Country Context

Romania held parliamentary elections in December 2016. A governing coalition composed of the Social Democratic Party (PSD) and the Liberal-Democratic Alliance (ALDE) appointed a Cabinet in June 29, 2017. The Government’s priorities for 2017–20 include investments in infrastructure, health care, education, job creation, and small and medium enterprise development, in addition to tax and pension reforms.

Anti-corruption activities continued to advance, and Romania’s record in combating corrupt practices continues to inform similar regional efforts. The credibility of the country’s National Anti-Corruption Directorate (DNA) was bolstered by its indictment of several high-profile figures in recent years, with strong public support demonstrated by the anti-corruption protests in February 2017 and additional protests against political attempts to weaken the independence of the prosecution services.

Romania has significantly reduced its macro-fiscal imbalances since 2008 and achieved one of the highest growth rates in the EU in 2016. However, Romania has one of the highest poverty rates in the EU. The share of Romanians at risk of poverty after social transfers increased from 22.1% in 2009 to 25.3% in 2016. On the other hand, the share of the at-risk population decreased from 43% in 2009 to 38.8% in 2016.

Economic growth in the first half of 2017 was fueled by private consumption boosted by fiscal stimuli and increases in the minimum and public sector wages and pensions. Despite improvements in recent years, concerns about governance and weak administration limit Romania’s competitive advantages.

At a Glance

- Romania’s economy posted 5.8% growth in the first half of 2017, the fastest in the European Union (EU), but it still faces the twin challenges of promoting inclusion and consolidating the sustainability of its growth model by focusing on better quality investments and higher productivity and exports, rather than domestic consumption alone.

- A new government was formed in June 2017, providing an opportunity for the stability needed to deepen reforms and ensure sustainable economic growth.

- The World Bank continues to engage in a strong partnership with Romania and maintains a large portfolio of lending, advisory services, and technical assistance in areas such as: center of government reforms, strategy formulation and budgetary reforms, the deinstitutionalization of children, education, transport, and the financial sector.

- The Bank’s lending portfolio and analytical work focus on supporting key structural reforms in education, health, social protection, the environment, and the judiciary, all of which are critical to fully unlocking Romania’s development potential.
The World Bank and Romania

Since joining the International Bank for Reconstruction and Development (IBRD) in 1972, Romania has received US$13.6 billion in commitments for over 117 IBRD loans, guarantees, and grants covering a broad range of sectors.

Under the Country Partnership Strategy (CPS) FY 2014–18, the World Bank supports Romania’s efforts to accelerate structural reforms. The overarching long-term objective of the CPS for Romania is to support the country’s convergence with the EU through robust, sustainable, and equitable growth and enhanced competitiveness.

The Bank engages in Romania through the full range of its instruments: development policy lending, investment lending, Advisory Services and Analytics (ASA), and especially Reimbursable Advisory Services (RAS). Engagement over FY14–18 aims at advancing poverty reduction and promoting shared prosperity through three pillars. These are:

- creating a 21st century Government;
- advancing growth and private sector job creation; and
- promoting social inclusion.

Key Engagement

The Romania program consists of a portfolio of seven projects and two trust funds and a program of 24 ASA tasks, of which nine are RAS. The active lending portfolio amounts to US$2.04 billion in net commitments (US$0.94 billion undisbursed), supplemented by two recipient-executed trust funds of over US$4.79 million (US$1.9 million undisbursed). ASAs address themes of major interest, ranging from partnerships for marginalized Roma to improving fiscal effectiveness. The ongoing nine RAS activities amount to over US$19.50 million and include support to the Chancellery of the Prime Minister, Ministry of Education, National Authority for the Protection of Children Rights and Adoption, National Agency for Public Procurement, Romanian Agency for Quality Assurance in Higher Education, and Ministry of Public Finance. Since 2010, 53 RAS agreements totaling US$85.52 million have been signed.

The Bank’s RAS program, launched in 2010, has diagnosed structural bottlenecks to growth and made recommendations for capacity building, many of which were implemented in 2012–15 under the Memorandum of Understanding (MoU) supporting the implementation of EU Structural and Cohesion Funds in Romania and the modernization of public administration.

In January 2016, the World Bank and the Government of Romania signed a new MoU, effective until 2023, that provides a framework for continued World Bank support to Romania's efforts to advance structural reforms, improve public administration, and achieve faster EU convergence.

After the successful experience of the past five years, the new MoU includes an extension of the advisory services to the entire ESIF 2014–20, including, for the first time in Europe, access to the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund.
Recent Economic Developments

Romania’s economy grew by 5.8% in the first half of 2017, the fastest in the EU. Growth was led by private consumption (up 7.4% year-on-year [y-o-y]), fueled by a reduction in the standard value added tax (VAT) rate from 24 to 20% in January 2016 and by minimum and public sector wage and pension increases. Investment growth was timid (up 1.1%), reflecting the poor performance of public investment mainly due to the drop in EU investment funding.

Inflation is on an upward trend, driven by the pickup in private consumption, but it remains within the boundaries of the Central Bank. Annual headline inflation moved into positive territory in February 2017 and reached 1.2% in August, as the base effect of the VAT cut dissipated. The National Bank of Romania (NBR) Board maintained the policy rate at 1.75% in August, amid early signs of corporate credit growth recovery (up 4.3% as of July 2017) and concerns over the outlook of the fiscal and income policy stance. Household credit grew by 6.6% y-o-y in July 2017, supported by the fiscal stimulus, labor market improvements, and low interest rates.

The labor market strengthened further on the back of strong economic growth and fiscal relaxation. Real wages increased by 13.5% y-o-y as of July 2017, and unemployment increased marginally by 0.2 percentage points from an eight-year low value of 5% registered in June 2017. Nonetheless, the low employment rate of 61.2% in the first quarter of 2017 reflects persistent structural rigidities in the labor market.

Fiscal policy has remained pro-cyclical in 2017. The budget execution posted a deficit of 0.63% of GDP in July 2017, an increase of 0.4 percentage points compared to the same period last year. The widening of the deficit reflects an 11.4% increase in public expenditure and a lower-than-expected revenue collection (up 9%), particularly from VAT (down 4.6%). The increase in current spending was driven by hikes in employee compensation (up 20.3%) and social assistance spending (up 10.7%), while public investment spending contracted by 34.4%.

Economic Outlook

Growth is expected to remain solid in 2017, fueled by additional fiscal relaxation measures. In early 2017, the VAT rate was further cut to 19% and supplementary measures were adopted by the Government, including an increase of 16% in the minimum wage and further tax reductions for pensions below a certain threshold. The additional pickup in consumption is expected to widen the current account deficit to 3.1% in 2017 from 2.4% at end-December 2016.

The NBR projects a gradual increase in inflation toward 2% at end-2017. The Government aims to maintain the fiscal deficit below 3% of GDP in 2017 through several fiscal measures, including increasing excise duties for fuels and requiring selected SOEs to pay dividends in advance of their 2017 profits. Exceeding the deficit limit of 3% of GDP would place Romania into the Excessive Deficit Procedure of the EU. The widening of the fiscal deficit will push public debt to 49.4% of GDP at end-2019 from 44.6% in 2016.

Nevertheless, public debt remains one of the lowest in the EU. Continued strong private consumption growth, aided by a lower VAT rate, growth in employment and real wages, and the new minimum inclusion income, should boost real incomes and lead to further declines in poverty incidence. The US$5.50/day 2011 purchasing power parity (PPP) poverty rate is projected to decline to 24.5% in 2017, 23.3% in 2018, and 22.4% in 2019. This is consistent with the rate trend for those at risk of poverty or social exclusion based on the EU’s statistics on income and living conditions (SILC), indicating that severe material deprivation has decreased significantly.

However, income inequality has increased, partially due to the diminishing redistributive effect of the tax and transfer system. The planned introduction of a minimum social inclusion income program in 2018 aims to consolidate three means-tested programs, doubling the current budget and increasing the adequacy and coverage of benefits.
Project Spotlight

Building a Greener and Cleaner Environment in Romania

Since 2007, the World Bank has supported Romania’s nationwide efforts to combat nutrient pollution. Agricultural production in Romania is concentrated in small farms under 5 hectares in size, the majority of which keep animals in the vicinity of the household without adequate collection and storage facilities for animal waste. Such environmentally unfriendly practices lead to the pollution of groundwater and pose a general health hazard for Romania’s rural population, such as the incidence of blue baby disease, which can lead to infant death.

The Integrated Nutrient Pollution Control Project (INPCP) supports the country’s efforts to reduce the discharge of nutrients (nitrogen and phosphorus) into water bodies and helps Romania comply with the provisions of the EU Nitrates Directive on a national scale. The project is currently the only intervention in Romania that finances direct investments in rural communities.

To date, INPCP has financed 82 platforms for the management and storage of animal waste in 77 rural communities around the country. These platforms have been equipped with new tractors, bins, and other essential tools needed to improve livestock manure management and prevent nitrates and other dangerous minerals from contaminating soil and water supplies. The project also financed several sewerage networks and wastewater treatment plants and the first pilot biogas installation in the city of Seini, Maramures County. The facility employs an integrated approach to addressing manure disposal, while generating biogas and electricity for the local community. The project has provided training and technical assistance to beneficiary communities and strengthened the institutional capacity of the relevant government institutions responsible for regulating, implementing, monitoring, and reporting on the requirements of the EU Nitrates and Water Framework Directives.

In 2016, a €48 million additional financing was approved to scale up investments in addressing nutrient pollution. Approximately 30,000 small farms are expected to benefit from support for manure collection and composting facilities, manure management, biogas production from animal waste, and sewage and wastewater treatment in about 100 highly vulnerable communes. The project aims to enhance public awareness about nitrate pollution and capture citizen feedback on implementation challenges and experiences to inform broader national efforts to reduce nutrient pollution.