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 on January 29, 2018, following the resignation of a short-lived Cabinet that governed from June 2017 to January 2018.

The Government’s priorities for 2018–20 include the improved absorption of European Union (EU) funds and a focus on securing investments in infrastructure, improving health care, reforming the pension system, and simplifying tax administration.

The Government’s program reconfirms Romania’s roadmap for achieving the Europe 2020 objectives for smart, sustainable, and inclusive growth and prioritizes the use of EU funds in line with the European Structural and Investment Funds (ESIF) envelope for 2014–20, which amounts to approximately €40 billion.

Anti-corruption activities continued to move forward, and Romania’s record in combating corrupt practices is informing 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.

In line with robust economic growth, the share of the population at risk of poverty or social exclusion decreased from a peak value of 47% in 2007 to 35.7% in 2017. The high poverty incidence continues to be associated with a reliance on agriculture and life in rural or marginalized areas.

At a Glance

- Romania’s growth remained strong in the first half of 2018 at 4% year-on-year, fueled by private consumption, but it still faces the twin challenges of maintaining macroeconomic stability and moving to a sustainable growth model built on increased investment, higher productivity, and exports rather than domestic consumption.

- A new government was formed in January 2018, providing an opportunity to create the stability needed to strengthen 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 public administration reforms, strategy formulation and budgetary reforms, the deinstitutionalization of children, education, transport, and the financial sector.

- The Bank’s lending portfolio and analytical work support 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 Framework (CPF) for FY19–23, the World Bank supports Romania's efforts to accelerate structural reforms. The overarching long-term objective of the CPF 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 FY19–23 aims at advancing poverty reduction and promoting shared prosperity through three pillars, which are:

- Ensuring equal opportunities for all; advancing growth and private sector job creation;
- Catalyzing private sector growth and competitiveness; and
- Building resilience to shocks.

Key Engagement

The Romania program consists of a portfolio of seven projects, one trust fund, and a program of 37 ASA tasks, of which 26 are RAS. The active lending portfolio amounts to US$1.4 billion in net commitments (US$778 million undisbursed), supplemented by one recipient-executed trust fund of over US$3.07 million (US$0.64 million undisbursed).

ASAs address themes of major interest, ranging from partnerships for marginalized Roma to improved fiscal effectiveness. The ongoing 14

RAS activities amount to over US$40.3 million and support the General Secretariat of the Government, the Ministry of Education, the National Authority for the Protection of Children's Rights and Adoption, the National Agency for Public Procurement, the Romanian Agency for Quality Assurance in Higher Education, the Ministry of Public Finance, the Municipality of Constanta, Bucharest District 5 City Hall, and the Municipality of Brasov. Since 2010, almost 60 RAS agreements, totaling roughly US$100 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 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.
Recent Economic Developments

Romania’s GDP grew by 4% in the first half of 2018, the sixth highest in the EU. Private consumption remained the main driver of growth, up 4.3% year-on-year (y-o-y), fueled by tax cuts, hikes in minimum and public sector wages, and increases in pensions that boosted disposable income. Investment, up 0.5% (y-o-y), underperformed despite the availability of EU funds. On the production side, information and communications technology (ICT) (up 5.3%) and industry (up 4.3%) were the main drivers of growth. Construction underperformed (down 0.4%), reflecting the sluggishness in the residential segment and the timid recovery in public infrastructure.

Higher disposable income and the pickup in consumption boosted inflation to 5.4% in June 2018. In response to inflationary pressures, the National Bank of Romania increased the policy rate three times in 2018 to 2.5%. This came amid robust private sector credit growth (up 6.8% as of June 2018) and concerns about the perspective of the fiscal stance.

The labor market benefited from the economic growth. Unemployment was close to historical lows at 4.5% as of June 2018, and real wages increased by 8.4% (y-o-y). Nonetheless, the low employment rate at 63.1%, coupled with high youth unemployment at 16.8% as of the first quarter of 2018, reflect persistent structural rigidities in the labor market.

The budget deficit widened to 1.6% of the projected GDP in the first half of 2018, driven by the increases in recurrent expenditure. Increases in public wages and pensions led to a 24.4% hike in the compensation of employees and a 17% increase in current spending. On the revenue side, the reduction of the income tax rate from 16 to 10% starting on January 1, 2018 led to a 21.5% contraction in personal income tax revenues. The impact of these measures was only partially offset by the increase in social contribution revenues (up 36.8%), reflecting the transfer of the social contribution burden from employers to employees.

Economic Outlook

The economy is projected to continue growing at around potential in 2018, albeit at a slower pace than in 2017. GDP will likely expand by around 4.1% in 2018, driven by the fiscal stimulus and aided by the demand from Europe. Continued growth in consumption is expected to widen the current account deficit to 4.1% in 2018.

The National Bank of Romania anticipates a gradual subsequent decline in inflation to 3.5% at the end of 2018, reflecting a lower contribution from fuel and administrative prices as well as a slowdown in private consumption dynamics, as no further fiscal boost to real disposable household income is envisioned for the rest of the year. However, the recent inflation spikes will push the annual average inflation rate to close to 5% in 2018.

The fiscal measures passed in 2017 and 2018 have put pressure on the consolidated budget deficit. Nonetheless, the Government has stated that, as in 2017, it would be ready to promote adjustment measures should the deficit threaten the 3% ceiling. The widening of the fiscal deficit toward 3% would push public debt to 45.4% of GDP at end-2020 from 43.3% in 2017. Despite this, public debt remains one of the lowest in the EU.

Strong private consumption, aided by the expansionary fiscal policy and continued growth in real wages, partly supported by minimum wage increases, should boost real incomes and lead to further declines in poverty incidence. The US$5.50 per day (2011 purchasing power parity) poverty rate is projected to decline to 22.3% in 2018, 21.7% in 2019, and 21.0% in 2020. This is consistent with the trend of the rate for those at risk of poverty or social exclusion (AROPE) for Romania based on the EU’s Statistics on Income and Living Conditions (SILC), indicating that severe material deprivation has decreased significantly.
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.

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.