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**[2]. 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[3]) 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[4]. 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

[3] QAG report 44570: Romania Country Lending Enhancement Review, August 2004, para 60

[4] 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[5] reports that

[5] 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).

<u>Pillar 1 – Accelerating Structural and Institutional Reforms for Sustained Growth</u>

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 78th to 47th 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[6]. 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[7]. 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**.

[6] Romania, Rigidity of Employment Index: Doing Business 2006: 62; DB 2007: 62; DB 2008: 66; DB 2009: 62.

[7] 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.

<u>Pillar 3 – Targeting Poverty Reduction and Promoting Social Inclusion</u>

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 form 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

<u>Strategic Relevance</u>

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[8].

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[9], 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[10] 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.

---

[8] IEG Using knowledge to improve development effectiveness (2008).

[9] 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.

[10] 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[11] 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[12] 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.

[11] 17 SILs including 2 co-financing GEFs, which component the Hazard Mitigation and Integrated Nutrient Pollution Control projects

[12] 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**[13]. 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[14] 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

[13] IEG Using knowledge to improve development effectiveness (2008).
[14] 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[15] months in FY08.

[15] 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.

<u>Country dialogue</u>

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[16]. 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

[16] 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

At CPS entry	CAS Outcomes	Milestones	Results at CPS completion
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 asa 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% I 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 initatiated 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% I 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)

At CPS entry	CAS Outcomes	Milestones	Results at CPS completion
High cost of doing business		Amendment of the Company Law	Achieved. The company law was amended substantially by introducing the OECD conrporate 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 181economies) in terms of easiness of starting a busines; 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)

At CPS entry	CAS Outcomes	Milestones	Results at CPS completion
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

At CPS entry	CAS Outcomes	Milestones	At CPS completion
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)

At CPS entry	CAS Outcomes	Milestones	At CPS completion
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)

At CPS entry	CAS Outcomes	Milestones	At CPS completion
Social and economic exclusion of disadvantaged groups	25% of services for Persons with Disabilites 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 cetners 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
2006	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
	Sub-Total	**447.0** [17]	**248.5**	
2007				
	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
	Sub-Total	**550.0** [18]	**349.4**	
2008				
	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
	Sub-Total	**450** [19]	**133.1**	
2009				
	Hidroelectrica/Tarnita (from 2008)	150	0	Dropped
	Electricity- Privatization Guarantee	50[20]	0	Not started
	Business Environment	50		Not started
	Fiscal & Governance DPL	150		Not started
	Human Development DPL 3	100		Not started
	Sub-Total	**450** [21]	**0**	
TOTAL		**1897.0**	**731.0**	

[17] CPS lending for FY2006 included the Municipal Services loan (US$ 128.5 mil.) moved to FY2007.

[18] 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.

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

4. CPS mentioned two possible operations: two partial risk guarantees (PRGs) of about US$ 50 mil. each for FY08-09.

[21] 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 • Labor Markets • Social Protection	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 • Changes in higher education financing • TA on students loans and scholarships • Instruments for measuring the relevance of education to labor market	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