247
Resource balance		-6,876	-10,154	-14,749	-23,740	-25,625	-12,695	-11,743	-11,737	-12,039
Net current transfers		3,691	4,474	6,079	6,597	8,774	7,461	7,668	7,871	8,624
Current account balance		-6,333	-8,577	-12,743	-22,826	-24,704	-12,961	-12,089	-12,841	-13,729
Net private foreign direct invest		5,020	6,477	8,600	9,834	15,000	7,000	8,000	8,000	8,000
Long-term loans (net)		2,894	5,937	9,000	15,318	6,007	7,652	6,746	7,623	12,553
Official		473	427	141	225	787	10,000	8,000	8,000	6,000
Private		2,421	5,511	8,859	10,093	5,220	-8,000	-4,000	-377	6,553
Other capital (net, incl. errors &		4,258	2,917	-3,836	3,840	6,810	-4,191	-610	-571	-5,116
Change in reserves <sup>d</sup>		-5,838	-6,754	-1,021	-6,166	-3,113	2,500	-2,047	-2,211	-1,707
<i>Memorandum items</i>										
Resource balance (% of GDP)		-9.1	-10.2	-12.0	-14.0	-12.8	-7.4	-6.3	-5.8	-5.3
Real annual growth rates ( YR05 prices)										
Merchandise exports (FOB)		..	..	12.2	14.4	17.5	-21.0	5.6	6.2	9.3
Primary		..	..	8.0	13.7	18.0	4.0	3.1	3.6	4.6
Manufactures		..	..	13.5	14.9	17.4	5.3	3.8	4.3	5.2
Merchandise imports (CIF)		..	..	8.9	15.3	12.0	-29.6	3.0	4.7	7.8

(Continued)

**Romania - Key Economic Indicators  
(Continued)**

Indicator	2003	Actual			Estimate			Projected		
		2004	2005	2006	2007	2008	2009	2010	2011	2012
<b>Public finance (as % of GDP at market prices)<sup>e</sup></b>										
Current revenues		28.5	30.0	29.9	30.6	32.1	30.2	32.1	30.4	32.1
Current expenditures		26.6	28.2	28.0	29.2	28.3	28.1	28.0	27.3	25.1
Current account surplus (+) or d		1.9	1.9	1.9	1.5	3.8	2.1	4.2	3.0	7.0
Capital expenditure		3.2	2.6	3.3	4.3	4.2	5.0	4.8	4.7	4.5
Foreign financing		..	..	..	1.2	0.7	1.0	0.3	0.5	0.0
<b>Monetary indicators</b>										
M2/GDP		26.2	30.0	29.2	36.6	34.5	33.3	32.3	31.3	33.3
Growth of M2 (%)		40.1	33.8	15.7	48.3	8.2	6.8	6.2	5.4	15.7
Private sector credit growth / total credit growth (%)		169.3	85.3	159.9	79.6	176.7	114.6	111.6	134.8	91.4
<b>Price indices( YR05 =100)</b>										
Merchandise export price index		..	100.0	100.9	100.0	100.4	100.9	102.4	103.8	106.4
Merchandise import price index		..	100.0	102.6	100.0	98.8	97.7	97.5	97.5	97.5
Merchandise terms of trade inde		..	100.0	98.3	100.0	101.7	103.3	105.0	106.5	109.1
Real exchange rate (US\$/LCU) <sup>f</sup>		..	..	..	..	..	..	..	..	..
<b>Real interest rates</b>										
Consumer price index (% chan		11.9	9.0	6.6	4.8	7.9	5.8	3.5	3.2	2.8
GDP deflator (% change)		15.5	12.2	10.6	12.7	14.0	9.9	6.9	5.1	4.8

a. GDP at factor cost

b. "GNFS" denotes "goods and nonfactor services."

c. Includes net unrequited transfers excluding official capital grants.

d. Includes use of IMF resources.

e. Consolidated central government.

f. "LCU" denotes "local currency units." An increase in US\$/LCU denotes appreciation.

## Romania - Key Exposure Indicators - Romania

As of Date 06/08/2009

Indicator	Actual			Estimate			Projected		
	2004	2005	2006	2007	2008	2009	2010	2011	2012
Total debt outstanding and disbursed (TDO) (US\$m) <sup>a</sup>	29,573	38,861	54,001	88,374	82,470	74,698	67,785	60,057	47,409
Net disbursements (US\$m) <sup>a</sup>	..	..	..	15,568	-5,875	-7,772	-6,912	-7,728	-12,649
Total debt service (TDS) (US\$m) <sup>a</sup>	..	..	..	11,721	11,248	10,517	11,342	9,668	9,582
Debt and debt service indicators (%)									
TDO/XGS <sup>b</sup>	107.0	104.9	135.2	143.0	117.6	93.1	75.8	62.1	44.9
TDO/GDP	39.2	39.3	44.4	47.1	41.1	33.4	27.3	22.0	15.9
TDS/XGS	..	..	..	19.0	16.0	13.1	12.7	10.0	9.1
Concessional/TDO	1.7	2.2	2.1	..	1.9	2.5	3.0	3.5	4.4
IBRD exposure indicators (%)									
IBRD DS/public DS	9.8	11.5	13.2	15.1	12.1	16.9	13.5	20.7	15.6
Preferred creditor DS/public DS (%) <sup>c</sup>	34.3	29.5	37.5	35.2	32.2	47.4	35.2	50.0	38.5
IBRD DS/XGS	0.8	0.8	0.8	0.6	0.6	0.6	0.5	0.5	0.5
IBRD TDO (US\$m) <sup>d</sup>	2,522	2,448	2,481	2,634	2,625	3,450	3,915	3,729	3,541
Of which present value of guarantees (US\$m)									
Share of IBRD portfolio (%)	2	2	2	2	3	3	3	3	3
IDA TDO (US\$m) <sup>d</sup>	..	..	..	0	0	0	0	0	0
IFC (US\$m)									
Loans	110.8	186.5	203.9	208.6	297.0	358.7	..	..	..
Equity and quasi-equity <sup>e</sup>	126.8	128.0	285.2	183.0	211.0	104.3	..	..	..
MIGA									
MIGA guarantees (US\$m)	131.8	84.8	..	..	..	..	..	..	..

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.

b. "XGS" denotes exports of goods and services, including workers' remittances.

c. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

d. Includes present value of guarantees.

e. Includes equity and quasi-equity types of both loan and equity instruments.

CAS Annex B8 - Romania  
Operations Portfolio (IBRD/IDA and Grants)  
As Of Date 06/08/2009

Closed Projects 74

**IBRD/IDA \***

Total Disbursed (Active)	458.61
of which has been repaid	13.68
Total Disbursed (Closed)	5,813.78
of which has been repaid	4,484.94
Total Disbursed (Active + Closed)	6,272.38
of which has been repaid	4,498.62
Total Undisbursed (Active)	1,136.73
Total Undisbursed (Closed)	0.00
Total Undisbursed (Active + Closed)	1,136.73

**Active Projects**

Project ID	Project Name	Last PSR		Fiscal Year	Original Amount in US\$ Millions					Difference Between Expected and Actual Disbursements <sup>4/</sup>		
		Supervision Rating			IBRD	IDA	GRANT	Cancel.	Undisb.	Orig.	Frm Rev'd	
		Development Objectives	Implementation Progress									
P100470	AVIAN FLU - RO	MU	U	2007	37.7				9.8	26.4	35.1	28.7
P100638	CESAR	MS	MU	2008	65					62.0	6.0	0.6
P086694	ECSEE APL #1 (CRL)	S	S	2005	84.3					53.1	41.7	20.1
P067367	FOREST DEVT	S	S	2003	25				3.7	2.7	6.3	2.3
P075163	HAZ MITIG	MS	MS	2004	150					94.1	74.1	72.4
P081950	HAZARD MITIGATION (GEI S	S	MS	2004			7			3.3	3.3	3.0
P078971	HEALTH SEC REF 2 (APL #MS	S	MS	2005	80					47.7	40.7	
P099528	INT. NUTRIENT POLLUTIOS	S	S	2008			5.5			5.0	-0.3	
P093775	INTEG NUTRIENT POLLUTS	S	S	2008	68.1					65.9	11.6	
P043881	IRRIG REHAB	MS	MS	2004	80					46.2	30.1	18.1
P090309	JUDICIAL REFORM	U	U	2006	130					140.7	125.8	51.5
P088165	KNOW ECON	S	S	2006	60					36.0	22.8	
P087807	MINE CLOSURE, ENV & S	MS	MS	2005	120					89.7	69.7	
P086949	MOD AGR KNOWLEDGE & MS	S	MU	2005	50					39.9	25.8	
P088252	Municipal Services Project	S	S	2007	131.7					96.8	14.1	
P073967	RURAL EDUC	S	S	2003	60					6.8	6.8	6.8
P093096	SOC INCL PROG (CRL)	MU	MU	2006	58.5					59.4	24.7	
P083620	TRANSPORT RESTRUCTU	U	MU	2005	225					167.6	167.6	
P093812	TRANSPORT SECTOR SUI	MS	MS	2007	180				35.0	101.7	121.7	
<b>Overall Result</b>					<b>1605.3</b>		<b>12.5</b>		<b>48.5</b>	<b>1145.1</b>	<b>827.8</b>	<b>203.4</b>

Romania  
Committed and Outstanding Investment Portfolio  
As of April 30, 2009  
(in US\$ millions)

Commitment Fiscal Year	Institution Short Name	Committed					Disbursed and Outstanding						
		LN Cmtd - IFC	ET Cmtd - IFC	QL + QE Cmtd - IFC	GT Cmtd - IFC	ALL Cmtd - IFC	ALL Cmtd - Part	LN Out - IFC	ET Out - IFC	QL + QE Out - IFC	GT Out - IFC	ALL Out - IFC	ALL Out - Part
2005/ 2008/ 2009	ATE Romania	13	7	0	0	20	0	0	7	0	0	7	0
2007/ 2008	Arabesque SRL	36	0	0	7	43	36	36	0	0	7	43	36
2003/ 2004/ 2006	Banca Comerciala	118	0	0	0	118	0	118	0	0	0	118	0
	Banat Construct	0	0	5	0	5	0	0	0	3	0	3	0
2007	Credit Europe Bk	41	0	0	0	41	0	41	0	0	0	41	0
2007	MedLife SA	7	5	0	0	12	0	5	5	0	0	10	0
2006	Petrotel-Lukoil	21	0	0	0	21	16	21	0	0	0	21	16
2002/ 2003/ 2004/ 2007	ProCreditRomania	10	2	0	0	12	0	10	2	0	0	12	0
2005	RGH	0	48	0	0	48	0	0	36	0	0	36	0
2004	Ro-Fin	3	0	0	0	3	0	3	0	0	0	3	0
2006	TTS SA	13	0	0	0	13	0	13	0	0	0	13	0
2008/ 2009	TTS Romania	0	7	13	0	20	0	0	0	13	0	13	0
2004/ 2005/ 2007/ 2009	Transilvaniabank	78	0	36	0	114	94	78	0	36	0	114	94
<b>Total Portfolio</b>		<b>340</b>	<b>68</b>	<b>53</b>	<b>7</b>	<b>469</b>	<b>146</b>	<b>326</b>	<b>50</b>	<b>51</b>	<b>7</b>	<b>435</b>	<b>146</b>

## RESULTS FRAMEWORK

CPS RESULTS AREAS AND OUTCOMES	INDICATIVE MILESTONES	WBG INSTRUMENTS
<b>CAS PILLAR 1: PUBLIC SECTOR REFORM</b> <b>GOALS:</b> <i>To improve the accountability and responsiveness of the public administration and to enhance predictability and efficiency in public resource management.</i> <b>Issues and Obstacles:</b> <i>Pro-cyclical fiscal policies and weak fiscal management have led to serious macroeconomic vulnerabilities. The budget process lacks predictability and transparency, as well as weak prioritization of public investment. Introduction of an MTEF will require capacity and support to both plan on a multi-year horizon and to link budget with outcomes. Public sector wages have more than doubled since 2005 contributing to pro-cyclical policies, but without adequately rewarding performance or productivity. Governance is weak and monitored by the EU bi-annually. The court system has a large back-log of cases.</i>		
<p><b>1.1 PUBLIC FINANCIAL MANAGEMENT</b>  <b>Objective:</b> Reduce fiscal vulnerabilities by restoring budget discipline, improving the effectiveness and efficiency of public expenditures, and improved resource mobilization.</p> <p>Outcome 1: An effective Medium Term Expenditure Framework operational by 2012</p> <ul style="list-style-type: none"> <li>• <u>Indicator 1:</u> Budget is executed consistent with the aggregate and ministerial expenditure ceilings approved by Parliament in the MTEF (2011-13).  <i>Baseline:</i> MTEF not approved by Parliament, no binding ministry ceilings, spending exceeds original budget amounts.</li> <li>• <u>Indicator 2:</u> Summary of multi-year public investment program annexed to budget and consistent with MTEF projections  Target: Annex included in budget with multi-year costing of projects vs. <i>Baseline:</i> Single year budget allocations only and no historical data.</li> </ul> <p>Outcome 2: Sustainable growth in public wage bill</p> <ul style="list-style-type: none"> <li>• <u>Indicator:</u> Annual expenditure for personnel is consistent with limits approved in MTEF and do not increase as a share of GDP above expected 2009 level.</li> </ul>	<ul style="list-style-type: none"> <li>• Fiscal Responsibility Law approved.</li> <li>• Independent Fiscal Council established.</li> <li>• MTEF approved by Parliament (prior to the annual budget) with three-year ceilings for major spending ministries and aggregate limit on personnel.</li> <li>• Wage bill for 2010 increases below the rate of inflation.</li> </ul>	<p>Ongoing:</p> <ul style="list-style-type: none"> <li>(a) Policy Briefs 2009</li> <li>(b) PEIR Update 2009</li> </ul> <p>New</p> <ul style="list-style-type: none"> <li>(c) DPL series</li> <li>(d) Programmatic series of PER updates focusing on opportunities for fiscal savings and efficiency gains in major expenditure categories, starting with education, health, transport, agriculture</li> <li>(e) AAA on fiscal decentralization</li> <li>(f) AAA on Public Financial Management</li> <li>(g) AAA on tax administration</li> </ul>

CPS RESULTS AREAS AND OUTCOMES	INDICATIVE MILESTONES	WBG INSTRUMENTS
<p>Target: no positive percentage variation against MTEF ceiling, and personnel expenditures at or below 2009 ratio to GDP. <i>Baseline:</i> 7.5 percent in 2009 and 8.4 percent in 2008</p>		
<p><b>1.2 PUBLIC ADMINISTRATION REFORM</b>  <b>Objective:</b> improve the public pay system to enhance transparency and predictability, motivate performance among public sector employees, attract and retain critical skills.</p> <p>Outcome: Align public sector pay system to EU practice (transparency, equity, ability to attract &amp; retain critical skills in public administration)</p> <ul style="list-style-type: none"> <li>• <u>Indicator 1:</u> Reduction in aggregate allowances and bonuses and limit amount for any individual Target: Maximum 30percent of the total public compensation.</li> <li>• <u>Indicator 2:</u> Align pay structures more closely to actual labor market conditions Target: Pay adjustments are targeted toward key positions reflecting salary survey results</li> </ul>	<ul style="list-style-type: none"> <li>• New salary legislation on public sector pay which limits non wage expenditures approved</li> <li>• Functional reviews of the public administration undertaken to identify budget resources that could be released for better targeting pay.</li> <li>• A detailed pay reform plan is approved by Government for implementing (a) a uniform job grading framework for the public service and (b) more closely aligning pay for selected benchmark jobs to actual labor market conditions (through a salary survey)</li> <li>• Regulations drafted that enforces compliance with merit based principles of employment and promotion</li> </ul>	<p>Ongoing</p> <p>(a) Public Sector Pay Practices in Romania 2007 and 2008</p> <p>New</p> <p>a) DPL series b) AAA on civil service pay, public administration and functional reviews</p>
<p><b>1.3 GOVERNANCE</b>  <b>Objective:</b> strengthen the efficiency and accountability of the justice system</p> <p>Outcome 1: Strengthened admin capacity of courts</p> <ul style="list-style-type: none"> <li>• <u>Indicator 1:</u> Introduction of new case mgmt techniques Target: new case mgmt techniques used by 30 percent of courts</li> <li>• <u>Indicator 2:</u> Trained economic managers Target: 50 percent of economic managers are trained and obtain satisfactory performance ratings</li> </ul> <p>Outcome 2: Enhanced competence, professionalism and</p>	<ul style="list-style-type: none"> <li>• Improved capacity of the court system to adjudicate disputes (in terms of fairness, speed, affordability, ability to enforce decisions)</li> <li>• New internal working arrangements within courts, whereby non-judicial tasks are transferred from judges to court clerks</li> <li>• Improved public image of the judiciary according to survey</li> </ul>	<p>Ongoing:</p> <p>a) Judicial Reform Project</p>

CPS RESULTS AREAS AND OUTCOMES	INDICATIVE MILESTONES	WBG INSTRUMENTS
integrity of judges and court staff <ul style="list-style-type: none"> <li>• <u>Indicator</u>: new qualification examination procedures are successfully piloted by NIM</li> </ul>		
<b>CAS PILLAR 2: GROWTH AND COMPETITIVENESS</b> <b>GOALS:</b> <i>in the short-run, put in place crisis-management measures in the financial sector; and in the medium-term, establish the building blocks for sustainable convergence to EU-average living standards through improved business environment, enhanced skills, better infrastructure and more efficient agriculture.</i> <b>Issues and Obstacles:</b> <i>The crisis has revealed weaknesses in financial sector supervision across the region, new, best practices will need to be adopted to strengthen the system. A recovery in growth will depend both on recovery in key trading partners and on the strength of Romania's own reforms and policies. All countries are seeking to emerge from the crisis in a strong position, so competition will be strong. Romania lags international competitors on education, business environment and agriculture productivity indicators. Transport and energy need significant investment and reform to be able to meet demand.</i>		
<b>2.1 FINANCIAL SECTOR</b> <b>Objective:</b> deepen and strengthen the resilience of the financial sector  Outcome 1: Improved stability and resilience of the financial system to economic shocks <ul style="list-style-type: none"> <li>• <u>Indicator 1</u>: Stress tests conducted, and Strategic Action Plan adopted and up-dated as needed</li> <li>• <u>Indicator 2</u>: Remove obstacles to out-of-court insolvency proceedings, and mortgage and corporate debt restructuring guidelines issued and applicable</li> </ul> Outcome 2: Improved governance of financial sector supervision. <ul style="list-style-type: none"> <li>• <u>Indicator 1</u>: Recommendations of the de La Rosiere report adopted, notably with respect to independence and autonomy of financial sector supervisors (CSA, CNVM, CSSPP)</li> <li>• <u>Indicator 2</u>: Supervision standards, regulations and practices strengthened (in line with Basel II)</li> </ul>	<ul style="list-style-type: none"> <li>• NBR has undertaken banking sector stress tests to serve as input into the Strategic Action Plan.</li> <li>• Amendments of the Insolvency Law are issued</li> <li>• A new draft Special Law on the Political Independence and Financial Autonomy of the Financial Sector Regulators and Supervisors is approved by Government</li> <li>• Legal and regulatory framework for bank resolution, mortgage and corporate debt restructuring improved</li> <li>• Internal governance structure for Basel II policy and accreditation decisions to be established within NBR</li> <li>• Assessment and amendments of (i) the adequacy definition of Fin. Conglomerates - Ordinance 99/06 and (ii) adequacy of supervision</li> <li>• Strengthen decision making and methods for Basel II adoption</li> </ul>	Ongoing <ul style="list-style-type: none"> <li>(a) FSAP November 2008</li> <li>(b) Consumer Literacy and protection</li> <li>(c) IFC financing to local financial institutions</li> </ul> New <ul style="list-style-type: none"> <li>(a) DPL series</li> <li>(b) Analytical and advisory services on financial sector</li> </ul>

CPS RESULTS AREAS AND OUTCOMES	INDICATIVE MILESTONES	WBG INSTRUMENTS
<p><b>2.2. BUSINESS ENVIRONMENT</b> Objective: improve the business environment, including institutional and policy framework for R&amp;D and innovation, and development of a knowledge-based society and economy.</p> <p>Outcome 1: Participation of disadvantaged communities in K-based society/economy</p> <ul style="list-style-type: none"> <li>• <u>Indicator</u>: Population in disadvantaged communities using LCeNs as tool for education, business or public admin (as percent of number of individuals with ICT access) Target 38 percent in 2011 vs. 17.5 percent in 2005</li> </ul>	<ul style="list-style-type: none"> <li>• National Strategy for the New Economy and Implementation of the Information Society. Develop</li> <li>• Local Community e-Networks (LCeNs) being used as tools to be used for education, business, public communication</li> </ul>	<p>Ongoing:</p> <ul style="list-style-type: none"> <li>a) Knowledge Economy project</li> <li>b) MAKIS project (R&amp;D component)</li> </ul> <p>New:</p> <ul style="list-style-type: none"> <li>(a) Advisory work on tax administration</li> </ul>
<p><b>2.3 EDUCATION</b> Objective: support Government to improve access to and quality of education in a fiscally sound manner</p> <p>Outcome 1: Improved efficiency in primary and secondary education by providing more flexible financing, more autonomy and enhanced accountability (focusing on results) to local authorities and school principles</p> <ul style="list-style-type: none"> <li>• <u>Indicator</u>: Increase in average class size. (Baseline: 19.6 in school year 2008/09. Target: 23 in school year 2013/14).</li> </ul> <p>Outcome 2: Provide financial support to tertiary students in a more equitable manner and with better incentives built into the support.</p> <ul style="list-style-type: none"> <li>• <u>Indicator 1</u>: Average duration of study of students receiving student loan compared to an appropriately selected “control group” of students (who will not receive the student loan).</li> <li>• <u>Indicator 2</u>: Average number of months it takes to find a job following graduation of students receiving student loan compared to an appropriately selected “control” group of students (who will not receive the student loan)</li> </ul>	<ul style="list-style-type: none"> <li>• Legislation adopted to enable per capita financing in eight counties, starting with school year 2010/11</li> <li>• All schools in 8 counties are financed using per capita finance, starting with school year 2010/11.</li> </ul> <ul style="list-style-type: none"> <li>• First disbursements from student loans scheme begin starting with the school year 2011/12</li> <li>• First cohort of students receiving student loans graduate from their programs in the summer of 2013.</li> </ul>	<p>Ongoing:</p> <ul style="list-style-type: none"> <li>(a) Knowledge Economy project</li> <li>(b) Rural Education project</li> <li>(c) Policy Briefs 2009</li> <li>(d) Education Policy Note in 2007</li> <li>(e) Discussion paper on Introducing a Student loan Scheme in Romania</li> <li>(f) PER update</li> </ul> <p>New:</p> <ul style="list-style-type: none"> <li>(a) TA on decentralization of primary and secondary education</li> <li>(b) TA program for the introduction of a Student Loans Scheme</li> <li>(c) IFC financing in private education</li> </ul>

CPS RESULTS AREAS AND OUTCOMES	INDICATIVE MILESTONES	WBG INSTRUMENTS
<p><u>Baseline and targets:</u> to be determined as part of the student loan design. However, students receiving loans should graduate faster and find jobs quicker than the appropriately selected control group of students</p>		
<p><b>2.4 AGRICULTURE AND RURAL DEVELOPMENT</b> Objective: provide advisory, technical and financial assistance to support the market-based restructuring and competitiveness of Romanian agriculture.</p> <p>Outcome 1: Increased capacity to provide advisory services to farmers and agro-processors in the EU accession environment</p> <ul style="list-style-type: none"> <li>• <u>Indicator</u> : Number of trained and graduated advisors Target 300 in 2013 vs. 0 in 2008</li> </ul> <p>Outcome 2: Support for regional convergence and territorial cohesion of Romania as defined in National Rural Development Plan 2007-2013</p> <ul style="list-style-type: none"> <li>• <u>Indicator</u>: Handbook of Socio-Econ Guide based on EU best practice available to farmers</li> </ul>	<ul style="list-style-type: none"> <li>• Systematic registration of property title of land in rural areas has begun</li> <li>• Integrated agricultural offices being rolled out nationwide</li> <li>• Piloting of socio-economic advisory services in X judet</li> <li>• Improved absorption rate of EU structural funds</li> <li>• Evidence of restructuring of the farming sector</li> </ul>	<p>Ongoing</p> <ul style="list-style-type: none"> <li>(a) CESAR project</li> <li>(b) MAKIS project</li> <li>(c) Irrigation Rehab and Reform project</li> <li>(d) AAA on the EU Common Agriculture Policy and national funds to maximize the impact on competitiveness.</li> <li>(e) AAA to strengthen the capacity of Government departments responsible for agriculture and rural development to enhance their strategic planning and programming capacity as one of the key expenditure categories in the budget</li> <li>(f) IFC direct lending to agribusiness projects and support to local financial institutions which provides MSMEs lending and agriculture financing</li> </ul>
<p><b>2.5 ENERGY AND ENVIRONMENT</b> Objective: Support Romania in implementing its energy strategy in line with EU Directives, including EU 20-20-20 targets, and implementing selected environmental directives.</p> <p>Outcome 1: Increase security of electricity supply through integration of regional markets, attracting private sector in the development of energy markets.</p> <ul style="list-style-type: none"> <li>• <u>Indicator 1</u>: Develop energy transmission services, including availability of ancillary services for stronger integration into regional markets, and absorption of energy generated by renewable sources.</li> </ul>	<ul style="list-style-type: none"> <li>• Romania and its electricity market and power system operates with help of ancillary services from Romania's Lotru project</li> </ul>	<p>Ongoing:</p> <ul style="list-style-type: none"> <li>(a) Energy Community in SEE</li> <li>(b) PRG Privatization of Banat and Dobrogea electricity distribution companies</li> <li>(c) Integrated Nutrient Pollution Control Project and GEF grant</li> <li>(d) Municipal Services Project</li> </ul>

CPS RESULTS AREAS AND OUTCOMES	INDICATIVE MILESTONES	WBG INSTRUMENTS
<ul style="list-style-type: none"> <li>Indicator 2: Increased private sector participation in investments in energy sector.</li> </ul> <p>Outcome 2: Implementation of the EU Water and Nitrate Directives</p> <ul style="list-style-type: none"> <li>Indicator : Favorable EU assessment of Romania's progress towards meeting EU Nitrates Directive</li> </ul>	<ul style="list-style-type: none"> <li>At least 80 percent of targeted NVZ show 10 percent reduction in nutrient discharge in water bodies</li> <li>Percentage of population in targeted NVZ area adopting preventive and remedial measures to reduce nutrient discharge</li> <li></li> </ul>	<p>New:</p> <ol style="list-style-type: none"> <li>IFC support to local financial institutions which provided energy efficiency lending.</li> <li>IFC direct lending to power projects and to renewable energy projects (wind and/or biomass).</li> </ol>
<p><b>2.6 TRANSPORT , HAZARD MITIGATION</b></p> <p>Objective: improve the efficiency of the roads and railways sub-sectors, help reduce the overall costs of transportation, improve road safety, and reduce the negative impacts of traffic congestion and pollution in selected cities.</p> <p>Outcome 1: Improved road safety</p> <ul style="list-style-type: none"> <li><u>Indicator</u>: Fatalities per 10,000 vehicles Target: 5 in 2009 vs. 6.7 in 2008</li> </ul> <p>Outcome 2: Improved emergency preparedness and response management</p> <ul style="list-style-type: none"> <li><u>Indicator 1</u>: The Emergency Management Information System is extended to include all central and local administration units</li> <li><u>Indicator 2</u>: A comprehensive Emergency Communication System is created to enable stable and reliable communication among decision makers and executive agencies during emergency.</li> <li><u>Indicator 3</u>: Investment programs for seismic retrofitting of public buildings, dam safety, and environmental safety of waste deposits from mining industry are prepared and funded.</li> </ul>	<ul style="list-style-type: none"> <li>Corrective measures taken at road sections with high traffic crash rates</li> <li>Road traffic crash database established</li> <li>Functionality of EMIS developed under Hazard Risk project is tested, and design for extension finalized</li> <li>Risk assessment of public buildings, dams and waste deposits is undertaken, based on country regulations to enable prioritization of investments</li> <li>Short term investment and financing plans prepared in accordance with risk assessment and prioritization.</li> </ul>	<p>Ongoing</p> <ol style="list-style-type: none"> <li>Transport Restructuring</li> <li>Transport Sector Support</li> <li>Hazards Risks Mitigation and Emergency Preparedness Project</li> </ol> <p>New</p> <ol style="list-style-type: none"> <li>IFC support financing of private sector in financing PPPs</li> </ol>

CPS RESULTS AREAS AND OUTCOMES	INDICATIVE MILESTONES	WBG INSTRUMENTS
<b>CAS PILLAR 3: SOCIAL AND SPATIAL INCLUSION</b> <b>GOALS:</b> <i>in the short-term, protect the vulnerable from the adverse effects of the crisis; in the medium-term, promote social inclusion and regional development.</i> <b>Issues and Obstacles:</b> <i>The crisis will temporarily increase the number of poor people, especially those involved in service and manufacturing industries. The long-term poor in rural areas and among some population groups remain hard to reach. Some of the social assistance programs are not well targeted. The pension system can be important for poverty reduction, but is currently running a deficit and does not reach all those who need it. Romania's health indicators are lagging the average of those in the EU in important areas.</i>		
<b>3.1 SOCIAL INCLUSION</b> Objective: assist Romania to improve the social inclusion and living conditions of most disadvantaged and vulnerable people in the Romanian society  Outcome 1: Improved social inclusion of Roma living in poor settlements <ul style="list-style-type: none"> <li>• <b>Indicator:</b> Gap in living condition index between targeted settlements and neighboring communities Target: Reduce by 20 percent in 2013 vs. 2007 level (TBD)</li> </ul> Outcome 2: Increased inclusiveness of children in disadvantaged groups in Early Childhood Education services in targeted areas <ul style="list-style-type: none"> <li>• <b>Indicator:</b> Number of children in disadvantaged groups participating in ECE Target: 5 percent in 2013 vs. None in 2007</li> </ul>	<ul style="list-style-type: none"> <li>• Improvements in water and road infrastructure evident in targeted Roma communities</li> <li>• Roma in poor settlements report a closer link (through annual consultations) with the local authorities, for addressing community needs</li> <li>• <b>Number of children in disadvantaged groups participating in ECE increasing annually</b></li> </ul>	Ongoing:  (a) Social Inclusion Project (b) Rural Education project (c) Mine Closure and Socio-Economic Regeneration

CPS RESULTS AREAS AND OUTCOMES	INDICATIVE MILESTONES	WBG INSTRUMENTS
<p><b>3.2. SOCIAL ASSISTANCE</b> Objective: improve the cost effectiveness and targeting of social assistance programs to mitigate the impact of the crisis on the vulnerable, and promote activation policies</p> <p>Outcome 1: increase the coverage and adequacy of the most efficient and well targeted social assistance program - the Guaranteed Minimum Income (GMI)</p> <ul style="list-style-type: none"> <li>• <u>Indicator 1</u>: Number of unpaid GMI entitled beneficiaries Target: 0 by 2011 vs. 25 percent in 2009</li> <li>• <u>Indicator 2</u>: Maintain level of benefit adequacy over time (share of benefits in average household consumption) Target: 25 percent in 2008 is maintained</li> </ul> <p>Outcome 2: Consolidate &amp; rationalize SA programs to better serve poor in most cost efficient manner</p> <ul style="list-style-type: none"> <li>• <u>Indicator</u>: Reduce the number of SA programs Target: 35 programs in 2008, reduced by 25 percent over the CPS period</li> </ul>	<ul style="list-style-type: none"> <li>• Legislation to improved design and funding of well targeted social assistance programs (e.g., GMI) is passed</li> <li>• More transparent and predictable GMI budget allocations &amp; benefits</li> <li>• Re-introduction of conditional cash transfer for CFB beneficiaries)</li> </ul>	<p>New:</p> <ul style="list-style-type: none"> <li>a) DPL series</li> <li>b) Programmatic poverty monitoring program</li> </ul>
<p><b>3.3. SOCIAL INSURANCE</b> Objective: strengthen the fiscal viability, integrity and equity of the multi-pillar pension system.</p> <p>Outcome 1: Improved fiscal sustainability of the public, pillar 1 pension.</p> <ul style="list-style-type: none"> <li>• <u>Indicator 1</u>: Deficit of Pension Pillar 1 is reduced as a result of parametric reforms (gradual move to indexation to inflation of pension benefits. Target: Reduced by 0.5 percent in 2015 as a result of parametric reforms</li> <li>• <u>Indicator 2</u>: Retirement age equalized Target: Increase retirement age for women to 65 beyond 2014</li> </ul> <p>Output 2: Improved equity of pension system</p> <ul style="list-style-type: none"> <li>• <u>Indicator</u>: Introduction of a zero pillar to cover elderly poor</li> </ul>	<ul style="list-style-type: none"> <li>• Pension legislation to introduces inflation indexation</li> <li>• Pension legislation introduces a move towards equalization of retirement age between men and women</li> <li>• Social insurance policy options for elderly poor, notably in rural areas, identified and solution initiated designing an appropriate social protection for elderly poor who are not covered at present</li> </ul>	<p>Ongoing</p> <ul style="list-style-type: none"> <li>(a) Policy Briefs 2009</li> <li>(b) Poverty Assessment Series (Phases I and II)</li> <li>(c) Pension Sector Policy Note 2007</li> <li>(d) Rapid Assessment of Impact of Economic Crisis on Poverty</li> </ul> <p>New:</p> <ul style="list-style-type: none"> <li>(a) DPL series</li> <li>(b) Analytical Work on Elderly Poor Pension Scheme</li> <li>(c) Analytical and advisory services on financial sector, and pension system</li> </ul>

CPS RESULTS AREAS AND OUTCOMES	INDICATIVE MILESTONES	WBG INSTRUMENTS
<p><b>3.4. HEALTH SECTOR</b> Objective: support the design and implementation of the Government's health sector reform program to (i) improve efficiency and quality of health services, (ii) mobilize additional resources for health and (iii) improve health outcomes</p> <p>Outcome 1: Better efficiency and quality of health services</p> <ul style="list-style-type: none"> <li>• <u>Indicator 1</u>: Annual rate of admission to acute care facilities Target: Reduce annual admission rate to acute care facilities from 229 per 1,000 people to below 200</li> <li>• <u>Indicator 2</u>: Annual growth rate of drug expenditures kept below 10 percent</li> <li>• <u>Indicator 3</u>: 24-hour death rate among patients treated in ER and then admitted to hospital Target: Decrease by 10 percent in 2013 vs. baseline 2007</li> <li>• <u>Indicator 4</u>: Maternal Mortality Ratio Target: decrease MMR by 20 percent in 2012 vs. baseline in 2004</li> </ul> <p>Outcome 2: Additional resources for health mobilized in a transparent and equitable manner</p> <ul style="list-style-type: none"> <li>• <u>Indicator 1</u>: Amount of copayment raised. Baseline: NA; target: TBD</li> <li>• <u>Indicator 2</u>: Coverage of copayment exemption among eligible population. Baseline: NA; target: &gt;70 percent</li> <li>• <u>Indicator 3</u>: percent of households with voluntary insurance. Baseline: NA. Target: 10 percent</li> </ul>	<ul style="list-style-type: none"> <li>• Adoption of the updated Hospital Rationalization Strategy through a Government Decision in/by 2010</li> <li>• Adoption of the Rural Primary Care Strategy in/by 2010</li> </ul> <ul style="list-style-type: none"> <li>• Adoption of the legislation of the revised benefit package, including (i) the introduction of copayments and exemption mechanisms for the poor and (ii) transparent mechanisms for inclusion of new technology and new drugs in the benefits package</li> <li>• Adoption of legislation for revised provider payment mechanisms</li> <li>• Adoption of legislation for voluntary health insurance</li> </ul>	<p>Ongoing</p> <ul style="list-style-type: none"> <li>(a) Health Sector Reform APL2</li> <li>(b) Health Sector Policy Note 2007</li> <li>(c) Policy Briefs 2009</li> <li>(d) IFC advisory services and financing to support private sector participation in the health sector</li> </ul> <p>New</p> <ul style="list-style-type: none"> <li>(a) DPL series</li> <li>(b) Analytical and advisory services on health sector reform</li> </ul>

**FY06 – FY09 CPS COMPLETION REPORT**  
(prepared Fall 2008)

1. **This Country Partnership Strategy Completion Report (CPSCR) assesses the effectiveness of the FY06-09 CPS for Romania<sup>2</sup>.** The CPSCR will i) assess the Bank's effectiveness in aligning its program with Romania's strategic goals; ii) detail the results achieved under the CPS; and iii) provide lessons for subsequent strategy design. The CPSCR team has used reviews of portfolio implementation undertaken by the Country Management Unit, the Quality Assurance Group and the Independent Evaluation Group. An outside consultant's assessments have also been used as input for this exercise, as well as interviews with selected client counterparts and with team members. This CPSCR is being prepared a few months ahead of the intended closure of the CPS so as to inform preparation of a new Partnership Strategy, which will cover future Bank involvement in ten new European Union (EU) Member States in Central Europe and the Baltic Countries.

### **Country Development Context**

2. **Romania's transition from a centralized to a market economy was challenging during the 1990's but strong progress was made this decade.** Romania had among the worst economic and social starting conditions of the transition economies. The 1990s were characterized by a precipitous fall in GDP per capita and an increase in poverty. But the financial crisis and the opening of EU accession negotiations, both in 1999, provided a stimulus for reform. A program of macroeconomic stabilization began to tackle the economic problems and elections in November 2000 brought a new Government with a new policy agenda. These policy efforts were supported by a World Bank financed adjustment operation and an IMF Stand By Arrangement. Between 1999 and 2006 (the start of the CPS), GDP per capita rose from \$2,900 to \$5,000 and the poverty rate fell from 35.9 percent to 13.8 percent of the population. Growth, reform and investor confidence were stimulated and sustained in large part by the prospect of EU accession.

3. **The prospect of EU accession provided a critical stimulus for reform.** The EU Accession Treaty was signed in April 2005. Accession was tentatively scheduled for January 1, 2007 but a safety clause allowed for a one year delay if Romania did not comply with key requirements. At the time the CPS was presented to the Board in May 2006 - just seven months ahead of Romania's anticipated EU entry date - activation of the safety clause and delay of EU membership remained distinct possibilities. The CPS noted the strong national consensus in favor of EU accession and the Government's policy and reform efforts focused intently on meeting the remaining accession requirements.

## **Alignment of the CPS with the Government's Own Strategic Goals**

### **4. The CPS was built around Romania's EU accession and convergence goals.**

The Government Program 2005-08 and a National Strategic Reference Framework coordinated by the Ministry of Public Finance were centered on the twin objectives of i) joining the EU in 2007 and ii) thereafter converging towards average EU living standards. The CPS was fully aligned with this agenda, and was also designed in two distinct parts: the pre-EU accession period and the post-accession period, with a break point for a joint review of the program intended shortly after accession occurred. The CPS pillars were designed to span both the pre- and post-accession parts of the CPS program.

### **5. The CPS pillars linked to the Government of Romania's priorities.**

The CPS outlined three ways in which Romania expected to accelerate economic convergence: enhancing competitiveness and the business environment; improving fiscal management; and modernizing the public sector. The first two pillars of the CPS - accelerating structural and institutional reforms for sustained growth; and addressing fiscal vulnerabilities and modernizing the public sector - directly support these country goals. In addition (and in line with the advice from an earlier review<sup>3</sup>) a third pillar was included that focused on targeting poverty reduction and promoting social inclusion.

### **6. To arrive at the CPS priorities, the CPS team had undertaken extensive consultation,**

including a conference in January 2005 attended by most of Romania's Ministers, the Prime Minister and a large part of the Bank's Romania team. At that conference, two distinct voices were heard: the line ministries proposed numerous investment projects for which they would wish to have the Bank's financial support during the CPS period, running to a billion dollars a year or more; meanwhile, the Central Bank Governor and an Adviser to the Prime Minister expressed reservations about the need for any Bank (or other IFI) involvement in Romania, given the economic boost provided by EU accession prospects, likely high inflows of foreign exchange, and Romania's borrowing needs and capacity. The Government divided its projects between the European agencies and the Bank. The proposed Bank lending program was set at approximately \$450-550m a year – the figure that appears in the CPS – a 50 percent increase over the envelopes set in previous CASs. The discomfort with continued IFI engagement among some influential counterparts appears to have gone unheeded by the Bank and is not mentioned in the CPS.

### **7. The CPS was presented to the Board shortly before EU accession.**

Almost two years passed between the expiry of the previous CPS and the Board presentation of the FY06-09 CPS, by which time there was only seven months left to the anticipated EU accession date and the first, pre-accession part of the CPS program was already well underway<sup>4</sup>. As some of the activities intended for this CPS were actually carried out in the CPS preparation period, they will be reported under this Completion Report. The

<sup>3</sup> QAG report 44570: Romania Country Lending Enhancement Review, August 2004, para 60

<sup>4</sup> This delay in Board presentation was not acknowledged in the CPS, but explains why some results targeted were achieved prior to the formal start of the CPS period.

bulk of the program activities implemented during the formal CPS period were from the post-accession part of the CPS.

### **Romania's Progress Towards its Goals during the CPS period**

8. **In many ways, the period under this CPS was very successful for Romania.** Romania achieved its primary goal of EU accession on 1 January 2007. The prospect and then reality of EU accession and the effect of the pre-accession reforms gave the economy a significant boost: over the CPS period growth remained steady and strong at 5-6 percent per annum, while market finance flowed in and credit expanded rapidly. Employment increased from 57.6 percent to 58.8 percent between 2005 and 2007 due to strong growth, a flourishing services sector and high levels of foreign direct investment.

9. **However, the fiscal and income policies pursued were largely pro-cyclical leading to imbalances and vulnerabilities that are no longer sustainable, while little progress was made on modernizing the public sector.** During the CPS period, strong growth and FDI flows masked the risks of lax fiscal policy, wage growth in excess of productivity and a widening current account deficit (the latter grew from 8.5 percent in 2005 to 10.5 percent in 2006 and 14 percent in 2007, moderating only slightly in 2008). As global economic conditions deteriorate and the external deficits keep growing, inflation has risen rapidly and investor confidence has been eroded. In late 2008, this led to depreciation of the currency and a sharp fall in national stock markets. The National Bank of Romania raised interest rates through 2007-08 without managing to dampen credit expansion until new prudential norms were introduced in the Fall 2008; it also intervened to support the lei in late 2008, which helped to stabilize the currency in the face of speculative attacks. Deep and rapid fiscal consolidation will be needed to avoid the risk of a hard landing. Institutional reforms in the public sector will be needed to support the restoration of growth and convergence of living standards with EU averages.

10. **Poverty declined during the period, largely due to strong growth, but may increase as a result of the financial crisis.** Extreme poverty declined from 4.6 percent in 2005 to 2.4 percent in 2007. Unemployment declined through the CPS period, but may well increase in the coming year as Romanians working overseas return home as their jobs are affected by the economic contraction taking place across Europe. Social inclusion has improved somewhat, with the increased provision of services for vulnerable groups, while spatial disparities have narrowed only very slightly. Governance indicators remained broadly unchanged through the CPS period, but the European Commission has highlighted concerns in its twice-yearly Compliance and Verification monitoring reports.

### **CPS Results – the Bank's Contribution to Romania's Progress**

11. **The Bank has played a significant role in supporting Romania's transition up to EU accession,** both in terms of its financial and intellectual contribution to the reform efforts, as well as by providing a stamp of approval which lent credibility to Romania's reform program. An Independent Evaluation Group (IEG) review<sup>5</sup> reports that

<sup>5</sup> IEG Using knowledge to improve development effectiveness (2008).

stakeholders in Romania rated the Bank's ESW and TA (2000-2006) highly - 4.7 on a scale of 1 (low) to 6 (high) – in terms of its influence on policy, citing particularly the Bank's core diagnostic work – a Public Expenditure Management review and a Public Expenditure and Institutional Review - undertaken in the CPS preparation period. On the lending side, the Programmatic Adjustment Loan (PAL) series was the main instrument through which the Bank supported the Government in its pre-accession structural reform agenda, in close collaboration with the EU and other partners. Overall, during the preparation period and pre-accession part of the CPS, the Bank's role in Romania was highly valued and successful.

12. **The Bank's influence declined considerably after EU accession.** The availability of market finance and EU grants rendered the Bank's financial assistance less necessary, while reform fatigue limited the Government's interest in further policy advice. Meanwhile, some line ministries continued to seek the Bank's advice. At around the time of accession, the governing coalition split leading to changes in policy direction. While few new Bank-supported activities were introduced post-accession, the portfolio of projects yielded some results. An overview is provided below under each of the three CPS pillars, with more detail in a Results Table (Annex 1).

#### Pillar 1 – Accelerating Structural and Institutional Reforms for Sustained Growth

13. **Pillar 1 aimed to put in place the key building blocks for a strong economy and sustained growth.** The Bank envisaged support in the following sectors: public finance, human development, environment, transport, energy, using the PAL as a cross-cutting reform framework, supported by Sector Investment Loans in most of the sectors mentioned above. AAA in public finance, private sector development, Country Economic Memorandum (CEM), was intended to provide a diagnostic base for the design of lending interventions or was undertaken at the request of the client.

14. **This pillar achieved partial results.** Romania took significant strides in reforming the financial sector, which was almost completely privatized and became a regional leader in South East Europe in energy sector reform and restructuring. The business environment improved, although taxes remain a problem for companies and individuals alike. However, the transport sector remains inefficient and largely unreformed. Agriculture continues in a bipolar form, with a few efficient agricultural companies and a large hinterland of subsistence farming undertaken by family units. The share of employment in agriculture as a proportion of total employment declined from 32 percent in 2004 to 27.5 percent in mid-2008.

15. **Many Bank operations performed well pre-accession but unraveled during the post-accession part of the CPS.** Four of the eight new investment loans proposed under this pillar of the CPS (Knowledge Economy (FY06), Transport (FY07), Agriculture (FY08) and Environmental Management (which became the Integrated Nutrient Reduction FY08) were approved and launched. The three-part PAL program underpinned many of the reforms associated with these investment loans. Even though PAL 2 and 3 were not approved or disbursed (in part because the IMF's program was

declared off-track), many of the reforms envisaged in the PAL series were undertaken. The first PAL was accompanied by a Private and Public Sector Institution Building loan that provided significant Technical Assistance (TA) resources to support implementation of PAL measures relating to public administration and was used for broader capacity building when the PAL series was dropped. A grant from the Netherlands (of US\$2.6m) supported the PAL series through technical assistance to improve public and private sector performance. On the private side, the grant supported reform in district heating; corporate governance; mining and infrastructure reforms; capital markets development; and regional development.

**16. The Bank Group played a major role in the transformation of the financial sector.** At the time of CPS preparation, this sector was characterized by low financial intermediation and thin, short-term capital markets. The CEM helped in the creation of a securities commission, while the PAL supported the privatization of the banking system. Nearly 100 percent of the banking system is now privately owned. Over the CPS period intermediation grew at a very fast rate, providing credit to a growing Romanian economy. However, a substantial part of this growth relied on external funding, especially from foreign mother banks, making Romania's banking system highly dependant on, and sensitive to, Western Europe's financial markets. As the external macro-financial environment facing Romania has deteriorated rapidly, substantial risks exist today that could adversely impact the financial system and reverse some of the progress achieved. In the financial sector, IFC supported the successful issuance of the first 7-year local currency bond. IFC's investment in BCR bank, following two failed privatization attempts, was highly successful and generated significant profits. During the CPS period, IFC provided over \$250 million of its own fund and help mobilized \$106 million to support six local financial institutions to increase access to finance to MSMEs. Most recently, IFC supported local currency term funding to a local bank to expand lending to the agriculture sector. Additionally, IFC invested in several regional private equity funds which provides scarce equity financing and managerial support to improve Romanian companies' competitiveness. CEC bank remains in majority public ownership.

**17. The Bank also played a significant role in the development of Romania's energy sector through the CPS period.** The Government's 2003 Energy Sector Road Map and 2007 Energy Strategy supported by the PAL program encompassed privatization so as to attract private investment, upgrade obsolete technology, increase efficiency and reduce losses. The Road Map was annexed to the EU *acquis* chapter dealing with energy. The strategies were implemented closely in the pre-accession period. A satisfactory regulatory framework was put in place and bill collection issues addressed, allowing Romania to privatize successfully some electricity and gas distribution companies (with the support of the World Bank's partial risk guarantee for the first transactions in electricity). Electricity markets (totaling about 9.5 million consumers) were liberalized, but few households or companies exercise their right to select an alternative energy provider resulting in a limited free market.

**18. During the post-accession part of the CPS, no new privatizations in the energy sector were launched, despite strong market interest.** The three distribution

companies that remain in the public sector could have been privatized as market interest was strong. Due to a halt in privatization of utilities, proposed IFC investments in the power sector were not pursued. Two further energy projects (FY08 and FY09) and a partial risk guarantee for generation privatization were envisaged during the CPS, but did not materialize due to the Government's opposition to further privatization in the energy sector and Romanian Government proposals to develop a national energy champion. After a slow start, the Bank also played a significant role in supporting the Romanian Fund for Energy Efficiency through a GEF project, which demonstrated to the banking community that investments in energy efficiency could be financially viable. Twenty projects were financed and the scheme is now being considered for purchase by a commercial bank.

19. **Romania's business environment was a constraint to growth at the time of CPS preparation.** Several aspects of this agenda – regulatory policies, labor laws and taxation, and transport costs - were targeted under the CPS through a combination of development policy loans and investment lending accompanied by AAA. However, a specific Business Environment loan envisaged for 2009 was not prepared. IFC invested in small Romanian private equity firms undertaking regional programs across the region. During the CPS period, the Romanian authorities implemented the recommendations of the 2003 Accounting and Auditing Report on the Observance of Standards and Codes (A+A ROSC). Some of the implementation activities were financed by two Dutch grants and the Public and Private Institution Building Loan (PPIBL). An update was carried out in 2008, which sets out new reform challenges and recommendations, which will help Romania to meet its corporate financial reporting obligations in the EU *acquis communautaire*.

20. **With the support of the PAL program, Romania achieved significant improvements in its business regulatory environment,** which was perceived as a particular problem (BEEPS 2005), including: simplification of administrative and regulatory procedures to reduce transaction costs for business entry and operation; improving the bankruptcy process; and improving transparency in the functioning of firms. An IFC Competitiveness Study became a good resource for the Government in determining which sectors would be competitive post-accession. However, progress was concentrated in the pre-accession part of the CPS and fell away during the post-accession part. The Bank's Doing Business reports show substantial improvements in the ease of doing business between 2005 and 2008 (Romania rose from 78<sup>th</sup> to 47<sup>th</sup> place, but remained in the same position for DB 2009). Business entry, targeted by the CPS, was substantially improved: it takes six procedures and 10 days to register a company, which is lower than the OECD average. BEEPS 2008 data is not yet available to determine whether the number of firms indicating uncertainty in regulatory policies has decreased since 2005.

21. **Mixed progress was made in addressing the rigid labor laws and high labor taxation that encouraged a thriving informal economy in Romania.** Several amendments to the Labor Code were enacted with the support of the PAL program, but Romania's relative rank in Doing Business' Rigidity of Employment index worsened

slightly between 2006 and 2008, returning to 2006 levels in Doing Business 2009<sup>6</sup>. However, reductions in labor taxation were achieved: contributions to pensions were reduced by 3 percent; to unemployment by 2 percent; and to health by 3 percent. Overall, labor taxation was reduced by 8-9 percent over the lifetime of the PAL program. In addition, a flat income tax of 16 percent was introduced in 2005. Nevertheless, labor taxation still remains one of the highest in Europe. Employment rates are increasing – according to the 2007 Labor Force Survey – but at 58.8 percent remain short of the 60 percent CPS target and the 70 percent Lisbon Strategy target.

**22. The CPS envisaged reductions in transport costs, but these were not achieved.** Through a Bank loan for road maintenance based on a Sector-Wide Approach loan and a Transport Reform project for institutional change, transport costs were envisaged to decline. Both were delayed and suffered from inadequate counterpart financing or Government commitment<sup>7</sup>. In roads, a program of road user charges was introduced to establish a reliable source of funding for road rehabilitation and maintenance and revenues from this source increased by more than 50 percent. In railways, increased track utilization was envisaged through the closing of unsustainable rail lines. However, instead of closing the lines, the Government tried to lease the lines to private parties and track utilization has remained stable or even decreased slightly. In waterways, IFC supported a fleet of barges on the Danube to improve transport logistics. Due to delays in implementation of both transport projects, most of these objectives have not been met. A Rural Development project, which closed during the CPS period, rehabilitated over 800km of roads thus reducing travel time to schools, markets and health centers by 10-20 percent and reduced the number of villages that were not accessible year-round from 71 percent to 43 percent.

**23. The Bank provided timely support through projects and technical assistance in agriculture to help Romania meet EU requirements.** A QAG review (2004) recommended Bank involvement in agriculture since the sector included 45 percent of the rural population and 67 percent of the poor, while productivity was at most 50 percent of corresponding levels amongst ‘old’ EU member states. Prior to EU accession, the Bank provided technical assistance that helped Romania to close pre-accession negotiations in agriculture. Post-accession, the Bank demonstrated high responsiveness through innovative just-in-time technical assistance following an urgent request for assistance to bring the Government’s National Rural Development Plan into compliance with EU requirements. This technical assistance ultimately helped Romania to obtain European Commission accreditation for \$11.5 million in EU agricultural and rural development funds.

**24. Support to the Government of Romania’s agricultural reform program by means of a Development Policy Loan (DPL) was considered but ultimately rejected.**

<sup>6</sup> Romania, Rigidity of Employment Index: Doing Business 2006: 62; DB 2007: 62; DB 2008: 66; DB 2009: 62.

<sup>7</sup> The QAG review referenced above recommended dropping the roads component, given the availability of other sources of financing and the lack of interest on the part of the Government of Romania in sectoral dialogue (para 48).

The Ministry of Agriculture and Rural Development and the Bank jointly considered an investment loan the more appropriate lending instrument given the long term nature of the targeted policy implementation challenges associated with the targeted reforms. A broad agricultural loan (CESAR) facilitating market-based restructuring through enhancing the ability of farmers, farm family members and farm workers to manage their assets and income was approved during FY08. The loan would assist the Government of Romania in initiating the national program of systematic property title registration of land assets in rural areas to improve the security of land property rights and reduce transaction costs on rural land markets. Equally important, it assists the Government of Romania in improving the delivery of socio-economic guidance services to the rural population. However, it has not yet been made effective mainly due to approval delays related to the Government's transition to the use of Treasury systems. The Modern Agriculture Knowledge Information System project has piloted service delivery models to help farmers access EU CAP funds and supports border inspection and food safety standards for EU compliance. Other projects in this area, including irrigation and hazard risk were initially delayed after the change in Government in 2005 but are now proceeding well. Two GEF grants (of US\$7m and US\$5.5m) directly support investment projects (Hazard Risk Mitigation and Integrated Nutrient Pollution Control) in the portfolio.

**25. In education, the Bank supported the Ministry of Education's reform of Higher Education financing plans with technical assistance.** The Ministry of Education and the Bank worked closely to develop a strategic document on student loans and scholarships and to deepen existing instruments for measuring the relevance of education to labor market demand. To improve the quality of education, national quality assurance agencies were established and are now operational for schools and higher education, however, Romanian students continue to under perform in international evaluations.

#### Pillar 2 – Addressing Fiscal Vulnerabilities and Modernizing the Public Sector

**26. Pillar 2 aimed to reduce the fiscal deficit and modernize the public sector.** The Bank envisaged support in the following sectors: the judiciary, revenue administration, municipal development, human development and energy, using the PAL as a cross-cutting reform framework, supported by Sector Investment Loans in most of the sectors mentioned above. AAA in public and municipal finance, civil service pay, as well as a Country Procurement Assessment Report, Country Financial Accountability Assessment and CEM, Policy Notes and fiduciary monitoring were intended to provide a diagnostic base for the design of lending interventions.

**27. Partial results were achieved under this pillar.** As under pillar 1, many of the gains made by Romania in the pre-accession were not extended or even unraveled during the post-accession part of the CPS. The restructuring of the pension system was a difficult, but successful reform, although the sustainability of this success is now under threat by promises of unsustainable increases in pension payouts.

28. **Some progress was made in privatization and reduction in the manufacturing sector, but the pace slowed during the CPS period.** By November 2007, the privatization company (Authority for State Assets Recovery, AVAS) had 1025 companies in its portfolio (down from 7676 in 1992) almost half of which are not privatizable and in various stages of liquidation. The PAL 2 program aimed to complete the divestiture of the state shareholdings by the end of 2006, but by this time only 86 of 153 companies in which AVAS held a majority ownership were privatized or liquidated, with a further 13 in different stages of privatization and the residual stakes were sold in only 23 of 421 companies in which AVAS held a minority position. Some of the companies subsequently returned into the AVAS portfolio due to breaches of the privatization contracts and the imposition of labor force conditions. Most of these companies have subsequently been re-privatized or liquidated. The slowdown in the pace of privatization is partially due to the lack of attractiveness of the remaining portfolio, but also due to inflexibility on the method of privatization and changes in economic policy

29. **The burden of the mining sector on the state budget was partly reduced during the CPS period,** but the gains have to be reviewed in light of a newly-prepared plan for restructuring the coal sector approved by the European Commission in 2007. Between 2002 and 2006, the Government closed 235 mining units and cut the number of employees in the lignite and hard coal sector from 45,700 to 28,500, while coal output barely changed. State aid to the mining industry did not decline measurably, however, as deeper restructuring was needed. The Romanian Government plans to spend EUR411 million in state aid over 2007-2010, while gradually reducing subsidies to the coal sector.

30. **Few public sector reforms took place, for example in civil service, judiciary or public financial management.** Lax fiscal policy contributed to widening fiscal balances, while a fragmented and cumbersome tax system led to widespread inefficiencies and evasion. (Doing Business 2009 places Romania last in terms of the number of tax payments: it is estimated that around 10 percent of taxpayers - including both firms and individuals - are evading taxes.) The fiscal deficits which were manageable during a period of strong growth will now inhibit a rapid and effective response to the international financial crisis.

31. **Just two (Judicial Reform and Municipal Services) of the eight new loans proposed under this pillar of the CPS were taken forward.** The anticipated follow-through with PAL 2 and 3, a Fiscal and Governance DPL and a Revenue Administration project did not materialize. A grant from the Netherlands (of US\$2.6m) supported the PAL series through technical assistance for judicial reforms; policy formulation; transparency, anti-corruption and governance reforms; public expenditure management, including budget preparation, execution and control and intergovernmental fiscal relations; and revenue administration.

32. **The CPS program helped the Government to reduce subsidies to state owned enterprises, which were high (although declining) at the time of CPS preparation.** A privatization agenda was pursued with the support of the PAL program in the manufacturing sector to reduce direct and indirect subsidies (see above). In the mining

sector, the CPS targeted the closure of loss making and non-viable mines through the PAL series and through continuation of a successful mine restructuring operation resulting in the closure of 31 small mines. A follow-up Mine Closure II project is tackling 20 more complex cases that potentially have environmental legacy issues.

33. **The pension system was substantially restructured and the public pension deficit eliminated.** Measures towards fiscal consolidation of the public pension system were underway prior to CPS preparation, however the system remained vulnerable: beneficiaries outnumbered contributors; the system provided low benefits; and was subject to ad hoc political decisions. Some considerable success was achieved on this ambitious and politically difficult agenda in the accession period of the CPS: the pension system was restructured with the support of the PAL program and a multi-pillar pension system launched in 2008, the retirement age was gradually increased and services unrelated to pensions were externalized. As a result, the public pension system achieved a surplus in 2006. This outcome however is threatened by a 50 percent increase in pensions announced in October 2008, which may put the system back into a deficit.

34. **A project to support Romania's efforts to reduce the health-related fiscal deficit was not taken forward, but Romania has made progress in reducing this part of the deficit.** At this moment the arrears in payment of the National Health Insurance Fund are small, pertaining only to some hospitals with high fixed costs and limited turnover and some pharmacies which exceeded their contract ceiling. Likewise, a project to improve tax compliance was not taken forward, but Romania's revenue collection has improved in recent years, probably as a result of the introduction of a flat tax in 2005. IFC has helped the NHIF to outsource dialysis services of 8 hospitals to the main private providers.

35. **Several projects aimed to help Romania to absorb the potential inflows of EU funds to which it became eligible at accession.** The CPS aimed to assist in improving Romania's capacity to absorb EU funds in a systemic way through the PAL program (which was dropped mid-series), a Fiscal and Governance DPL (which was never prepared) and through institutional capacity building under a second Rural and Regional Development loan (which was never prepared). An IDF grant, which closed in 2008, helped to increase the capacity of the Managing Authority for EU grants to prepare detailed cost-benefit analysis for projects eligible for EU financing and so improved Romania's capacity to manage flows of EU funds.

36. **Further, improved absorptive capacity was attempted at the sectoral level** where sub-components of Bank-supported projects were introduced to help with the identification and preparation of project pipelines to improve the absorption of EU funds. The MAKIS project developed a Training and Information Center in Bucharest (and three others are planned) to serve as a knowledge resource base, accreditation and training center for extension agents, food safety specialists and researchers, which will increase the capacity of researchers to develop proposals for EU funding and will prepare them to benefit fully from the funds once they become available, as well as "Integrated Agricultural Offices" or 'one stop service centers' which bring together agricultural

advisory and administration services and serve as the main service point for filing applications for CAP support schemes, provision of information and advice on support programs, farm management and technical advice. Other projects, including the Social Inclusion Project, Transport Sector Support, Municipal Services, Integrated Nutrient Pollution and Complementing EU support for Agricultural Restructuring (CESAR) also aimed to improve absorptive capacity, but most of these projects have been delayed or are not yet effective. Absorptive capacity of EU funds remains low.

**37. Limited improvements were made in the civil service through Bank interventions.** The PAL series targeted a broad range of objectives for improving the civil service in Romania, while a Fiscal and Governance DPL, intended to deepen the PAL-supported reforms, was never taken forward. Given a lack of political support for deep civil service reforms, the PAL focused on improving the civil service agency in monitoring indicators. The indicators were monitored partially, irregularly and infrequently and there is no evidence to suggest that the indicators were monitored after the PAL series was dropped. The CPS also targeted a more meritocratic civil service. Some legislative changes were made to the Civil Service and Conflict of Interest Laws and the Law of Declaration of Assets as amended is now one of the strictest in the EU, but not all have been fully implemented. A medium term Civil Service Pay and Employment strategy was also drafted, but not implemented.

**38. Some progress was made in improving public financial management (PFM), although more remains to be done.** Improvements in PFM were targeted by the PAL series. A Strategic Development Plan was drafted and some progress made in improving internal and external audit and accounting standards, as well as in enhancing the quality of the annual budget process. However, linkages between resources and performance remain weak and the absence of a medium-term strategic framework undermines efforts to improve the prioritization, efficiency, predictability and transparency of resource allocation. As pressure grows on the Government's budget and public spending comes under strain, such weaknesses will inhibit the Government's ability to respond to the current financial crisis.

**39. In the judicial sector the Bank was responsive to an urgent request for assistance with this important element in the EU accession agenda and approved a Judicial Reform Loan.** There was strong support for reform in this area under one Minister in the pre-accession period, but interest waned rapidly when she left the post and Romania joined the EU. To increase efficiency and reduce administrative costs, a study on the rationalization of the court system was completed, but it was not implemented.

### Pillar 3 – Targeting Poverty Reduction and Promoting Social Inclusion

**40. Pillar 3 aimed to reduce poverty and improve the livelihoods of those marginalized in society.** The Bank envisaged support in the following sectors: human development, rural and regional development, using the PAL as a cross-cutting reform framework, supported by Sector Investment Loans in most of the sectors mentioned above. AAA, including on rural/regional development, poverty monitoring, a CEM and a

series of policy notes in health, was intended to provide a diagnostic base for the design of lending interventions or was undertaken at the request of the client.

41. **Few results have been achieved (so far) under this pillar.** Poverty has been reduced as a result of strong growth, but this is under threat as the economic situation deteriorates. Social inclusion has improved as a result of increased services targeted towards vulnerable groups. Regional disparities have narrowed, but only very slightly, in most of Romania's regions over the CPS period.

42. **Only one of eight potential new loans anticipated under this pillar of the CPS were approved – the Social Inclusion Project.** As most of the CPS monitoring indicators relate to this project and it has been delayed, few results can be seen from this pillar yet. The anticipated Rural and Regional project and the Human Development DPL series, were not taken forward. It is the only pillar that did not directly relate to Romania's EU accession ambition and therefore did not benefit from the drive and momentum behind the other pillars during the early years of the CPS.

43. **Poverty was reduced over the CPS period, largely due to economic growth, but some groups were left behind.** The CPS aimed to support Romania's goal of halving extreme poverty through improving coverage of the Minimum Income Guarantee program and reforming eligibility rules. The extreme poverty rate has been reduced dramatically (below the CPS target), as a result of strong and sustained economic growth. At the same time, social assistance is becoming progressively less targeted, the Minimum Income Guarantee program was partially reformed, but as GDP continues to rise, the relative size of the guaranteed income is actually declining and coverage of the poor is decreasing. A programmatic Poverty Monitoring AAA program was undertaken to work with the Romanian authorities to build capacity to monitor poverty and social inclusion trends, as well as to evaluate social programs aiming to reduce social exclusion. The program was only partially successful, mainly due to understaffing in the relevant Government departments, resulting in low levels of participation and knowledge transfer.

44. **The on-going Social Services Project helped to improve services for some vulnerable groups.** The development and provision of social assistance services and employment services contributed to a certain extent to the social inclusion of persons coming from various groups at risk. Out of 1520 persons with disabilities that were enrolled on employment counseling services, 770 succeeded in getting full employment - a 50.6 percent placement rate. The provision of multi-functional social assistance services in 70 community based centers contributed to the social inclusion of children at risk, victims of domestic violence, persons with disabilities and the elderly.

45. **An Institutional Development Fund (IDF) grant and a Japanese Social Development Fund Grant supported Romania's Roma agenda.** The National Roma Agency and line ministries involved in the Decade for Roma Inclusion were direct beneficiaries of the IDF grant, which supported the formulation of inclusive policies for housing and education; training for regional and local authorities in the development of inclusive development plans; and establishment of a monitoring and evaluation system to

help the National Roma Agency oversee and evaluate the implementation of Roma programs. A Japanese Social Development Fund (JSDF) grant also supported priority programs for Roma inclusion and empowerment by working with local and regional Roma NGOs and creating partnerships between Roma communities and the local public administration. The grant is linked to a project that has only recently started, so it is too early to assess results at this stage.

46. **Regional disparities between central and rural regions were high at the start of the CPS period and remain so today, although in most regions they have narrowed slightly.** The Bank proposed engagement on Regional Development issues through lending and technical assistance. A Regional Development Loan was planned, which would have built on the recommendations of ESW undertaken earlier in the decade and was intended as a complement to the Mine Closure project, to examine potential areas of competitiveness and to bring social and economic regeneration measures to poorer parts of western Romania. However, views within Government were mixed on the approach and there was no single counterpart. Eventually, the Mine Closure II project incorporated a socio-economic regeneration component.

47. **Technical assistance to the Government of Romania to formulate its regional and rural development programs and assist in their implementation was successful.** A conference at the outset (2006) opened a substantive policy dialogue with the Ministry of Development, Public Works and Housing and led to the adoption of many policy recommendations in the Government's regional program. However, the decision not to pursue the Regional Development project limited the Bank's involvement in implementation.

48. **Information technology is helping to bridge spatial and knowledge disparities.** To reduce the disparities in knowledge between lagging and central regions, a Knowledge Economy project has provided about 1.8 million people (or 44 percent of the most knowledge-disadvantaged communities) with access to information communication technology through the establishment of 255 Local Community electronic Networks. The aim of the project is to see these networks evolve into a daily tool for education, business and public communication with the Government, with increasing private management and financial self-sustainability. The project was championed by local governments and was recently awarded the European Commission's e-Inclusion Medal Award 2008.

49. **Another Bank-supported project aimed to reduce urban-rural divides by improving access to good quality rural education.** The gap between urban and rural students who scored well at national examinations for grade 8 decreased from 16.5 percent in 2001/2 to 13.8 percent in 2006/7. Successful interventions under Bank-financed projects are now being replicated by the Government at national level using EU structural funds.

50. **A range of social disparities were targeted by the Social Investment Project.** The project supported a range of interventions to improve the living conditions for Roma,

to increase attendance at Early Childhood Development Programs, to improve facilities for persons with disabilities to EU standards and to improve multifunctional centers for youth at risk to help them enter employment. The project suffered significant delays, but has now picked up and is expected to deliver results in 2009.

51. **Health sector improvements were targeted under an on-going Health Sector Reform project, in PAL 2 and a series of Human Development DPLs** (the latter two were not taken forward). The nature of potential reforms was assessed in a series of Human Development policy notes, discussed with stakeholders in 2007. The recommendations pertained to continuing hospital reform for the purpose of increasing efficiency and quality of care, redressing the bias towards inpatient care, improving pharmaceutical pricing methodology and establishment of reimbursement list, improving access to care in underserved areas, and addressing the HR issues (diminishing supply of health professionals). The recommendations yielded limited improvements in pharmaceutical pricing methodology and establishment of reimbursement list an increase in payments for family doctors. The restructuring of health care services in underserved areas to ensure access and quality was not taken forward due to a change in Romanian legislation that treats primary health care practices as private ventures which can not benefit from public money and regulation ambiguities regarding the privatization of medical infrastructure. A micro-credit scheme was also dropped, at the request of the Government. IFC, however, supported some operations in the health sector, namely the expansion of private hospitals which will increase the supply of higher quality hospital services in Romania and help relieve some of the burden currently placed on the public health system, and allow public health resources to focus on lower income segments of the population and emergency services.

## **Bank Performance**

### Strategic Relevance

52. **The CPS design was fully in line with and relevant to the Government of Romania's agenda:** support for EU accession and for continued convergence thereafter. Projects were designed with a strong EU focus helping Romania either to meet EU accession requirements (for example, in judicial reform), membership obligations and EU Directives (for example, the Integrated Nutrient Pollution Control) and/or to absorb EU financing.

53. **The Bank's analytical and advisory work also played a major role in preparing Romania for EU accession.** The Country Economic Memorandum (2004) focused on the policy areas and challenges that underpinned Romania's integration into the EU structures: trade, agriculture, enterprise restructuring, business environment, energy, environment and the labor market. A Public Expenditure and Institutional Review (PEIR, 2006) helped Romania be better prepared to improve the quality and effectiveness of planning and public spending to meet the demands of the EU accession and absorb EU funds, while maintaining prudent macroeconomic policies. A large number of policy measures recommended by the two reports were included in the PAL program, which constituted *de facto* the framework in which the EU accession reform

program was pursued by the Romanian authorities. Romanian officials report that the Bank helped with their dialogue with the EU and may have contributed to its successful entry into the EU<sup>8</sup>.

54. **The CPS program design was anchored by adjustment loans intended to deal with systemic reform issues, complemented by a series of investment projects and AAA products.** In the first, pre-accession part of the CPS, the on-going PAL series performed this anchor function effectively (as did the external anchor of EU accession). Even though PAL 2 and PAL 3 did not materialize, many of the reforms identified for these loans were undertaken. However, in the second, post-accession part of the program, the PAL program was discontinued, the proposed Human Development DPL series and the Fiscal and Governance DPLs were not prepared. At the same time as the external anchor of EU accession disappeared, so too did the program anchor.

55. **The program moved from high-case to low-case through the CPS period.** Given the evident importance attached to the PAL series as a centerpiece for the program, it is surprising that this DPL series was only forecast for a high-case scenario. Triggers for this high case scenario were anyway those essential for continuing the PAL series (appropriate macroeconomic conditions and progress on PAL triggers). Thus, the CPS started in – and was built around - the high case scenario. When the DPLs were abandoned mid-CPS<sup>9</sup>, the program moved to the base case of investment loans (intended to link to the PAL), heavy on procurement of equipment and light on policy, at just under 40 percent of the indicative amounts given in the CPS. When they too unraveled in the absence of an anchor<sup>10</sup> the CPS slipped towards the low case scenario of AAA only. (Annex 2 – Planned and Actual Lending).

56. **The Bank endeavored to adapt the portfolio to meet new needs:** just-in-time technical assistance was provided to help the Romanian Government with its National Rural Development program and, at the Government's request, an emergency Avian Flu operation was prepared. The Bank examined opportunities to use Romanian environmental standards and fiduciary controls in project implementation. Furthermore, the Bank has signed a Memorandum of Understanding with the Romanian Government in preparation for adoption of the Romanian's new public debt management system (due to commence January 2009), which will use Romania's treasury to pre-finance all expenditures in Bank-supported projects and simply request reimbursement from the Bank. However, concerns remain about the readiness of the authorities to implement the system and the Government's current financial capacity to pre-finance all project expenditures: these concerns are being addressed by the Ministry of Public Finance, which has requested a shift back to the advance system of disbursement in early 2009.

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<sup>8</sup> IEG Using knowledge to improve development effectiveness (2008).

<sup>9</sup> The Romania Country Assistance Evaluation (OED, May 2005), finds that when government commitment is clearly weak, it is important for the Bank to acknowledge this explicitly and refrain from continuing with adjustment lending.

<sup>10</sup> The same CAE noted that investment lending in a distorted policy environment is unlikely to achieve its objectives.

### Major Factors that Affected CPS Implementation

57. **The CPS recognized the defining moment that EU accession would bring, yet when it happened, the Bank did not rebalance its program rapidly enough.** Following accession and a change in the governing coalition, interest in borrowing from the Bank waned rapidly. The Bank underestimated the rapid loss in its strategic relevance as Romania rapidly adjusted its financing strategy towards increased use of market finance, investment loans from the European Investment Bank and Structural and Cohesion grants from the EU. The break-up of the governing coalition at around the same time as accession also contributed to the change in approach towards the Bank. As a result of the diminished dialogue, the intended joint review of the partnership strategy did not take place and the portfolio was not adjusted towards a new partnership approach. IFC was relatively less affected than the Bank by the change in Government financing preferences and the shift towards EU institutions as preferred partners.

58. **The risks identified in the CPS materialized.** Three risks were identified in the CPS: i) failure to address weaknesses in the macroeconomic framework; ii) slippages in the reform agenda (especially if the EU safety clause is invoked and accession is delayed); and iii) lack of attention to strengthening institutional capacity. Each of these risks played out, although the slippage in the reform agenda was more due to the achievement EU accession, which led to some relaxation of the reform path, rather than due to the feared delay in EU accession. The financial crisis that erupted in late 2008 will severely test the economy while attention to institutional strengthening has been limited.

### Quality of Bank Services

#### Portfolio

59. **As of September 2008, Romania's active portfolio consists of 17 projects<sup>11</sup> with total commitments of US\$ 1.62 billion, of which US\$ 1.18 billion remains undisbursed.** During the CPS period, eight projects (or one third of the portfolio, totaling US \$731 million) were approved, corresponding to 38.5 percent of the indicative FY06-09 lending program. The new loans were agreed in the early years of the CPS: three projects in FY06; three in FY07; and two in FY08; none so far in FY09. Investment operations now account for the entire portfolio, although a DPL operation will be presented at the same time as the new CPS.

60. **At the start of this CPS, the Bank's portfolio in Romania was third largest in ECA and operations approved prior to this CPS generally exhibited strong quality.** IEG reviews of the eight projects that closed during FY06-09<sup>12</sup> show that 100 percent had satisfactory outcomes and likely sustainability. For all eight projects the quality at entry, quality of supervision and the Borrower performance were rated satisfactory or higher. These outcomes confirm the highly relevant and valued Bank-Romania pre-accession partnership.

<sup>11</sup> 17 SILs including 2 co-financing GEFs, which component the Hazard Mitigation and Integrated Nutrient Pollution Control projects

<sup>12</sup> 10 projects closed FY06-08, of which 8 reviewed by IEG.

61. **Romanian in-country stakeholders rated the Bank strongly (4.7 out of 6) in terms of building capacity and strengthening institutions**<sup>13</sup>. They specifically noted that the Bank's comparative advantage is in accumulating practical knowledge and best practice experience from many different countries which could help them avoid costly mistakes.

62. **As Government interest in new loans declined, so too did portfolio quality.** Commitments at risk, a measure of the likelihood that projects will not meet their stated development objectives on time, increased sharply from zero in FY05 to 36 percent in mid-FY08. A portfolio-wide review held in early 2008 assessed the reasons for the portfolio quality deterioration and factors affecting the disbursement performance. Key factors include: (i) Government weakness in strategic planning and sectoral policy, which triggers frequent changes in policy priorities and directions; (ii) absence of an effective medium-term expenditure framework which results in uncertainty regarding funds availability and imposition of spending ceilings; (iii) limited funding being made available during the annual budget cycle leaving projects hopeful but not certain of increased financing during periodic budget rectifications; and (iv) poor managerial practices (insufficient decentralization of project implementation responsibilities, frequent changes of project management teams, lack of coordination among key players involved in project implementation and cumbersome approval process of budget financed investments). The review helped stimulate improved portfolio performance, resulting in a healthy disbursement ratio of 18.2 percent at the end of FY08, compared to just 10 percent a year earlier, while the number of projects at risk was reduced from six to three and commitments at risk went down from 26.3 percent to 12.3 percent by end FY08.

63. **Financial Management performance was generally good while procurement has been problematic.** Financial management performance was generally satisfactory and compliance with audit and reporting covenants good (with the exception of some audit reports for the road and railway entities, although the previously long delays have also been significantly reduced). The public procurement law aligned with EU directives was adopted prior to Romania's EU accession, but procurement risks for eight projects<sup>14</sup> in the portfolio are considered to be high. In most instances this relates to weak capacity of the implementing agencies to handle procurement related work. Two projects in the portfolio are considered procurement problematic based on an assessment made by task teams during supervision and slow implementation progress.

64. **IFC's portfolio has performed well.** During the CPS period IFC invested a total of \$383 million of its own fund and help mobilized \$191 million in 15 projects. These included 8 projects in the financial sector, a project to support the modernization of refinery, a project to improve river transportation, a project to support the first private hospital chain and a project in transportation and warehousing. Additionally IFC invested in regional projects in private equity funds, which allowed investments in smaller competitive companies as well as in oil and gas exploration, covering Turkey and

<sup>13</sup> IEG Using knowledge to improve development effectiveness (2008).

<sup>14</sup> Forest Development, Hazard Mitigation loan and associated GEF project, Health Sector Reforms, Social Inclusion, Avian Flu, Transport Restructuring and Transport Sector Support Projects.

Romania. IFC-Bank cooperation throughout the period was strong. The CPS envisaged some links, for example with IFC supporting privatizations in infrastructure and energy proposed through the PAL series, but these were stopped when the policy loan series was dropped.

#### Analytical and Advisory Work

65. **The lending portfolio was complemented by a series of analytical and advisory activities (AAA),** which perform a variety of functions: due diligence for the Bank; policy options and advice for the Government; and technical work to assist in the preparation or implementation of loans.

66. **AAA from both the Bank and IFC was relatively light, given the size of the program and declined, rather than increased, as the program moved into the low case** (Annex 3 – AAA Delivered). However, while the Ministry of Economy and Finance showed no interest in Bank loans, the line Ministries continued to be receptive to analytical advice, suggesting that AAA could have been scaled up effectively as the main channel for policy guidance to line ministries, but instead as interest in loans declined, so too did the budget allocated to Romania. Some IFC health sector work paved the way for the out-sourcing of eight dialysis centers, while the IFC's Competitiveness Study helped the authorities analyze sector competitiveness compared to their EU counterparts.

67. **As mentioned above, AAA work that was particularly useful in the pre-accession part of the CPS helped Romania to prepare for EU accession.** Romanian officials noted that they were interested in the Bank looking ahead and identifying the next generation of policies and issues that would be important in the future, giving the example of the Romanian Food and Agriculture in a European Perspective analytical work and related technical assistance, which set out the impacts of the prospective reform of the EU Common Agricultural Policy (CAP) in 2013 on Romania. On many of the studies, the partnership between the line ministry and the Bank staff was close, while the frequent participation of Romanian specialists in the AAA work helped enhance local capacity and ownership and secure realism and best outcomes.

68. **Generally, dissemination of AAA work took place in country and in the local language with the significant participation of Government officials** from the Ministry of Economy and Finance, line Ministries and agencies, representatives of professional organizations, think tanks, researchers, academia and, when appropriate, the press. For example, in June 2007 the Romania Country Office organized a series of workshops to disseminate four policy notes on health and pharmaceuticals, pensions, poverty and social assistance, and education to prepare for and underpin a series of proposed Human Development DPLs (which were not ultimately prepared).

#### Delivery

69. **In line with the deterioration in portfolio quality and the reduction in demand for new IBRD loans, so too lead times for those projects that were under preparation increased significantly** from 12 months in FY06 to 23<sup>15</sup> months in FY08.

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<sup>15</sup> Average lag from PCN to approval

Likewise, the elapsed time between the benchmark spending of US\$30,000 before a concept note is prepared and Board approval has also increased from 14 months in FY06 to 22.35 months in FY08. Both indicators are now significantly higher than ECA and Bank-wide averages.

70. **In FY06-07, the average 11-month preparation time for ESW products was in line with the envisaged target of 12 months.** However, to remain relevant and to reposition the Bank as a knowledge-provider, this lead time will need to be shortened further to provide shorter, more responsive analytical work, so long as this does not undermine the technical quality of the work.

71. **Project management through the CPS period was significantly decentralized to the country office.** At the time of the CPS three projects were led by staff in the country office; this has increased to ten during the CPS period, but currently stands at six. Local team leaders are closer to the projects and to understanding the political economy behind delays or obstacles. However, some were left with limited supervision and support from their sector units.

#### Country dialogue

72. **Through the CPS implementation period, the divergence of views between the Government's wishes from the Bank and the Bank's proposed program increased.** On the one hand, as accession became a certainty and then a reality, Romania became eligible for structural and cohesion funds, reform fatigue set in while the fruits of the earlier reforms were enjoyed, financial market access became easier, the anchor of the pre-accession requirements was lost and Romania became even more determined to avoid the perceived stigma of continued association with a development Bank. This latter may be particularly pronounced given the perceived influence of the Bank over policy setting (although the EU's power in the same respect was not perceived negatively). There is also some evidence of the Bank adjusting operations to meet HQ-requirements (for example grouping multiple projects into one and manipulating delivery dates) but in doing so losing the ownership of the counterparts. Furthermore, the Bank heard the demand from line ministries for continued engagement but was not able to demonstrate its value-added to a reluctant Ministry of Finance. In its apparent determination to press ahead with loans for which there was no ownership in the Ministry of Finance, the Bank only further alienated its main counterpart.

73. **The level of interest in Bank support for development programs in the convergence part of the CPS dropped off sharply after accession with the change in Government and improved access to external financing.** Romania adjusted rapidly to its new circumstances and the Bank was not able to adjust rapidly enough. One project was dropped in FY06 (including the core programmatic adjustment loan (PAL) series), two in FY07, three in FY08 and by FY09 there were no lending projects in the pipeline. Significantly, all the proposed DPLs were dropped. Only two new investment loans were agreed post-accession (but experienced lengthy approval and effectiveness delays). Implementation of projects already underway worsened (the decline began around 2005) and the dialogue between the Bank and the Government declined as the Government

became more focused on market financing<sup>16</sup>. During the post-accession part of the CPS, the Bank's role in Romania diminished considerably and in September 2007 the Government expressed interest in graduation from Bank lending.

#### Monitoring and Evaluation

74. **CPS monitoring was linked to the PAL program.** The CPS envisaged that monitoring of the program would take place through the Project Implementation Unit for the PAL program in the Chancellery of the Prime Minister's office, which was staffed with specialists covering the main areas of reform. This arrangement was intended to sustain the impact of the PAL program under changing circumstances. Monthly and quarterly progress reports were prepared on specific monitoring indicators linked to the CPS monitoring framework. Quarterly Portfolio Reviews were held between the Ministry of Finance and the Country Director. However, when the PAL was dropped in 2006, the regular monitoring and meetings stopped.

75. **Once the PAL had been dropped, joint portfolio monitoring continued, but with greater frequency.** Progress on individual projects was reported separately and brought together on several occasions – in 2006 and 2008 – when joint Portfolio-wide Reviews were undertaken at the Bank's instigation with representatives of the Bank, the Ministry of Economy and Finance, project management units, line ministries and agencies, as well as throughout 2007 in quarterly portfolio reviews to redress deteriorating portfolio quality. The reviews identified particular problems in projects and resulted in agreement as to the proposed actions to resolve such issues.

#### **Lessons Learned**

- Identify the Bank's comparative advantage vis-à-vis other external partners and design the program around these areas. The Bank did not heed sufficiently the need for a different approach towards a MIC client no longer dependent on Bank financing. The program continued to emphasize large loans when other larger, faster, cheaper financing sources were available and did not re-focus the Bank's role as a knowledge-provider or technical adviser. The dissonance between the desire of line ministries to continue borrowing and the desire of the Ministry of Economy and Finance to diversify its sources of financing was not resolved. The lack of commitment and therefore budgetary resources from the Bank's key counterpart in the Ministry of Economy and Finance hindered successful implementation of several projects. The Bank should focus on its areas comparative advantage in some key reform areas (see Section B below).
- Allow flexibility in a CPS to manage changing circumstances and the prevailing needs. Given the fact that the program spanned such an important historical moment for Romania, the CPS program was somewhat over-determined with a program of loans outlined for all four years of the CPS. The Bank appeared to have a pre-set agenda and was unable to adjust with sufficient flexibility in line with the Government's revised priorities. While ILs and AAA can reinforce a

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<sup>16</sup> The QAG review referenced above already foreshadowed that 'after accession the Bank may be perceived as less important and Romanians may have a reduced interest in the relationship'.

DPL series, they should not be so inextricably linked as to create an ‘all-or-nothing’ program. Likewise, investment projects should not be overly complex (in technical and financing terms), which results in implementation delays and the need for restructuring or capacity building during implementation. The program should be designed so it can be scaled up or down according to the Government’s demand. As the lack of interest in lending manifested itself, the Bank could have stepped-up its AAA program to demonstrate its value-added and develop a new knowledge partnership, but instead AAA declined in line with the lending program.

- Anticipate and manage political transitions. The CPS acknowledged that much of the commitment to reforms had been due to EU accession aspirations, but anticipated this reform commitment would continue to achieve convergence. In doing so, it underestimated an understandable reform fatigue after years of reforms in preparation for accession. At times, the Bank heard only the voices it chose to or sought agreement to its plans from other parts of Romania’s governance structure. Such dialogue was counter-productive. The Bank should maintain dialogue with a wide range of stakeholders across the political spectrum, at all levels of the civil service and with a wide range of public stakeholders, including businesses, special interest groups and other non-governmental organizations.

## **Conclusion**

76. The Bank was an important partner in Romania’s development prior to accession. However, a change in Government, EU accession and the Bank’s narrow focus on lending limited the effectiveness of Bank support during the post-accession period. With a new approach, focused on the Bank’s value-added in reform-oriented and knowledge products, a successful new partnership could be forged again.

**Pillar 1 Accelerating Structural and Institutional Reforms for Sustained Growth**

<b>At CPS entry</b>	<b>CAS Outcomes</b>	<b>Milestones</b>	<b>Results at CPS completion</b>
Incomplete privatization agenda in banking sector. 62.5% of banking assets state-owned. In 2003, 3 of the 39 credit institutions were state owned.	Increase in private sector share of banking assets to 100%	Completion of privatization of BCR and CEC banks	Substantially Achieved. 98% of banking assets privatized. BCR privatized in Dec 2005 through an open, international and competitive tender in the largest privatization deal to date in Romania. CEC not privatized. In 2007, 2 of the 42 credit institutions are state owned (CEC and Eximbank).
Incomplete privatization agenda in enterprise sector. Weight of private sector in GDP was 67.7% in 2003	Completion of divestiture of manufacturing SOEs	Completion of privatization of SOEs held by AVAS	Partially achieved. 86 of 153 companies in which AVAS held a majority ownership were privatized or liquidated, with a further 13 in different stages of privatization, while the residual stakes were sold in only 23 of 421 companies in which AVAS held a minority position. The weight of the private sector in GDP was 71.8% in 2006
Rigidities in the labor market due to employment protection legislation	Reduction of rigidities in hiring and firing as measured by Cost of Doing Business indices	Amendments of the Labor Code to improve flexibility	Partially Achieved. Amends to the Labor Code were enacted under PAL 2 preparation. DB shows that labor market flexibility has improved a little (149 to 143), but still remains rather rigid.
Employment rate among 15-64 years olds 58% in 2004	Increase in employment rate of population aged 15-64 from 58%   2004 to 60% in 2009		Partially Achieved. Employment rates 58.8% in 2007 (Labour Force Survey). Labor codes were amended and may have had a positive effect on employment, but attribution of the increase in employment to this alone is unrealistic.
Rigidities in land markets. Incomplete land restitution/demarcation process.	Increased activity in agriculture land markets as measured by the number of land registrations and lease contracts	Successful introduction of land restitution and demarcation reform program in 2-4 judets	Not achieved. Project not effective yet due to delays in Government transition to Treasury systems.No systematic registration process underway at this time but expected to be initiated in early 2009. ANCPI (National Cadastre Agency) has completed one pilot.
Slow farm restructuring process farmers unable to employ EU CAP funds for competitiveness enhancement	Decrease in share of employment in agriculture to total from 32% in 2004 to 28%   2009	Implementation of service delivery models pilots in 2 judets	Achieved. New service delivery model being implemented under MAKIS project. Integrated Agricultural Offices (integrated service centres) provide "one-stop-shop" service points for agricultural and EU funding advice to farmers.
High cost of doing business	Percentage of firms indicating uncertainty about regulatory policies as a problem declines relative to 2005 in the next BEEPS	Implementation of Silent Approval Law	Not achieved. The Government drafted an Ordinance that cover 455 areas subject of the silent approval law. However, the Ordinance is being reviewed by the line Ministries and has not yet been approved by Parliament

**Pillar 1 Accelerating Structural and Institutional Reforms for Sustained Growth (Cont'd)**

<b>At CPS entry</b>	<b>CAS Outcomes</b>	<b>Milestones</b>	<b>Results at CPS completion</b>
High cost of doing business		Amendment of the Company Law	Achieved. The company law was amended substantially by introducing the OECD corporate governance principles and aligning it with five EU directives
High cost of doing business		Alignment of business entry requirements with EU Countries	Achieved. The Doing Business 2009 report places Romania as one of the best performers (26 place out of the 181 economies) in terms of easiness of starting a business; it takes six procedures, 10 days to register a company. Less than OECD countries' average.
High labor taxation	Reduction in labor taxation in a sustainable way by 2%	Introduction of the multi-pillar pension system by 2008	Achieved. Multi-pillar pension system created and operational. Final legislation for second mandatory private pillar prepared under the PAL 1 and 2, and launched in 2008. Contributions to: Pensions down by 3%, Unemployment by 2%, Health by 3%.
High transport costs. 67% of national road in good or fair condition	Increase in percentage of national road in good or fair condition from 67% in 2005 to 75% in 2009	Establishment of a reliable funding for road rehabilitation and maintenance by introducing Road User Charge and Road Data Register	Partially achieved. The design of the Road Data Register has been completed under TRP and implementation is ongoing. Revenues from road user charges (Rovignette) increased by more than 50%. However, the percentage of national road in good or fair condition is estimated to have deteriorated to 63%.
High transport costs. Railway track utilization 2,223 (in thousand traffic units per route km) in 2005	Increasing railway track utilization (in thousand traffic units per route km) from 2,223 in 2005 to 3000 in 2009	In the railway sector, elimination of 40 hazardous locations and decrease lines with speed restrictions by 180kms	Not achieved. Track utilization has remained stable or decreased slightly. Rail lines have not been closed, but instead leased to private parties (with limited success). Elimination of hazardous locations not yet achieved, but on track.
Incomplete reform in energy sector to improve efficiency and meet EU requirements	100% electricity market liberalization as measured by number of customers eligible to choose supplier and free to enter bilateral contracts with supplier	Satisfactory implementation of power sector road map under PAL program	Achieved. Electricity market liberalization achieved in 2007. Approximately 9,500, 000 customers, including households, could exercise their right to select an electricity supplier/negotiate bilateral contracts in the free market, but few do so. Only 50% of the energy consumed by industry is traded on the free market. The power sector road map was implemented well until 2006. Since then implementation has continued with the exception of the privatization program.

**Pillar 1 Accelerating Structural and Institutional Reforms for Sustained Growth (Cont'd)**

<b>At CPS entry</b>	<b>CAS Outcomes</b>	<b>Milestones</b>	<b>Results at CPS completion</b>
Insufficient alignment of education relevance to the labor market.	Improvement in education quality by 2.5 to 5% based on various assessments and examination results	Implementation of program for improving quality assurance and accountability in primary and secondary schools and higher education	Partially achieved. National quality assurance agencies were set up for primary and secondary schools and higher education and they are operational. However, at national level, Romanian student performance in PISA 2006 was below OECD and EU average scores. In PIRLS 2006 Romanian student scores were 36 of 45 participating countries and Romania scores declined between 2001 and 2006
Insufficient alignment of education relevance to the labor market.	Reduction in secondary education drop-out rate from 1.7% in 2004 to 1.2% in 2009		Not achieved. Drop-out rates have actually increased to 2.1% in 2006
Poor regulatory framework and institutional capacity to implement the EU Nitrates Directive	20% improved soil and water quality in the areas covered by the Bank project	Development of testing of sub-legislation in line with EU Directives	Not achieved. The project start has been delayed by almost 2 years.
Poor regulatory framework and institutional capacity to implement the EU Nitrates Directive		Implementation of integrated action plans for remedial interventions at the water basin level	Not achieved. The project start was delayed by almost 2 years due to a combination of Government transition to use of Treasury systems (which delayed Negotiations by 7 months) and a lengthy period to effectiveness (approaching 1 year).

**Pillar 2 Addressing Fiscal Vulnerabilities and Modernizing the Public Sector**

<b>At CPS entry</b>	<b>CAS Outcomes</b>	<b>Milestones</b>	<b>At CPS completion</b>
High total subsidies to the enterprise sector including selected state enterprises	Reduction in enterprise subsidies as percent of GDP from 2.2 in 2002 to less than 1.5 in 2009	Closure of loss making and non-viable mines	Achieved. Under the 2004 Government strategy for restructuring the mining sector, the Government closed 235 mining units and cut the number of total employees in the lignite and hard coal sector from 45,700 in 2002 to 28,500 in 2006 without affecting output. Three of the more difficult mines have been closed under the Bank-supported project. Enterprise subsidies being phased out by 2010.

## Pillar 2 Addressing Fiscal Vulnerabilities and Modernizing the Public Sector (Cont'd)

At CPS entry	CAS Outcomes	Milestones	At CPS completion
Fiscal vulnerability from quasi fiscal energy subsidies	Reduction of quasi-fiscal energy subsidies as % of GDP from 1.7 in 2004 to less than 1 in 2009 including clean-up of past arrears	Privatization of three electricity distribution companies	Substantially Achieved. Although there is no information available on the level of arrears in the energy sector on an aggregate basis, the team believes that they declined considerably after 2004, very likely below 1% of GDP. Termoelectrica and some local producers are likely to be the only companies still in arrears, although this could change in the current financial crisis. The first two of eight distribution companies were sold in 2005 and three more in 2006. Privatization of the remaining three was stopped in 2007.
Fiscal vulnerability from quasi fiscal energy subsidies	Reduction of quasi-fiscal energy subsidies as % of GDP from 1.7 in 2004 to less than 1 in 2009 including clean-up of past arrears	Increase in electricity and gas tariffs	Achieved. Energy sector regulator has adjusted electricity and gas prices.
Fiscal vulnerability from high pension liabilities	Maintenance of public pensions deficit at less than 1% of GDP or identification of funding sources if deficit temporarily widens as a result of appropriate policies	Increase in retirement age	Achieved. The public pension system has been in surplus in recent years, following a comprehensive restructuring, including by: gradually increasing the retirement age, externalizing services unrelated to pensions contributions, transferring the pensions of agricultural workers to the state budget, improving revenue collection and indexing benefits to inflation.
Unsustainable health financing	Reduction in amount of arrears by health care providers to suppliers by more than 50% between 2005 and 2009	Implementation of health reform package in PAL and strengthened by HD DPL series	Partially achieved. Arrears to suppliers fluctuate, but have at times been eliminated altogether, only to increase again.
Unsustainable health financing	Reduction in amount of arrears by health care providers to suppliers by more than 50% between 2005 and 2009	Implementation of health reform package in PAL and strengthened by HD DPL series	Achieved due to increased Health Insurance Fund revenues (higher salaries). Arrears to suppliers are minimal but the sustainability of this situation is doubtful because of the projected reduction of employers contribution to the Health Insurance Fund.

**Pillar 2 Addressing Fiscal Vulnerabilities and Modernizing the Public Sector (Cont'd)**

<b>At CPS entry</b>	<b>CAS Outcomes</b>	<b>Milestones</b>	<b>At CPS completion</b>
Unsustainable health financing	Incidence of informal payments in the health sector reduced from 10% of total health sector expenditure in 2005 to 5% in 2008 based on info from surveys	Adoption of informal payments reduction measures	Unknown. No formal measures were taken in this regard. There is no officially published data that allows an assessment of whether the level of informal payments has decreased.
Limited capacity to absorb EU pre- and post-accession funds.	More than 75% absorption of EU funds in the water and wastewater sectors in counties supported by Bank project	Eu grants committed to 11 counties for water and wastewater projects amounting to about \$500 million	Partially Achieved. Activities are on-going in 10 counties, the EU is financing the 11th. The indicator is on track to be exceeded well before the closing date of the project as applications corresponding to EUR 850 million of EU grants should be submitted by June 2009.
Inefficient public administration. Perceived high levels of corruption in administration	More meritocratic civil service as indicated by: incidence of formal evaluations for civil servants exceeding 95% each year during the CPS period; and increase in the % of civil servants with university degrees to 77% for central administration and 50% for local administration	Adoption and implementation of a medium term Civil Service Pay and Employment Strategy	Not achieved. The Strategy was drafted, but not implemented due to the lack of political will.
Inefficient public administration. Perceived high levels of corruption in administration		Enactment of new Civil Service Law	Achieved. Amendments to the Civil Service Law were adopted
Perceived high levels of corruption in administration		Amendments to strengthen the Conflict of Interest Law	Partially achieved. The Conflict of Interest law was amended, but it is not clear that it is being implemented.
Perceived high levels of corruption in administration		Publication of declarations as required in the Law of Declaration of Assets	Achieved. Amendments to the law of Declaration of Assets adopted in 2004 were substantial and resulted in a marked improvement of the process and quality of public declaration of assets. The declaration is one of the strictest in the EU.

## Pillar 2 Addressing Fiscal Vulnerabilities and Modernizing the Public Sector (Cont'd)

At CPS entry	CAS Outcomes	Milestones	At CPS completion
Inefficient public administration.		Implementation of the Strategic Development Plan for Public Financial Management in the PAL program	Partially achieved. The SDP was drafted. Some progress in improving internal and external audit and accounting standards, as well as in enhancing the quality of the annual budget process, has been achieved. However, linkages between performance and resources allocated in the public sector remain weak.
Inefficient judicial system	Reduction of time spent by courts on administrative matters by 30%	Implementation of the program for rationalization of the court system	Not achieved. The proposed program for court rationalization has not been taken forward.

## Pillar 3 Targeting Poverty Reduction and Promoting Social Inclusion

At CPS entry	CAS Outcomes	Milestones	At CPS completion
Limited effectiveness of the social assistance system	Halving of the extreme poverty rate of 11% in 2003 by 2009	Improved coverage of the MIG scheme by reforming eligibility rules	Partially achieved. Extreme poverty rates are below the target rate at 2.4% in 2007 but this was mainly due to economic growth. The MIG scheme was reformed (partially), but its funding is now decreasing relative to GDP and coverage is decreasing
Social and economic exclusion of disadvantaged groups	20% reduction of gaps between selected depressed areas and neighbouring communities as measured by the living conditions index	Implementation of the Priority Interventions Program through the Social Development Funds	Not (yet) achieved. Works for small infrastructure rehabilitation has started in 25 selected localities but have not yet been completed.
Social and economic exclusion of disadvantaged groups	70% of Roma in targeted settlements acknowledging an improvement in basic living conditions	Implementation of the Priority Interventions Program through the Social Development Funds	Not (yet) achieved. Works for small infrastructure rehabilitation has started in 25 selected localities but have not yet been completed.
Social and economic exclusion of disadvantaged groups	5% increase in children from targeted communities participating in Early Childhood Education program	Enactment and implementation of a coherent Early Childhood Education legislation to promote access	Not achieved. Kindergartens will be rehabilitated to support this objective, but the works have not yet started.

**Pillar 3 Targeting Poverty Reduction and Promoting Social Inclusion (Cont'd)**

<b>At CPS entry</b>	<b>CAS Outcomes</b>	<b>Milestones</b>	<b>At CPS completion</b>
Social and economic exclusion of disadvantaged groups	25% of services for Persons with Disabilities scoring at least 80% on the standards compliance index for each main category of quality standards	Rehabilitation of existing facilities aligned to EU standards for Persons with Disabilities	Not (yet) achieved. Works for the rehabilitation and construction of long-term care institutions for persons with disabilities will start in 2009.
Social and economic exclusion of disadvantaged groups	40% increase in the rate of employment of youth 18+ benefiting from multifunctional centres	Increased financing for multi-functional centres catering to youth at risk	Not (yet) achieved. Works for the construction of social assistance multi-functional centres will start in 2009.
Poor health outcomes and access by certain groups	Reduction by 10% of people who forego medical care for financial reasons	Restructuring of health care services in underserved areas to ensure access and quality.	Not achieved. The Primary Health Care part of the project dropped as Govt could not accept public money for primary health care institutions which are technically private and due to a lack of a primary care strategy. However aside from geographically impaired access and the supply failure in some areas, certain poor groups forego available medical care services for financial reasons (specialized ambulatory, dental, optical care, and services deemed to require high informal payments, like surgery).
Poor access to markets by households in rural areas	Increased availability and condition of infrastructure in rural and economically depressed areas	Improved capacity at the local level to plan and implement small infrastructure projects	Not achieved. Regional Development Project dropped. Mining Rehabilitation II project is promoting socio-economic regeneration in rural mining areas.
Poor access to markets by households in rural areas	Increased availability and condition of infrastructure in rural and economically depressed areas	Adoption and implementation of the Regional Development Strategy for economically depressed areas in line with EU requirements	Not achieved. It did happen, driven by the need to access EU funds, but not under a Bank project and not with the same comprehensiveness.

## Annex 2: Original and Actual CPS Lending Program

Fiscal Year	Project ID	Planned US\$ M	Actuals US\$ M	Status
<b>2006</b>	Judicial Reform	130	130	Approved and active
	Knowledge Economy	60	60	Approved and active
	Social Inclusion	58.5	58.5	Approved and active
	Revenue Administration Reform	70	0	Negotiated
	<b>Sub-Total</b>	<b>447.0<sup>17</sup></b>	<b>248.5</b>	
<b>2007</b>				
	PAL 2	150	0	Dropped
	Municipal Services (from 2006)	128.5	131.7	Approved and active
	Transport Sector Support	150	180	Approved and active
	Avian Flu	35	37.7	Approved and active
	Human Development DPL 1	100	0	Dropped
	<b>Sub-Total</b>	<b>550.0<sup>18</sup></b>	<b>349.4</b>	
<b>2008</b>				
	Complementing EU Support for Agricultural Restructuring (from 2007)	65	65	Approved but not yet effective
	Integrated Nutrient Pollution Control (was Enviro Mgt project from 2007)	50	68.1	Effective December 8, 2008
	Rural and Regional Development	50	0	Preparation on hold
	PAL 3	150	0	Dropped
	Human Development DPL 2	100	0	Dropped
	<b>Sub-Total</b>	<b>450<sup>19</sup></b>	<b>133.1</b>	
<b>2009</b>				
	Hidroelectrica/Tarnita (from 2008)	150	0	Dropped
	Electricity- Privatization Guarantee	50 <sup>20</sup>	0	Not started
	Business Environment	50		Not started
	Fiscal & Governance DPL	150		Not started
	Human Development DPL 3	100		Not started
	<b>Sub-Total</b>	<b>450<sup>21</sup></b>	<b>0</b>	
<b>TOTAL</b>		<b>1897.0</b>	<b>731.0</b>	

<sup>17</sup> CPS lending for FY2006 included the Municipal Services loan (US\$ 128.5 mil.) moved to FY2007.

<sup>18</sup> CPS lending for FY2007 included an Agriculture loan of US\$ 65 mil. (now CESAR) and an Environment Management loan of US\$ 50 mil. (now Integrated Nutrient Pollution) moved to FY 2008.

<sup>19</sup> CPS lending for FY2008 included an Energy loan of US\$ 150 mil (now Hidroelectrica/Tarnita project) moved to FY 2009.

<sup>20</sup> CPS mentioned two possible operations: two partial risk guarantees (PRGs) of about US\$ 50 mil. each for FY08-09.

<sup>21</sup> CPS lending for FY2009 included an Energy2 or Transport 2 loan with a value of US\$ 150 mil. In addition there are two possible Partial Risk Guarantees operations, one in FY08 and another in FY09, initially estimated at US\$ 50 mil. each

### Annex 3: Analytical and Advisory Program

Activity	Type of product	Status
FY 07 Implementation of Regional Development and Integration with other EU Operational Programs (TA)	TA	Delivered June 2008
FY07 Private Sector Development Strategy in Romania after EU Accession: Policy Priorities and Implications	ESW	Delivered May 2007
FY07 Poverty Monitoring Analytical and Advisory Assistance Program	ESW	Delivered June 2007
FY07 Municipal Finance Policy Note	Policy Note	Delivered June 2007
FY07 Public , HD, PSD Policy Notes	ESW	Delivered June 2007
FY08 Analytical guidance in revising the National Rural Development Program	TA	Delivered Dec 2007
FY08 ROSC (Reports on Observance of Accounting and Auditing Standard and Codes) - Follow-up TA	TA	Delivered June 2008
FY08 Poverty Monitoring Analytical and Advisory Assistance Program – II <ul style="list-style-type: none"> <li>• Labor Markets</li> <li>• Social Protection</li> </ul>	ESW	Delivered June 2008
FY08 Public Pay and Employment Surveys on the public sector pay practices and employment policies.	ESW	Delivered June 2008
FY08 Visioning EU Convergence Challenges in achieving convergence of real incomes towards the EU levels.	ESW	Dissemination Conference held April 2008
FY09 Reform of Higher Education Financing <ul style="list-style-type: none"> <li>• Changes in higher education financing</li> <li>• TA on students loans and scholarships</li> <li>• Instruments for measuring the relevance of education to labor market</li> </ul>	TA	Delivered January 2009
FY09 FSAP Update	ESW	Delivered January 2009
FY09 Green Investment Scheme Implementation	TA	Draft. Review Scheduled for Spring 2009
FY09 Public Expenditures and Institutional Review Update	ESW	Moved to FY10
FY09 Review Financial Oversight & Procurement in State Owned Enterprises	ESW	Moved to FY10

## Annex E FY10-13 Romania CPS Stakeholder Consultations

1. **Process.** Stakeholder consultations were held in May 2009 with representatives of the trade unions, non-governmental organizations, academia, youth organizations, the Parliament, and IFI's. The CPS tight processing schedule and competing claims on stakeholders' availability (e.g. Parliament's heavy agenda, electoral campaign for the European Parliament) influenced the extent of consultations – but outreach and consultations will continue through CPS implementation to allow the Bank to be responsive to new demands and to adjust its program appropriately. The consultations thus far sought to validate the CPS findings, proposed strategy and Bank program, and to discuss the perception of stakeholders concerning risks and opportunities in the current context of Romania. Further consultations are envisaged with national and local governments, the business community/private sector, and other stakeholders. The consultations for the 2009- 2013 Country Partnership Strategy are held directly with the groups identified above, and through the local website of the Bank with a wider audience.
2. **Topics for discussion.** The consultations provided a venue for a meaningful exchange of views with Government and various stakeholders on the critical challenges of current economic crisis affecting Romania and long-term prospects as well as policy options and programs that would address these challenges. The main topics included:
  - Lessons learned from past and ongoing work of the Bank in Romania
  - Political and economic context, risks and opportunities
  - Scope for resuming reform
  - Consistency of proposed Bank program with needs and expectations
3. **Results.** The discussions tapped a large array of sensitive issues and provided a reality check against World Bank's existing assessments and perceptions. The issues of governance at national and local level, surfaced throughout all consultations. Participants were in agreement about the main issues that need immediate attention: social protection in response to ongoing economic crisis, education, health, infrastructure, EU convergence.
4. **Key messages.** The following is a summary of the key messages received from stakeholders.
  - 4.1. **General Messages**
    - General concern about the commitment and capacity of the political leadership to design and implement needed reforms
    - High risk of coalition politics for both reform and project implementation
    - Virtual consensus that the culture of corruption has not been reversed or diminished.

- Need to scale up and communicate successful experiences, including reforms piloted by Bank-financed projects and the result of analytical work
- Concern with implementation capacities in both central and local administrations
- Reservations about the extent to which current cooperation of the Government with IFIs goes beyond financial needs and is driven by genuine acceptance of the need for reform
- Advice extended to the Bank on balancing flexibility (to promote ownership) with the need for firmness, especially concerning agreed reform objectives and specific project outcomes.
- The Bank program should consider sectoral strategies and not only 3 main national programmatic documents (NRP 2007, GP 2009, Lisbon Agenda)
- Need for donors/lenders better coordination
- Need for better inter-ministerial coordination and at local level

#### 4.2. Sector messages

##### **Education**

- Identified as the neediest area for reform. Repeated failed attempts to reform the sector did more harm than good
- Society as a whole is reform adverse because education (curricula) is still very much un-reformed
- Teachers' pay must be linked to broader reform objectives and outcomes

##### **Public Sector**

- Public Administration suffering from weak professionalism and management skills of political leaders and public servants
- Perceived inefficiency of the bureaucracy, lacking communication and coordination, hampering delivery of public services
- Public sector pay and numbers were inflated by the demilitarization of army, police, and other institutions

#### 5. Overall Conclusions

- Bank has been a respected partner for Romania and still has a role to play due to its expertise, analytical work, and independence.
- Main priorities for further Bank work in Romania should address the areas in which structural reforms lacked, failed or lagged during pre- and post-EU accession period.
- Key areas for development in partnership with the Bank are education, health, capacity building in public administration for better absorption of EU-funds.

