April 2017

Country Context

Romania held parliamentary elections on December 11, 2016. A governing coalition composed of the Social Democratic Party (PSD) and the Liberal-Democratic Alliance (ALDE) appointed a cabinet on January 4, 2017 led by Prime Minister Sorin Grindeanu. The Government’s priorities for 2017–20 include investments in infrastructure, health care, education, job creation, and small and medium enterprise development. Anti-corruption activities have 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.

Although Romania has significantly reduced its macro-fiscal imbalances since the 2008 financial crisis and achieved one of the highest growth rates in the EU in 2016, the challenge for the Government is to sustain growth by removing structural obstacles to the economy and to ensure that the benefits of prosperity reach all citizens, particularly the poor and vulnerable.

Romania has one of the highest poverty rates in the EU. The share of Romanians at risk of poverty after social transfers increased from 22.9% in 2012 to 25.4% in 2015. However, the share of the population at risk of poverty and social exclusion decreased from 43.2% in 2012 to 37.4% in 2015.

At a Glance

- Romania’s economy posted a 4.8% growth in 2016, a new post-crisis high and the third highest in the European Union (EU), but the country 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.

- The new Government that formed in January 2017 represents an opportunity to promote stability, 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 justice, all of which are critical to fully unlocking Romania’s development potential.

<table>
<thead>
<tr>
<th>ROMANIA</th>
<th>2016</th>
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<tr>
<td>Population, million</td>
<td>19.6</td>
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<tr>
<td>GDP, current US$ billion</td>
<td>187.0</td>
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<tr>
<td>GDP per capita, current US$</td>
<td>9,528</td>
</tr>
<tr>
<td>Life Expectancy at birth, years (2014)</td>
<td>75.1</td>
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Country Snapshot

The World Bank in Romania
The World Bank and Romania

Since joining the International Bank for Reconstruction and Development (IBRD) in 1972, Romania has received US$13.5 billion in commitments for over 99 projects covering a broad range of sectors.

Under the Country Partnership Strategy (CPS) FY14–18, the World Bank supports Romania’s efforts to accelerate structural reforms. The overarching long-term objective of the CPS 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 utilizes a full array of Bank instruments and consists of a portfolio of seven projects and four trust funds, as well as a program of 20 ASA tasks, of which 10 are RAS. The active lending portfolio amounts to US$2.14 billion in net commitments (US$1.68 billion undisbursed), supplemented by three recipient-executed trust funds of over US$10 million (US$2.7 million undisbursed).

ASAs address themes of major interest, ranging from partnerships for marginalized Roma to improving fiscal effectiveness. The ongoing 10 RAS activities amount to over US$19 million and support the Roma Education Fund, the Chancellery of the Prime Minister, the Ministry of Education, the National Authority for the Protection of Children's Rights and Adoption, the National Agency for Public Procurement, the Ministry of European Funds, and the Ministry of Public Finance.

Since 2010, 52 RAS agreements totaling US$83.41 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 during 2012–15 under the aegis of 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 an 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.

**WORLD BANK PORTFOLIO**

- No. of Projects: 7
- IBRD Lending: 7 Loans ($2,130 Million)
- GEF: 1 Grant ($5.5 Million)
- Other TFs: 3 Grants ($4.7 Million)
- ASA: 20 Activities, of which 10 RAS ($19.18 Million)
**Recent Economic Developments**

Romania’s economy grew by 4.8% in 2016, the highest since 2008 and the third fastest in the EU. Growth was led by private consumption (up 6.8% year-on-year [y-o-y]), which was fueled by a reduction in the standard value added tax (VAT) rate from 24 to 20% in January 2016 and by increases in the minimum and public sector wages and pensions. Investment growth stalled as public investment declined due to the drop in EU investment funding.

Inflation fell to a record low in 2016 and remains subdued, supporting an accommodative monetary policy. Annual headline inflation moved into positive territory in February 2017 (0.2%), as the base effect of the VAT cut dissipated. The National Bank of Romania (NBR) maintained the policy rate at 1.75% in February, amid negative corporate credit growth (down 3.5% y-o-y as of January 2017) and increasing concerns over the further relaxation of the fiscal stance. Household credit grew by 4.6% y-o-y in January 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 12% y-o-y and unemployment fell to 5.5%, an eight-year low, as of end-December 2016. Nonetheless, the low employment rate of 61.6% in the fourth quarter reflects persistent structural rigidities in the labor market.

Fiscal policy turned pro-cyclical in 2016. The budget deficit was 2.4% of GDP at end-2016, lower than the initial target of 2.8% but on an upward trend due to the fiscal stimuli. On the revenue side, improvements in the collection of corporate income tax (up 11.7% y-o-y), social contributions (up 6.3% y-o-y), and personal income tax (up 4.2% y-o-y) partially offset the reduction in VAT revenues (down 9.6% y-o-y). Low public investment spending (down 31.6% y-o-y at end-December), especially from EU funds, contributed to the lower-than-expected deficit.

**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.

Coupled with a positive output gap and increased import prices, aggregate demand will drive inflation upward. The NBR projects a gradual increase in inflation toward 1.7% at the end of 2017. The consolidated budget deficit is projected to go above 3% of GDP in 2017, placing Romania on a trajectory toward reentering the EU’s Excessive Deficit Procedure. The widening of the fiscal deficit will push public debt to 42.8% of GDP at end-2019 from 39.9% in 2015. 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$2.50/day 2005 purchasing power parity (PPP) poverty rate is projected to further decline to below 5% in 2019, and the US$5/day 2005 PPP poverty rate is projected to decline to 14.7%.

This is consistent with the rate trend for those at risk of poverty or social exclusion (AROPE) based on EU statistics on income and living conditions, indicating that severe material deprivation 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 3 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 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 project has provided training and technical assistance to beneficiary communities and contributed to strengthening 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.