@#&OPS~Doctype~OPS^blank@pidaprdpfcoverpage#doctemplate

Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 07-Jun-2024 | Report No: PIDDA00103

BASIC INFORMATION

A. Basic Project Data

Project Beneficiary(ies)	Operation ID	Operation Name	
Romania	P181517	Romania Fiscal Management and Green Growth Development Policy Loan	
Region	Estimated Approval Date	Practice Area (Lead)	Financing Instrument
EUROPE AND CENTRAL ASIA	25-Jul-2024	Macroeconomics, Trade and Investment	Development Policy Financing (DPF)
Borrower(s)	Implementing Agency		
Romania	Ministry of Finance		

Proposed Development Objective(s)

The Project Development Objective (PDO) is to support the Government of Romania to: i) strengthen fiscal management, inclusion, and green public investment; and ii) promote private financing for the green transition.

Financing (US$, Millions)

Maximizing Finance for Development

Is this an MFD-Enabling Project (MFD-EP)? Yes

Is this project Private Capital Enabling (PCE)? Yes

SUMMARY

Total Financing	**650.00**

DETAILS

Total World Bank Group Financing	**650.00**
World Bank Lending	650.00

Decision

The review did authorize the preparation to continue

Explanation

B. Introduction and Context

Country Context

1. **Romania has made considerable economic progress over the past two decades, but it needs to further enhance the sustainability and inclusiveness of its growth.** Over the past couple of decades, Romania has achieved impressive economic progress, transitioning to a market-based economic model, acceding to the European Union (EU) in 2007 and reaching high income status. Real GDP per capita in purchasing power parity more than doubled (from US$12,177 to US$32,496) between 2000 and 2022, and income convergence with the EU accelerated. From 2015 to 2020, the share of Romanians living below the upper-middle-income poverty line (i.e., on less than US$6.85-a-day in 2017 PPP) declined rapidly from 27.8 to 10.7 percent. However, economic prosperity has been unevenly distributed, with widening regional disparities in income and service delivery, and poverty and inequality rates that are consistently among the highest in the EU (Romania Systematic Country Diagnostic Update 2023). Going forward, inclusive growth objectives will need to be reconciled with equally ambitious climate commitments (Romania Country Climate and Development Report - CCDR, 2023).

2. **The macroeconomic policy framework is adequate for the purpose of this operation, but short- and medium-term fiscal risks require prudent management.** Having showed resilience and posted a strong post-pandemic recovery (dampened by the impacts of Russia's invasion of Ukraine), economic growth is expected to accelerate over the medium term, supported by private consumption and EU-financed investment. The twin deficits have diminished considerably from their peak during the pandemic and are expected to keep declining, aiding the sustainability of growth. Additionally, the National Recovery and Resilience Plan (NRRP) targets are supporting critical structural reforms, including public wages and pensions, with beneficial impacts for the growth outlook in the medium and long term. The National Bank of Romania (NBR) anticipates a decline in inflation[1], though along a somewhat elevated trajectory, lessening the probability of a hike in the monetary policy rate.

3. **The Government has pledged to bring the fiscal deficit to below 3 percent of GDP in the medium term, as evidenced by its commitment to undertake politically difficult reforms on taxes, pensions and public sector wages, supported by the World Bank and the European Commission (EC).** Compliance with the priority of pursuing fiscal consolidation is mandated as a condition for accessing funds from the European Resilience and Recovery Facility (RRF), and for exiting the excessive deficit procedure (EDP) of the EU, which resumes in 2024 after a pandemic-related pause. This, in turn, will require permanent compensatory measures of at least 2 percent of GDP on the tax side from 2025 onwards in order to ensure that the process of fiscal consolidation continues. While the policy decisions will be taken after the 2024 elections, the key options for sources of additional revenues include personal income tax (PIT), value-added tax (VAT) and property taxes, some of which are supported by this Development Policy Loan (DPL), as well as measures to improve tax collection. The EC and the Government are expected to reach an agreement under the 2024 European

[1] According to the latest NBR Board decision on monetary policy in April 2024.

Semester process[2] on the medium-term fiscal adjustment path in order for Romania to exit the EDP. The Bank team will continue to closely engage with the Romanian authorities on the options for additional fiscal measures, in coordination with the IMF and the EC.

Relationship to CPF

4. **This Development Policy Loan (DPL) is aligned with the forthcoming Country Partnership Framework (CPF) FY25-29[3].** The program contributes to the overarching goal of promoting prosperity and addressing inequality in a livable Romania. In particular, the program is expected to contribute to enabling private sector resource mobilization and participation in the green transition, manifesting a One World Bank Group (WBG) approach. Being at the frontier of the decarbonization agenda, the DPL represents a sizeable contribution to the Bank's knowledge agenda on global challenges, with potential for spillovers. Measures supported by this DPL also contribute to the cross-cutting theme of *enhancing institutions to serve all people and businesses.* The program presents a sectoral and thematic continuation to the FY22-FY23 series of two DPLs, and complements the proposed Disaster Risk Management DPL CAT-DDO (P502111), which supports measures that include climate adaptation and resilience. The DPL benefits from, and links directly to, the WBG's extensive Reimbursable Advisory Services (RAS) and Technical Assistance support in energy, transport, and fiscal and financial management. The program supported by this DPL stems directly from the recommendations of the CCDR, Country Private Sector Diagnostic (CPSD) and other WBG analytics. The WBG's existing and planned engagements will support the implementation of the reforms supported by the DPL.

C. Proposed Development Objective(s)

5. The Project Development Objective (PDO) is to support the Government of Romania to: i) strengthen fiscal management, inclusion, and green public investment; and ii) promote private financing for the green transition.

Key Results

6. **Results supported by this operation contribute to several WBG results outlined in the Corporate Scorecard, including increased revenues-to-GDP, GW of renewable energy capacity enabled, and net GHG emissions per year.** The pension reforms are expected to reduce the pension envelope relative to the counterfactual trajectory in the medium term and increase the equity in the system. The tax policy reforms aim to boost tax collection and bring an estimated one percent of GDP in additional revenue to the budget annually. The tax changes in the transport sector are expected to bring important revenue to the budget and help accelerate the transition to a decarbonized economy. The issuance of sovereign green bonds aims to promote the transition to a greener economy, further diversify the investor base for Government securities, and attract investors who are interested in financial instruments that generate a positive environmental and social impact; and to catalyze green bonds issuances by the private sector. The reforms in the energy sector are expected to bring private investment to support installation of renewable energy sources (offshore wind, green hydrogen and others) and energy efficiency measures, supporting decarbonization objectives and increasing the energy sector's resilience to the impacts of climate change. The Public-Private Partnership (PPP) law is expected to kickstart the PPP investments, especially in green and social infrastructure. As such, the proposed DPL operation is expected to significantly contribute to Corporate Scorecard results in a number of areas pertaining to prosperity, planet, infrastructure and other cross-cutting themes.

[2] The European Semester is part of the European Union's Economic Governance Framework. During the European Semester, Member States align their budgetary and economic policies with the rules agreed at EU level. This process of socio-economic policy coordination takes place annually from November until July.
[3] The CPF is expected to be discussed by the World Bank Group (WBG) Board in early FY25.

D. Project Description

7. **This proposed operation for US$650 million is a standalone Development Policy Loan (DPL) to support the Government of Romania to: i) strengthen fiscal management, inclusion, and green public investment; and ii) promote private financing for the green transition.** The measures supported by the proposed operation present a close thematic and sectoral continuation of reforms supported under the previous series of two DPLs in FY22-23,[4] and anchored in the Government's medium-term reform program (the NRRP, also supported by the EC Recovery and Resilience Facility, RRF, which helps ensure reform continuity). The proposed operation can thus be considered programmatic in nature, while being processed as a standalone operation, given the political context (multi-level national and EU elections in 2024). Measures under *Pillar I: Strengthen fiscal management, inclusion, and green public investment* support substantive pension and tax reforms for medium-term fiscal sustainability and increased equity; adjusting fiscal incentives in a revenue-enhancing manner to support the decarbonization of transport (where emissions continue to rise); and support the issuance of the first green bond to support green public investment. Measures under *Pillar II: Promote private financing for the green transition* support laying the foundations for increased private sector participation in renewable energy and energy efficiency, including through the introduction of novel financing instruments for green investments, actions in offshore wind, green hydrogen, and other renewable energy capacity, as well as the broader strengthening of the PPP legislation. The WB-IFC extensive collaboration on the reform agenda supported by this operation champions the One WBG Approach.

E. Implementation

Institutional and Implementation Arrangements

8. The Ministry of Finance (MoF) leads the effort in coordinating the overall implementation of the DPL. The MoF has experience and is conversant with the World Bank policies and procedures through lending, RAS and TA operations. Given the history of budget lending operations in Romania, some institutional capacity has been built up on data requirements and overall monitoring arrangements. Romania is a subscriber to the IMF's Special Data Dissemination Standard Plus (SDDS Plus) since November 2019. In addition, data is generally available through the MoF and the National Bank of Romania website. The World Bank team will continue to provide support to the Government in monitoring the reform progress and results. The monitoring of the results will be coordinated by the MoF which has a dedicated team for overseeing project implementation. The team works in coordination with the relevant ministries and agencies participating in the program. The MoF team has extensive experience in working on DPLs and has played a similar monitoring role in the past.

9. **The World Bank team works closely with relevant ministries and agencies to monitor progress**. This includes the MoF, the NBR, the Chancellery of the Prime Minister, Ministry of Energy, Ministry of Environment, Water and Forests, Ministry of Development, Public Works and Administration, and other relevant ministries and agencies.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

10. **Prior actions #1, #3, #4 and #6 are expected to have overall positive impact on wellbeing and/or equity; although there are risks that certain vulnerable groups are negatively affected in the short run and would require further support.** PA#1 (pension reform) is expected to increase gender equality, lower inequality, and have a neutral impact on poverty. As the share of elderly population at-risk of poverty is lower than the average population, overall

[4] P178912, P179297.

pensioners may not be negatively affects. The correction index (PA#1) elimination is expected to increase the overall equity in the pension system, although certain vulnerable populations, such as older women who are more likely to be at-risk of poverty, would require further support in the short run. Equalizing the retirement age for men and women (PA#1) is expected to promote greater gender equality for future generations by narrowing the pension gap. Modifications to the service pension regimes (PA#1) are expected to help the transition towards a more equitable pension system and have a neutral impact on poverty. Implementing a new tax policy for vehicles to encourage green transportation (PA#3) and increase excises for fossil fuels (PA#4) is expected to have positive impacts on health in the long run and particularly benefit 11 percent of the population that remains without health insurance which are mainly the poor and marginalized groups. However, there are some associated risks that the poor may be negatively impacted in the short run by increasing transportation costs of goods and services or potential job losses. While there are significant welfare benefits in the development of offshore wind farms (PA#6) through investment boost and job creation, there are some risks associated in the short run, including potential increases in energy prices that can negatively affect the poor.

11. **PA#2 (reducing tax expenditures) will likely negatively affect poverty, with measures available to mitigate the impact; the remaining prior actions will likely have a neutral impact, yet with upside or downside risks.** Changes in the VAT and excise for tobacco and alcohol under PA#2 can be expected to negatively affect low-income households and may increase poverty and inequality; thus, potential mitigation measures should be considered to reduce the negative effect. These include the implementation of the minimum inclusion income (VMI) law and indexation of key benefits to the Social Responsibility Index (SRI), supported under the previous DPF series. Introducing payments of health contributions in previously exempt sectors (PA#2) may have an adverse effect on poverty and inequality, as these sectors are overrepresented among the poor (7 percent of the poor bottom 20 percent work in construction and 72 percent in agriculture). Eliminating PIT exemption for some categories of employees in the IT sector (PA#2) is expected to increase progressivity and reduce inequality with no effects on poverty. Actions to support low-carbon technologies for electricity production (PA#7) and the production of green hydrogen (PA#8) are expected to have positive social impacts in the long run by mitigating climate change. However, if the initial costs of these technologies are high and passed on to consumers, there is a risk of increased energy prices that would disproportionately affect low-income households. Special consideration should ensure that the transition to low-carbon technologies does not disproportionately burden vulnerable populations. In the short term, the regulation of energy service contracts (PA#9) and mobilizing private capital for energy efficiency (PA#10) are expected to have a neutral effect on wellbeing, with the potential to reduce energy poverty in the long run. While amending the PPP legislation (PA#11) is not expected to have an impact on welfare in the short or medium term, it has the potential to benefit lagging regions in the long run.

Environmental, Forests, and Other Natural Resource Aspects

12. **The DPL supports reforms that are expected to have significant positive environmental effects, while minor implementation-related potential negative environmental effects in the medium- to long-term can be mitigated and dealt with by the existing legal framework.** The reforms under Pillars I and II will contribute to fostering decarbonization and enhancing climate resilience through action on green bonds, renewable energy development, and energy efficiency. Potential negative environmental effects (direct or indirect) that could arise from their implementation include infrastructure development impacts, waste generation, etc., but can be managed and dealt with by Romania's existing legal framework for environmental assessments and waste management. Over the last decade, Romania has made significant progress in revising its regulatory and compliance assurance mechanisms and institutions, including integrated environmental permitting and the EIA legal framework. Also, the waste management sector has an advanced environmental policy and legal framework, smoothing the path towards sustainable development, even though further strengthening of enforcement and monitoring are needed.

G. Risks and Mitigation

13. **The overall risk rating for this operation is moderate.** Among the risk categories, macroeconomic risks are deemed to be substantial, while political and governance, sectoral strategies and policies, institutional capacity for implementation and sustainability, and environmental and social risks are rated as moderate; all other risk categories are rated as low. The risk ratings reflect the increasing complexity of Romania's inclusive and greener development agenda. The inherent macroeconomic risks are rated substantial due to high structural fiscal deficits, whose consolidation this operation supports. Further mitigation measures are presented by the Government's commitment and progress on other structural fiscal policy items, including public wages. While the legislative and regulatory framework of the country is strong, the relatively weaker implementation capacity risks reducing the impact of reforms. This risk (rated as moderate) is mitigated by the fact that Romania receives significant assistance from the World Bank, the EC and other development partners for institutional capacity strengthening. Given the challenges related to ruling coalitions and frequent changes of governments in the past, with further uncertainty arising from the EU elections, however, residual risks to the program development objective remain. The WBG will continue to provide technical assistance; and capacity building efforts will also be undertaken for many of the reforms. Close supervision of this operation will help address the challenges related to institutional capacity. The WBG's existing and planned engagements will support the implementation of reforms.

CONTACT POINT

World Bank

Emilija Timmis
Senior Economist

Catalin Pauna
Senior Economist

Mariano Gonzalez Serrano
Senior Energy Specialist

Borrower/Client/Recipient

Romania
Aura Tudor
Senior Adviser
Aura.Tudor@mfinante.gov.ro

Implementing Agencies

Ministry of Finance
Aura Tudor
Senior Adviser
Aura.Tudor@mfinante.gov.ro

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: http://www.worldbank.org/projects

APPROVAL

Task Team Leader(s):	Emilija Timmis, Catalin Pauna, Mariano Gonzalez Serrano

Approved By

Practice Manager/Manager:	Jasmin Chakeri	08-May-2024
Country Director:	Marina Wes	07-Jun-2024