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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A

PROPOSED LOAN

IN THE AMOUNT OF EUR 599.1 MILLION (EQUIVALENT TO US$650 MILLION) TO

ROMANIA

FOR THE

Romania Fiscal Management and Green Growth Development Policy Loan

June 26, 2024

Macroeconomics, Trade and Investment Global Practice
Europe And Central Asia Region

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Romania

GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of May 31, 2024)

Currency Unit

US$1.00 = Lei 4.60 = EUR 0.92

ABBREVIATIONS AND ACRONYMS

ANRE	Energy Regulatory Authority
ASA	Advisory Services and Analytics
CAD	Current Account Deficit
CCDR	Country Climate and Development Report
CPF	Country Partnership Framework
CPSD	Country Private Sector Diagnostic
DPL	Development Policy Loan
DSA	Debt Sustainability Analysis
EC	European Commission
EDP	Excessive Deficit Procedure
EGD	European Green Deal
EIA	Environmental Impact Assessment
ESCO	Energy Services Company
EU	European Union
GEO	Government Emergency Ordinance
GDP	Gross Domestic Product
GHG	Greenhouse Gas
GNP	Gross National Product
HLO	High-Level Outcome
IBRD	International Bank for Reconstruction and Development
ICR	Implementation Completion and Results Report
IDA	International Development Association
IFC	International Finance Corporation
IMF	International Monetary Fund
IT	Information Technology
LDP	Letter of Development Policy
LTRS	Long-Term Renovation Strategy
MFD-E	Maximizing Finance for Development-Enabling
MOF	Ministry of Finance
NBR	National Bank of Romania
NDC	Nationally Determined Contribution
NECP	National Energy and Climate Plan
NPL	Non-Performing Loan
NRRP	National Recovery and Resilience Plan
OECD	Organisation for Economic Cooperation and Development
PA(s)	Prior Action(s)
PCE	Private Capital Enabling
PCM	Private Capital Mobilization
PFM	Public Financial Management
PFR	Public Finance Review
PIT	Personal Income Tax
PPA	Power Purchase Agreement
PPP	Public-Private Partnership
ppp	Purchasing Power Parity
RAS	Reimbursable Advisory Services
RE	Renewable Energy
RRF	Recovery and Resilience Facility
SCD	Systematic Country Diagnostic
SDR	Special Drawing Rights
SMEs	Small and Medium Enterprises
SRI	Social Reference Indicator
TA	Technical Advisory
VAT	Value-Added Tax
VMI	Minimum Inclusion Income
WB	World Bank
WBG	World Bank Group

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Romania Fiscal Management and Green Growth Development Policy Loan
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SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Operation ID	Programmatic
P181517	No

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.

Organizations

Borrower:	Romania
Implementing Agency:	Ministry of Finance

PROJECT FINANCING DATA (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

World Bank Group Financing

International Bank for Reconstruction and Development (IBRD)	650.00

PRACTICE AREA(S)

Practice Area (Lead)	**Contributing Practice Areas**
Macroeconomics, Trade and Investment	Energy & Extractives; Finance, Competitiveness and Innovation; Governance; Environment, Natural Resources & the Blue Economy

CLIMATE

Climate Change and Disaster Screening

Yes, it has been screened and the results are discussed in the Operation Document

OVERALL RISK RATING

Overall Risk	Moderate

RESULTS

Indicator Name	Baseline (2023)	Target (2026)
RI#1. Proportion of (women/men) pensioners getting old-age pension below or at the minimum pension (Percentage)	Women 29/ Men 13 (2022)	Women 25/ Men 11.50
RI#2. VAT collection increase relative to baseline (Lei)	0	2,000 million
RI#3. Additional revenue collected from the reduction of exemptions for constructions, agriculture, food industry and IT relative to baseline (Lei)	0	4,000 million
RI#4. Excises per ton of leaded gasoline (Lei)	2,704	4,000
RI#5. Revenues raised from the new distance-based toll system (Lei)	0	1,500 million
RI#6. Sovereign green bonds issued (cumulative, Euro)	0	2,000 million
RI#7. Offshore wind capacity ready to be tendered out to the private sector (MW)	0	1500
RI#8: New renewable capacity for electricity generation installed (MW)	0	950
RI#9: New renewable capacity contracted for green hydrogen generation (electrolyzers) (MW)	0	60
RI#10. Number of private companies registered in the national database of ESCOs	0	20
RI#11: Loans signed for energy efficiency to firms, in amount (Euro)	69 million	170 million
RI#12. Number of PPP projects initiated (Number)	0	At least 1

Note: RI#7-9 contribute to WBG Corporate Scorecard indicator 'GW of renewable energy capacity enabled', RI#2-5 to increased tax collections, with other linkages articulated in section 4.

IBRD PROGRAM DOCUMENT FOR A PROPOSED LOAN TO ROMANIA

1. INTRODUCTION AND COUNTRY CONTEXT

1. **Romania has made considerable economic progress over the past two decades, but it needs more sustainable and inclusive growth.** Over the past decades, Romania has achieved impressive economic progress, transitioning to a market-based economic model and acceding to the European Union (EU) in 2007 and reaching high income status. Real Gross Domestic Product (GDP) per capita in purchasing power parity (ppp) more than doubled from US$12,177 in 2000 to US$32,496 in 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. Going forward, inclusive growth objectives will need to be reconciled with equally ambitious climate commitments.

2. **While Romania still has substantive growth potential, which can further advance income convergence, ensuring economically and environmentally sustainable growth requires structural reforms.** The World Bank's EU Regular Economic Report 8 (2022) and recent core diagnostics show that Romania can accelerate its potential GDP growth from 3.7 percent to 5.2 percent per year over the next decade through structural reforms that enhance investment and labor productivity, strengthen institutions, and advance human capital in an inclusive and sustainable manner. The required improvements in all factors of growth are fundamentally underpinned by improving fiscal sustainability and safeguarding sound macroeconomic management to ensure investments in human and physical capital, as well as the green transition, are feasible. Considering sustained high structural fiscal deficits, a medium-term rationalization of expenditures driving these deficits (e.g., pensions) and a gradual increase in tax collection (currently among the lowest in the EU) will be fundamental to ensure fiscal space for critical inclusive growth-enhancing expenditures. Fiscal reforms would also support favorable financing costs for public and private investment in physical capital, especially considering the financing needs of the green transition.

3. **Romania can significantly improve its living standards while decarbonizing the economy, but achieving ambitious climate commitments will require policy action and sizeable investments from the public and private sectors.** As a member state of the EU, Romania has committed to key tenets of the European Green Deal (EGD): (i) reducing net greenhouse gas (GHG) emissions by at least 55 percent by 2030, relative to 1990 levels; and (ii) achieving net zero GHG emissions by 2050. The Romania CCDR finds that the transition in the energy sector—encompassing electricity generation, buildings, and transport, which currently account for a combined 66 percent of the country's GHG emissions—is paramount to achieving climate mitigation goals and facilitating the whole-of-economy transition. Furthermore, Romania's high vulnerability to climate change (particularly floods and droughts) necessitates adaptation measures, including in the energy sector. The CCDR estimates the investment needs that balance growth and climate mitigation in key decarbonizing sectors – electricity generation, buildings and transport alone – at US$356 billion by 2050 (around 3 percent of cumulative GDP), with a further 1.3 percent of cumulative GDP required for climate adaptation. Although public financing (including from the potentially accessible EU funds) will play a critical role, Romania faces substantive fiscal constraints, and incentivizing green investment from the private sector will be key. Mobilizing public, blended, and private finance hinges on putting in place appropriate institutional and governance frameworks and incentives, enabling the financial sector to efficiently allocate capital toward the transition to net zero.

4. **Romania is also prone to high disaster and climate change risks, which translate into significant macro-fiscal risks, highlighting the need for contingent finance to support quick response and recovery.** Average annual expected losses due to earthquakes are assessed to amount to €512 million, or 0.23 percent of GDP, and average annual expected losses due to floods amount to €1.7 billion, or 0.8 percent of GDP. These figures place Romania in the top five EU countries for earthquake- and flood-related average annual losses. Additional contingent finance will be needed to support a quick response to and recovery from potential disasters.

5. **This proposed operation is a standalone Development Policy Loan (DPL) for the equivalent of US$650 million (EUR 599.1 million) 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 are in close thematic and sectoral continuation of reforms supported under the previous series of two DPLs FY22-23[1], and anchored in the government's medium-term reform program (National Resilience and Recovery Plan (NRRP), also supported by the European Commission (EC)'s Recovery and Resilience Facility (RRF), which helps ensure reform continuity. The proposed operation can thus be considered programmatic in nature, while being processed on a standalone basis, 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 enhanced medium-term fiscal sustainability and increased equity; adjust fiscal incentives to enhance revenues and support the decarbonization of transport (where GHG 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, measures to boost offshore wind, green hydrogen, and other renewable energy capacity, as well as the broader strengthening of the Public-Private Partnership (PPP) legislation. In addition to climate change mitigation and adaptation action supported through this operation, the World Bank Group (WBG) supports Romania to strengthen its preparedness for disasters and mitigate climate change risks through a complementary Romania Second Disaster Risk Management DPL with a Cat DDO (P50211), which is operationalizing the new WBG Crisis Response Toolkit.

6. **The reform agenda supported by this operation is anchored in the Romania FY19-23 Country Partnership Framework (CPF), with the extensive World Bank (WB)-IFC collaboration championing the One WBG.** The reform program is aligned with the CPF's three focus areas: (i) ensuring equal opportunities for all; (ii) catalyzing private sector growth and competitiveness; and (iii) building resilience to shocks, given the fiscal measures supported by the project, and its focus on enabling private sector resource mobilization and participation in the green transition. Being at the frontier of the decarbonization agenda, the DPL also presents a sizeable contribution to the WBG' knowledge agenda on global challenges, with potential for spillovers. In addition, the reform program supported by this DPL is highly complementary to the efforts of other development partners, and together with the WBG's broader country program will help Romania unlock sizeable funds from the EU (see section 4 for more details).

7. **The program supported by this DPL builds on the focus areas of the Systematic Country Diagnostic (SCD) Update, recommendations from the Country Climate and Development Report (CCDR), Country Private Sector Diagnostic (CPSD) and other analytics** like the forthcoming Public Finance Review (PFR). It also links to complementary technical assistance (TA) through trust funded, Reimbursable Advisory Services (RAS) and upstream advisory engagements, including joint IBRD-IFC work on creating a more favorable policy and regulatory environment for private capital and investment, which continue to support the program's implementation. The DPL is aligned with the CPF, with considerations for the linkages and cross-sectoral nature of issues in an advanced economy with a rapidly aging population, being at the global frontier of climate action, with corresponding potential for knowledge spillovers, particularly on partnering with the EU and private sector.

2. MACROECONOMIC POLICY FRAMEWORK

8. **The macroeconomic policy framework is adequate for the purpose of this operation, but short- and medium-term fiscal risks require prudent management.** 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 continue declining, aiding the sustainability of growth. Additionally, the NRRP targets are supporting critical structural reforms, including public wages and pensions, with beneficial impacts for

[1] P178912, P179297, which supported the Government of Romania's efforts to: 1) strengthen inclusion and fiscal management; and 2) foster decarbonization and climate resilience.

the growth outlook in the medium and long term. The National Bank of Romania (NBR) anticipates a decline in inflation[2], though along a somewhat elevated trajectory, lessening the probability of a hike in the monetary policy rate.

2.1. RECENT ECONOMIC DEVELOPMENTS

9. **Romania's economy posted strong post-pandemic growth at 5.7 percent in 2021 and 4.1 percent in 2022, but lost some of this momentum in 2023, expanding at 2.1 percent, in line with the EU's weakened economic activity.** Public investment supported by EU funds was the main growth driver in 2023. The contribution of private consumption remained significant, benefiting from higher wages and low unemployment. Growth was dampened by the high global inflation and interest rates and the slowdown in EU growth. Trade and current account deficits narrowed despite weakening goods export volumes, supported by higher services surplus and import compression (see Table 1).

10. **Monetary policy has been tightened in response to higher inflation.** The inflation rate surged to 13.8 percent in 2022, driven by a substantial increase in energy and food prices amidst multiple supply-side shocks, while excess aggregate demand enabled the transmission of these pressures into consumer prices. The broad-based price increases and the risk of inflation expectations deviating from the NBR target led to a gradual normalization of the monetary policy. The NBR gradually raised its policy rate to 7 percent in January 2023 from 1.25 percent in August 2021, aiming to bring inflation down to the 2.5 (+/- 1) percent target. Gradually declining energy and food market pressures, supported by energy subsidies and caps on the mark-ups of staple food items, along with improved inflation expectations, helped ease the headline inflation rate to 10.4 percent in 2023, although it remained among the highest in the EU.[3] Nevertheless, stronger evidence of inflation converging towards its target range is needed before a potential reduction of the monetary policy rate. Romania's exchange rate regime is classified as a managed float with no concrete timeline for joining the eurozone.

11. **The bank-dominated financial system remains sound and resilient.** Romania's banking sector accounts for around 75 percent of the financial system in Q3, 2023, and has assets estimated at 53.1 percent of GDP as of end-2023. This is less than half of what is seen in peer countries like Poland, Bulgaria, Hungary, and Croatia, and about one-fifth of the EU average. Non-bank financial institutions offer limited long-term financing, and Romania's capital markets are the shallowest in Europe. The banking system's exposure to government securities, primarily denominated in local currency, remains comparatively high among EU countries, though marginally decreased to 19.2 percent of total assets in September 2023, from 20 percent in March 2023. However, the non-performing loan (NPL) ratio of the banking system is low at 2.6 percent as of September 2023 and falls into the low-risk bucket, as defined by the European Banking Authority. The NPL coverage by provisions stood at 65.1 percent in September 2023, well above the EU average of 42.9 percent.

12. **The current account deficit (CAD) narrowed in 2023, supported by improvements in the trade balance, while reserve coverage remained stable.** The CAD had widened in recent years, reaching 9.1 percent of GDP in 2022 due to the increasing goods trade deficit and deteriorating primary income balance. Romania historically recorded significant goods trade deficits, reflecting factors hindering competitiveness across most industrial sectors, and structural vulnerabilities, such as high energy intensity of key industrial sectors, which renders it susceptible to energy shocks. The overvaluation of the real effective exchange rate in the context of higher inflation differential between Romania and its euro area trading partners affected price competitiveness. The CAD narrowed to 7 percent of GDP in 2023, supported by a higher services surplus, a modest import compression and stabilizing energy prices. The CAD is primarily financed by foreign direct investment (FDI, around 2.1 percent of GDP) and portfolio investment (around 4.4 percent of GDP). Foreign exchange reserves remained relatively stable and provided a cover of 5.6 months of goods and services imports as of end-2023, compared to 4.9 months at the end of 2021.

13. **Fiscal consolidation efforts remain at risk of external shocks, persistent structural fiscal challenges and additional expenditure demands in the context of existing political and social pressures.** Romania had high structural

[2] According to the latest NBR Board decision on monetary policy in May 2024.

[3] Government provided social transfers to cushion the vulnerable from the price increases. The net nominal wage increases were 15.5 percent year-over-year (y-o-y) in December 2023.

fiscal deficits already prior to the pandemic and has been under the EU Excessive Deficit Procedure (EDP) since 2020. Numerous tax exemptions and changes to the tax policy regime, alongside the tax administration's low capacity to collect revenues, have contributed to Romania having one of the lowest tax-to-GDP ratios in the EU. Public expenditures are also low by EU standards and inefficient, leading to suboptimal outcomes in critical areas such as health and education. Some progress has been made in reducing the fiscal deficit from 9.3 percent of GDP in 2020 to 6.6 percent in 2023. However, a more significant fiscal consolidation was hindered by persistent structural pressures from expenditure items such as the public wage bill and pensions, alongside short-term challenges arising from the spillovers from geopolitical developments. Pressures stem from spending to protect poorer households from high food prices as well as energy subsidies to partially shield households and firms. The deficits over the past four years (and particularly during the pandemic), raised the level of public debt from 35.1 percent of GDP in 2019 to 48.8 percent in December 2023, although remaining lower than that of many EU member states. The new EU fiscal framework is likely to further strengthen national ownership of fiscal adjustments and facilitate a more gradual and sustainable adjustment of public debt ratios.

Table 1. Romania: Selected Economic and Financial Indicators

	2020	2021	2022	2023e	2024f	2025f	2026f	2027f
Annual percentage change, unless otherwise indicated								
National Accounts								
GDP at constant prices	-3.7	5.7	4.1	2.1	3.3	3.8	3.8	3.7
Consumption	-2.8	5.9	3.7	3.5	3.4	4.6	4.5	4.4
Investment	1.1	2.9	5.9	14.4	8.4	7.9	7.8	7.7
Exports of goods and services	-9.5	12.6	9.7	-1.4	5.4	6.0	6.2	6.4
Imports of goods and services	-5.2	14.8	9.5	-1.4	7.5	8.2	8.3	8.5
Sectoral contribution to growth								
Agriculture (ppts)	-0.7	0.2	-1.0	0.4	0.1	0.1	0.1	0.1
Industry (ppts)	-1.8	1.8	-1.2	-0.5	0.2	0.4	0.4	0.4
Services (ppts)	-0.4	2.7	5.1	1.1	2.6	2.9	2.8	2.7
Inflation								
GDP deflator (percent)	4.1	5.4	13.2	12.2	5.4	3.0	3.1	2.8
CPI (percent, average)	2.6	5.1	13.8	10.4	6.3	3.9	3.2	2.9
Selected monetary accounts								
Banks' credit to the government	25.3	18.6	1.4	13.1	…	…	…	…
Banks' credit to private sector	5.5	14.8	12.1	6.4	…	…	…	…
Broad money (M2) (end of period)	15.3	15.8	6.8	10.7	…	…	…	…
External sector								
Exports FOB	-8.2	22.3	23.4	-2.2	8.2	5.9	6.1	5.5
Imports CIF	-4.8	24.2	28.4	-3.9	7.4	5.5	5.7	5.1
Terms of trade	10.3	19.0	32.4	-9.2	-4.4	-3.9	-3.8	-3.5
Percentage of GDP, unless otherwise indicated								
Current account balance (including grants)	-4.9	-7.2	-9.1	-7.0	-6.3	-6.1	-5.9	-5.5
Foreign direct investment (net)	1.4	3.7	3.5	2.1	2.9	3.1	3.2	3.2
Debt								
Public debt (external and domestic)	46.7	48.5	47.5	48.8	51.6	53.6	54.0	54.7
External public debt	23.8	23.9	23.6	24.8	26.5	27.7	28.0	28.3
Debt service	5.7	6.0	7.6	9.0	6.6	5.1	5.6	3.9
Fiscal accounts								
Total revenue and grants	32.5	32.9	33.7	33.6	34.5	34.5	36.2	36.5
Total expenditure and net lending	41.8	40.0	40.0	40.2	41.4	39.8	40.0	40.4
Overall fiscal balance (with grants)	-9.3	-7.2	-6.3	-6.6	-6.9	-5.3	-3.8	-3.9
Memorandum items								
GDP per capita (annual change, %)	-3.2	6.6	4.5	2.1	4.9	4.8	4.5	4.5
Gross reserves (US$ billions, end of period)	51.7	51.8	55.4	71.9	…	…	…	…
In months of next year's imports	5.6	4.9	4.4	5.6	…	…	…	…
Nominal GDP (LCU, billions)	1,067	1,189	1,401	1,606	1,752	1,887	2,019	2,152
Nominal GDP (US$, billions)	252	286	301	351	383	411	438	467

Source: Ministry of Finance; National Bank of Romania; National Institute of Statistics, Eurostat; IMF; Bank staff estimates, as of April 2024.
Legend: CIF = cost, insurance, and freight; FOB = free on board; LCU = local currency unit; ppt = percentage point; e = estimate; f = forecast.

Table 2. Key Fiscal Indicators (Percent of GDP)

	2020	2021	2022	2023e	2024f	2025f	2026f	2027f
Total revenues and grants	**32.5**	**32.9**	**33.7**	**33.6**	**34.5**	**34.5**	**36.2**	**36.5**
Tax revenues	26.8	27.1	27.4	27.3	27.8	29.1	30.7	30.9
Direct taxes	4.7	5.1	6.1	6.2	6.5	7.6	8.0	8.0
Indirect taxes	9.6	10.1	10.4	10.3	10.5	10.7	11.7	11.7
Taxes on goods and services	9.5	9.9	10.2	10.1	10.3	10.5	11.5	11.5
Taxes on international trade	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social insurance contributions	11.8	11.3	10.7	10.6	10.7	10.7	10.9	11.1
Other taxes	0.7	0.6	0.2	0.2	0.1	0.1	0.1	0.1
Non-tax revenues	4.4	4.1	4.4	2.7	2.6	2.6	2.6	2.6
Other revenues	1.3	1.7	1.9	3.6	4.1	2.9	3.0	3.1
Total expenditures	**41.8**	**40.0**	**40.0**	**40.2**	**41.4**	**39.8**	**40.0**	**40.4**
Current expenditures	36.0	34.4	33.6	33.7	35.3	34.2	34.3	34.6
Wages and salaries	12.2	11.2	10.0	9.9	10.4	9.5	9.8	10.0
Goods and services	5.9	5.9	5.6	5.6	5.6	5.5	5.5	5.5
Subsidies and transfers [a]	16.5	15.8	16.5	16.6	17.5	17.4	17.3	17.2
Interest payments	1.4	1.5	1.5	1.6	1.8	1.8	1.7	1.9
Capital expenditures	4.6	4.2	4.3	4.2	4.4	3.9	4.0	4.1
Other expenditures	1.2	1.4	2.1	1.8	1.7	1.7	1.7	1.7
Overall fiscal balance (including grants)	**-9.3**	**-7.2**	**-6.3**	**-6.6**	**-6.9**	**-5.3**	**-3.8**	**-3.9**
Public financing sources [b]	**14.0**	**11.1**	**10.7**	**11.5**	**11.7**	**8.6**	**7.6**	**5.9**
Domestic	8.3	6.6	6.7	8.3	7.3	5.4	4.9	3.7
External	5.7	4.5	4.0	3.2	4.4	3.2	2.7	2.2

Source: Eurostat, World Bank projections based on Ameco and MoF data. Note: Data on an accrual basis; a) Subsidies and transfers mostly capture public pensions and other social transfers; b) The financing needs reflect the fiscal deficit and the principal repayments on public debt.

Table 3. Public and Publicly Guaranteed Debt Stock and Debt Service

	Debt Stock (end of period)			Debt Service			
	2023			2024	2025	2024	2025
	in million US$	Percent of Total	Percent of GDP	in million US$		Percent of GDP	
Total PPG Debt	**174,280**	**100**	**48.8**	**27,226**	**20,887**	6.6	5.1
Domestic Debt	**85,654**	**49.1**	**24.0**	**19,311**	**13,395**	4.7	3.3
Treasury bills	2,116	0.1	0.6				
Treasury bonds	67,318	38.6	18.8				
Others	16,220	9.2	4.6				
External Debt	**88,626**	**50.9**	**24.9**	**7,914**	**7,492**	1.9	1.8
Multilateral creditors	16,616	9.5	4.6				
Bilateral creditors	11	0.0	0.0				
Commercial creditors	72,009	41.4	20.3				

Source: Ministry of Finance, Bank staff estimates for domestic and external debt breakdown. Note: Debt Service includes the principal, interest and commission.

Table 4. External Financing Requirements and Sources (percent of GDP)

	2020	2021	2022	2023e	2024f	2025f	2026f	2027f
External financing needs	**28.0**	**27.0**	**27.8**	**26.2**	**26.1**	**25.9**	**25.5**	**25.2**
Current account deficit (positive number stands for deficit)	4.9	7.2	9.1	7.0	6.3	6.1	5.9	5.5
External amortization	23.1	19.8	18.7	19.2	19.8	19.8	19.6	19.7
Financing sources	**28.0**	**27.0**	**27.8**	**26.2**	**26.1**	**25.9**	**25.5**	**25.2**
External borrowing (new and debt rollover)	29.0	24.7	26.5	28.3	26.3	25.1	24.1	23.6
Foreign direct investment (net)	1.4	3.7	3.5	2.1	2.9	3.1	3.2	3.2
Change in reserves (-)	-2.3	-1.4	-2.3	-4.3	-3.1	-2.3	-1.7	-1.6

Source: National Bank of Romania, European Commission, World Bank estimates and projections. Note: External Financing Needs defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

14. **Growth is expected to accelerate to 3.3 percent in 2024, driven by private consumption and EU funds supporting investment.** However, Romania's short-term growth prospects are dampened by external shocks, persistent structural fiscal challenges, and political and social pressures in the context of the 2024 multi-level national and EU elections. In 2024 growth will be primarily driven by an increase in private consumption due to rising disposable incomes, including from increases in pension and public sector wages (particularly in the health, education, and defense sectors). This will in turn

boost private sector wages, although the increase is expected to remain within single digits. Additionally, domestic demand will benefit from enhanced infrastructure investments, particularly in highways with EU funding, and a slight uptick in private investment. Growth is expected to firm over the medium term closer to potential, with downside risks from further economic spillovers of Russia's invasion of Ukraine or impediments to the EU funds absorption.

15. **Inflation is expected to moderate over the medium term, driven by supply-side factors.** The NBR is expected to maintain the policy rate at 7 percent until robust disinflation signals emerge, which will anchor inflationary expectations and accelerate the closing of the output gap. Pressures from higher labor costs, including from the recent and expected wage hikes in the context of the elections, will slow the disinflation process. However, inflation will continue to decrease, driven by supply-side factors, including the downward adjustments in commodity prices, and the base effect. Inflation is expected to continue to gradually decline from 10.4 percent in 2023 to 6.3 percent in 2024, and towards 3 percent over the medium term, consistent with NBR's official forecast, anticipating headline inflation reaching 3.5 percent by Q4, 2025.

16. **The current account deficit will remain elevated, but is projected to decline in the medium term.** Fiscal consolidation should slow down the growth in imports, which, along with rising services exports, will improve the terms of trade. The secondary income surplus may decrease, reflecting lower remittances from major EU economies, while the primary income balance may benefit from more companies relocating operations to Romania in the current regional context. The CAD is expected to be adequately financed by FDI, portfolio investment, and capital transfers from the EU. In the medium term, the CAD is projected to converge to the pre-pandemic level, supported by the deceleration of import prices, and global growth and trade pick-up.

17. **The Government has to bring the fiscal deficit to below 3 percent of GDP in the medium term under the EU fiscal framework, and is committed to doing so, as evidenced by its progress in undertaking politically difficult reforms on taxes, pensions and public sector wages, supported by the World Bank and the EC**. Compliance with the priority of pursuing fiscal consolidation is mandated as a condition for accessing funds from the RRF, and for exiting the 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 to ensure that the process of fiscal consolidation continues. While some policy decisions will be taken after the 2024 elections, the key options for sources of additional revenues include the Personal Income Tax (PIT), Value-Added Tax (VAT) and property taxes, some of which are supported by this DPL, as well as administrative measures to improve tax collection. The elimination of tax exemptions and preferential treatment would also bring in important resources to the budget. The EC and the Government are expected to reach an agreement under the 2024 European Semester process[4] on the medium-term fiscal adjustment path for Romania to exit the excessive deficit procedure. 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.

18. **Public debt has risen during economic downturns, but remains below the EU average and is projected to gradually stabilize over the medium term.** Under the baseline scenario of the Debt Sustainability Analysis (DSA), public debt is projected to reach 54.7 percent of GDP by end-2027, below the 60 percent threshold set forth by the Maastricht Criteria. Debt levels are most vulnerable to growth and primary deficit shocks; difficulties in containing the fiscal deficit could push public debt to 58.8 percent of GDP by end-2027, while a combined macro shock could raise public debt to around 67.3 percent of GDP (Figure 1). Some of the risks are mitigated by the Government debt management strategy, which supports a prudent maturity profile with an average remaining maturity of total debt at 7.4 years (9.9 years for Eurobonds) as of December 2023. Most of the debt pays fixed interest and is primarily in local currency (Lei) and Euros, supporting a stable borrowing profile. Romania has access to domestic and international capital markets (in addition to the EU funds), but because of its twin deficits and fiscal pressures, its borrowing terms are constrained by higher rates than its regional peers.

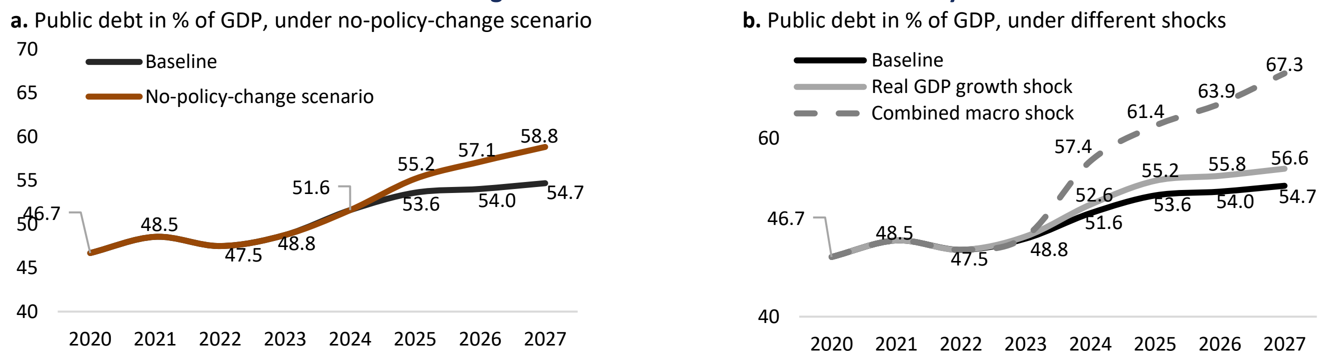
[4] The European Semester is part of the EU's Economic Governance Framework. During the European Semester, Member States align their budgetary and economic policies with the rules agreed at the EU level. This process takes place annually from November until July.

19. **The primary risks to the macroeconomic outlook arise from the economic spillovers due to external shocks and from fiscal pressures, which are particularly significant in 2024.** Under a no-policy-change scenario, the fiscal deficit would stabilize at a high level of over 6 percent of GDP for the medium term, pushing public debt to close to 60 percent of GDP by 2028. Such a scenario would likely lead to a downgrade of Romania's credit rating, discouraging investors and seriously affecting the country's borrowing costs. It would also put Romania into collision with the EU Economic Governance Framework[5].

20. **These risks are partly mitigated by the current and committed key structural reforms and investment priorities.** These commitments are specified in several Government documents, particularly the NRRP, and by the associated large amounts of EU grants and concessional loans that come with meeting these commitments. At the request of the Government and the European Commission, the Bank supports the NRRP implementation by providing technical assistance and just-in-time advice to the Ministry of European Investments and Projects, which coordinates and monitors the implementation of the Plan, and to various central and line ministries on specific reforms and investments articulated in the NRRP. The Government is committed to reducing the fiscal deficit, and has initiated a series of tax hikes, and the elimination or reduction of a relatively large number of exemptions in January 2024, to the tune of around one percent of GDP. Despite these efforts, revenues may fall short of the 2024 Government budget projections. Additional permanent revenues will be necessary to cover rising pensions and wages expenses starting from 2025.

21. **Policy and administration measures for balancing the budget over the medium term can be identified**. Options are available on both the revenue and expenditure sides of the budget. Several taxes that contribute significantly to the budget have rates below the EU average. For example, at 10 percent, Romania's PIT rate is the lowest in the EU, alongside Bulgaria's (the third lowest is in Hungary, at 15 percent). Similarly, statutory VAT, at 19 percent, is below the average of the EU of around 22.4 percent. Therefore, adjustments of some taxes towards the EU averages, coupled with measures to reduce or eliminate some of the remaining tax exemptions and privileged treatment, and with measures to improve the equity of the tax system, could yield over 2.5 percent of GDP in additional revenues. More revenue can be raised from improving tax administration. The recently introduced e-invoice and e-transport instruments, for example, should result in a reduction of the VAT gap, while the ongoing digitalization of the Tax Agency should yield substantial revenue to the budget in the medium term, when benchmarked to peers. Containing the growth of some main expenditure items, such as the public wage bill, and reducing or eliminating inefficient investments could result in savings of around 1.7 percent of GDP. Cumulatively, measures can be identified to support a fiscal adjustment of over 4 percent of GDP and therefore bring the fiscal deficit to below 3 percent of GDP over the medium term. Such an adjustment would be in line with the Economic Governance Framework of the EU and in compliance with Romania's NRRP commitments.[6]

Figure 1. Romania Public Debt Sustainability



Source: World Bank simulations as of May 2024, based on MoF and Eurostat historical data. *Notes:* The no-policy-change scenario (panel a) reflects a higher deficit for 2024–2027, averaging 6.8 percent of the projected GDP compared to 4.9 percent in the "most likely" scenario; and assumes no compensatory measures on the

[5] The overall objective of the new Economic Governance Framework is to reduce debt ratios and deficits of the EU member states in a gradual, realistic, sustained and growth-friendly manner while protecting reforms and investment in strategic areas such as digital, green, social or defense. At the same time, the framework will provide appropriate room for counter-cyclical policies and address macroeconomic imbalances.

[6] Component 8. Tax and pension reforms, Reform #4 Review of the Tax framework.

revenue and expenditure sides. The real GDP shock scenario (panel b) simulates a trajectory of 1.4 percentage points below the "most likely" path in 2024, and an average GDP growth of 2.6 percent for 2024–2027. The combined macro shock reflects (i) a moderate economic recovery; (ii) overshooting of the fiscal deficit; (iii) a real exchange rate depreciation of about 13 percent (which equals the maximum 10-year average) in 2024; and (iv) an interest rate hike of 597 basis points.

2.3. IMF RELATIONS

22. **The IMF Executive Board concluded the Article IV Consultation and endorsed the staff appraisal in December 2023.** The Article IV Staff Assessment acknowledges Romania's robust economic recovery from recent economic shocks. An IMF mission to Romania in late January 2024 acknowledged that the 2023 fiscal package was a step in the right direction and would generate additional revenue. In terms of policy priorities, the IMF staff assert that effective fiscal consolidation is needed to restore the soundness of government finances. Romania does not have an ongoing IMF program.

3. GOVERNMENT PROGRAM

23. **The Government's medium-term program, the NRRP, aims to build a cohesive and open society by leveraging enhancements in the education and health system, while concurrently addressing inequalities between men and women, and between urban and rural areas.** At an operational level, the Government's program aims to implement the reforms outlined in the NRRP with a focus on enhancing institutional capacity, fostering corporate governance, meeting the European energy and transport decarbonization targets, the digitization of transport and enhancing safety within the sector. The NRRP is a government document outlining its reform and investment priorities, proposing programs and projects that support resilience and crisis preparedness and promote adaptability, sustainability, and inclusive growth through major reforms and key investments. It is also a prerequisite for accessing funds from the RRF. The NRRP is primarily focused on six pillars: (i) green transition; (ii) digital transformation; (iii) smart, sustainable, and inclusive growth; (iv) social and territorial cohesion; (v) health, and economic, social and institutional resilience; and (vi) policies for the next generation, children, and the youth. Key reforms that have been/will be undertaken in these six areas include pension reforms; judicial reforms; public administration reforms; tax reforms; reform of the social inclusion programs and the minimum wage; education and healthcare reforms; and decarbonization reforms, particularly in energy and transport.

24. **The World Bank has been providing support to the Government of Romania in many of the key reform areas over several years, in the period preceding and during the development and implementation of the NRRP.** These reform areas include decarbonization and climate resilience measures, the long-term renovation strategy, social inclusion measures, reforms in education and health sectors, and fiscal and pension reforms, especially through RAS engagements. Given the World Bank long-term engagement with the Government of Romania in these key sectors, the outputs of the Bank's technical assistance helped shape the Government priorities, which were then formalized in the NRRP. In addition, the Bank supports the NRRP implementation, at the request of the EC, by providing technical assistance and just-in-time advice to the Ministry of European Investments and Projects, which coordinates and monitors the implementation of the Plan. In addition to funds from the RRF, the Government of Romania has access to structural EU funds, including the Cohesion Fund, under the Multiannual (2021-2027) Financial Framework of the EU (i.e., the EU budget). While the Government's program prioritizes the implementation of reforms outlined in the NRRP, Romania is committed to the United Nations (UN) Sustainable Development Goals (SDGs), and is signatory to the European Grean Deal, with concrete emission reduction target – net zero – by 2050.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

25. **The Program Development Objective 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.** The proposed operation represents a close thematic and sectoral continuation of reforms supported under the previous series of two DPLs FY22-23, building on them in line with the CPF priorities, the recommendations of core diagnostics, and anchored in the Government's medium-term reform program (NRRP, supported by RRF). The continued support and engagement are ensured by ongoing complementary TA and RAS programs across the critical reform areas. The closing date for this operation is December 31, 2026, to ensure sufficient time for all the prior actions to achieve their impact.

26. **This program is aligned with the goals of the Paris Agreement (mitigation, adaptation and resilience – please see Annex 6 for the detailed assessment).** The operation is consistent with the findings of the Romania CCDR, updated EU Nationally Determined Contribution (NDC) to the Paris Agreement,[7] Romanian Energy Strategy 2022-2030[8] and the (draft) National Energy and Climate Plan (NECP), Romanian Long-Term Strategy,[9] Romanian Climate Change Adaptation Strategy 2023–2030/2050,[10] the National Energy Efficiency Action Plan[11] and the National Climate Change Strategy 2013–2020.[12] Several prior actions address some of the country's mitigation and adaptation priorities and contribute to climate action. Concerning mitigation, the reforms under prior actions are not expected to increase greenhouse gas (GHG) emissions, reduce carbon sinks, or introduce barriers to low-emissions development. The Decarbonization Law[13] ban any potential investment in coal technologies, in alignment with EU norms on de-carbonization and Paris Agreement mitigation goals. Concerning adaptation and resilience, the reforms under prior actions are not expected to be significantly adversely affected by risks from climate hazards. All investments will be aligned with the EU Adaptation Strategy and subject to the Floods Directive (Directive 2007/60/EC on the assessment and management of flood risks), as Romania is a member country of the EU. Reforms under PA#3, PA#4, PA#5, PA#6, PA#7, PA#8, PA#9, PA#10 and PA#11 aim at supporting mitigation and adaptation action in the specific context of Romania.

27. **The operation supports the Government across the key pillars of the NRRP, facilitating private investment and increased absorption of EU funds and building on the close partnership with the EC.** The measures implemented to facilitate private investment in renewable energy (offshore wind, green hydrogen, among others), energy efficiency, and carbon pricing in transport, align with the first NRRP objective of *'Green Transition'* and will facilitate the absorption of EU funds channeled under the RRF to incentivize growth and the green transition, as well as broader economic and social development objectives. The fiscal reforms aid fiscal sustainability and, together with green finance measures, support the third NRRP pillar *'Smart, sustainable, and inclusive growth'*. Legislative changes to the PPP framework will stimulate private sector investments in renewable energy as well as areas under other NRRP pillars.

28. **The Government is actively trying to crowd-in private sector investment, particularly in the energy sector, to develop much-needed infrastructure as it seeks to achieve its legally binding decarbonization targets amidst fiscal constraints.** Given the sizable amount of investment needed for decarbonization as discussed earlier and with the Government's fiscal constraints, incentivizing green investment from the private sector is key for achieving the green growth objectives. The proposed reforms in this DPL are pivotal for enabling Maximizing Finance for Development (MFD-E) and Private Capital (PCE).

29. **The design of this operation incorporates both general and country-specific lessons from past operations, and broader WBG engagements.** The 2019 Implementation Completion and Results Report (ICR) on the past programmatic Fiscal Effectiveness and Growth DPL series[14] included the following lessons: (i) DPLs require Government's ownership and leadership of reforms to ensure sustainability; (ii) legislative reforms supported by DPLs would benefit from outreach to relevant parliamentary commissions and inclusion of key parliamentarians in capacity building programs; (iii) the use of emergency ordinances could be more selective, but they do enable legislative action in the context of heavy bureaucratic burden; (iv) the RAS program was critical for the design and implementation of the DPL program; and (v) reforms affecting market functioning should be contingent on the capacity of regulatory agencies to prevent market distortions. Several

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[7] EC. 2020. "Submission by Germany and the European Commission on Behalf of the European Union and Its Member States." Link.
[8] https://energie.gov.ro/wp-content/uploads/2022/08/Strategia-2030_DGJRI_AM_12.08.2022_MU_Clean_25.08.2022-1.pdf
[9] Government of Romania. 2023. "Long-Term Strategy." Link.
[10] MEWF. "National Framework." Link.
[11] https://energy.ec.europa.eu/system/files/2023-07/ro_neeap_ro.pdf
[12] Government of Romania. 2013. "National Climate Change Strategy 2013–2020." Link.
[13] The Decarbonization Law no. 334/2022 –supported under *Romania Second Programmatic Inclusive and Green Growth DPF (P178912)*–, includes firm commitments to (i) ban the construction of new energy capacities for the production of electricity based on lignite or coal, (ii) phase out of lignite and coal-fired electricity generation, decommissioning and closing of the entire installed capacity of lignite and coal-fired power (4,920 MW), by December 31, 2032, (iii) stop lignite and coal extraction/production by December 31, 2032, and (iv) execute safety and shutdown works and greening for quarries and mines.
[14] The ICR for the most recent DPF series is expected to be conducted in FY25.

lessons from the FY19-23 CPF Completion and Learning Review are also taken into account. Specifically, the following lessons have been incorporated in the current operation: close collaboration with IFC and other parts of the WBG; prior actions are underpinned by significant analytical work; capacity building efforts and technical assistance are being provided on most of the reforms, mostly through RAS and Advisory Services and Analytics (ASAs), jointly with IFC Upstream whenever relevant.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Pillar I: Strengthen fiscal management, inclusion, and green public investment

30. **Measures under the first pillar support critical reforms for medium-term fiscal sustainability, equity, and green public investment.** Substantive pension reforms correct the medium-term trajectory of the pension envelope for a population facing aging and emigration, and increase equity in the system, particularly for women. Taxation reforms tackle key tax expenditures in established sectors and increase tax collection in support of short-to-medium term fiscal consolidation efforts, including expanding the tax base. The carbon pricing in the transport sector serves the dual purpose of enhancing revenue collection and encouraging the green transition in a sector critical for achieving decarbonization targets. Green bond issuances support the mobilization of resources for green public investment.

PA#1. To improve the long-term fiscal sustainability and increase equity of the pensions system, the Borrower has: (i) taken measures to reform the general public pensions, including by ensuring that the pension point value increases by up to the average annual inflation rate plus fifty (50) percent of real wage increases, by eliminating the correction index, and by gradually increasing the retirement age for women to that of men, as evidenced by the enactment of the Law no. 360/2023; and (ii) revised the service pensions regimes to gradually align retirement age and reduce the replacement rate, as evidenced by the enactment of the Law no. 282/2023.

31. **PA#1(i): Ad-hoc increases in pension indexation under previous legislation led to unsustainable and inequitable increases in the public pension envelope, contributing to the widening of the structural fiscal deficit.** Since 2016, ad-hoc indexations of the pension point value exceeded the indexation of 100 percent of the inflation rate plus 50 percent of the real average gross wage growth. In addition to the sustainability challenge from such ad-hoc increases, the introduction of a correction index for new pensioners, linking their benefits to the rapidly growing national gross average wage, resulted in the widening of inequality among retirees by increasing the benefit of new retirees by over 40 percent as compared to pensioners with the same number of points that retired before the introduction of the correction index.

32. **The new pension law, enacted in November 2023, aims to stabilize and contain the pension envelope (as a share of GDP), contributing to medium-term fiscal consolidation and greater equity in the system, including for women.** The correction index is eliminated with the simplification of the formula[15], reducing inequalities between pensioners retiring in different years. The indexation rule is set to follow a corridor with a floor of the inflation rate and a cap of the growth of the social insurance revenues, with periodic reviews of the expenditure projections and policy adjustments if they are forecast to exceed the level envisaged at the time of the reform. A similar review of expenditure projections with compensatory measures, if needed, is required for any policy proposals related to the pension system. Measures are included in the reform to strengthen equity and sustainability, including measures aimed at increasing benefits for retirees with long careers, mostly benefitting pensioners with low pensions; a review of special working conditions parameters with the same effect; and a reduction of the number of years for early retirement.

33. **The reform being implemented is poised to increase pension income levels for women, reducing the pronounced gender gap.** Currently at 24.0 percent, the income pension gap arises because women typically work fewer years due to caregiving responsibilities, resulting in lower lifetime earnings and reduced pension contributions. Recognizing these challenges, the reform includes several key measures: i) Maternity leave will now be counted as a contributory period, directly benefitting women's pension accruals; ii) The retirement age for women will gradually increase to match that of men at 65 by 2035, encouraging longer participation in the workforce and aiming to equalize the duration of working life between genders; iii) A new points system will reward extended labor participation, whereby

[15] The formula now uses only the total number of pension points and the reference point value, which are multiplied to produce the benefit amount.

longer work tenures translate into higher pensions. This system incentivizes women to remain in the workforce, thereby increasing their pension contributions and eventual benefits; iv) In September 2024, a one-off pension recalculation will address existing inequalities within the pension system. This adjustment will disproportionately benefit those with lower pensions, primarily women, by significantly increasing their pension amounts. These initiatives align with the recommendation of the Romania Gender Assessment (2023) and are designed to close the gender gap in pensions by supporting women's continued and extended participation in the labor market.

34. **PA#1(ii): Elevated special pensions for selected civil service categories put additional pressure on the budget and lead to sizeable inequities in the system.** There are six categories of civil service pension plans in Romania (diplomats, parliamentary staff, civil aeronautics, auxiliary court staff, magistrates, and military service pensions). The replacement rate[16] for both military (65 percent) and civil service (80 percent) pensions is significantly higher than the targeted replacement rate in the general pension system of 41 percent. It is also applied to a favorable earnings reference period – 1 month to 1 year before retirement instead of full career earnings in the case of the general pension system. In addition, for some categories eligibility criteria were met with as few as four years in profession, and all benefitted from reduced retirement age. As a result, significant supplements are paid from the budget to cover the difference between the social insurance part of the service pensions and the guaranteed amount, defining up to 94 percent of the benefit.

35. **The special pension reform ensures convergence in the civil special pensions, increasing equity and enhancing medium-term fiscal sustainability.** There will be significant long-term convergence among various civil service pension plans as well as with the military pension plan and the general pension system. The retirement age for all plans except magistrates (which were significantly protected by several rulings of the Constitutional Court of Romania) has been set at the level of the standard retirement age for the general pension system. While the replacement rate has been unified for all plans (except magistrates) at 65 percent, the definition of the pay has been set to gradually extend to 25 years of average earnings valorized by inflation (except magistrates) with simple average. All benefits have been capped at the level of net wage and additional tiered tax rates have been introduced for benefits that exceed the average net and gross wages. While the initial benefit for service pension plans still exceeds the benefit in the general pension system, this difference is smaller due to less favorable valorization rates and is phased out over time due to less favorable indexation.

36. **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.** As a result of these measures, the pension expenditures are expected to peak in 2025-26 as a share of GDP and start declining in the subsequent years, demonstrating a substantive improvement compared to the business-as-usual scenario in the absence of the reform. The measures are expected to increase equity in the system, with fewer pensioners and especially fewer women receiving below minimum pension.

PA#2. To increase revenue collection, the Borrower has: (i) reduced the number of products and services to which the reduced value added tax (VAT) rates of five (5) percent and nine (9) percent apply; (ii) introduced the payment of health contributions for the economic sectors that were previously exempt (i.e. construction, agriculture, food) and the payment of personal income tax for the information technology (IT) sector; and (iii) increased excises for tobacco and alcoholic drinks, as evidenced by enactment of the Law no. 296/2023.

37. **PA#2: At around 27 percent, Romania's tax-to-GDP ratio is the second lowest in the EU after Ireland.** This is due to a combination of some of the lowest tax rates in the EU (e.g., PIT rate of 10 percent is the lowest in the EU), large tax exemptions and privileged tax treatment for some large sectors (IT, agriculture, construction, and food industry) and a low capacity of the Tax Administration Agency. In the context of the commitment of the Government towards the EU to pursue fiscal consolidation, while accommodating spending needs associated with the pension and public wage reforms, the Government has embarked on a series of tax policy reforms. These reforms were largely informed by a report prepared by the World Bank under a Tax Reform RAS.

[16] Individual net pensions as a share of net pre-retirement earning.

38. **The tax policy reforms aim to boost tax collection by rationalizing some of the key tax expenditures, while protecting fiscal incentives for renewables through indirect carbon pricing.** The VAT reform measures eliminate the reduced 5 percent and 9 percent VAT rates for a large number of goods and services and instead apply the standard VAT rate of 19 percent. The reduced 5 percent rate will continue to apply to firewood, thermal heat, books, and some recreational activities[17], while the 9 percent rate will apply to food, medicines, water supply, pesticides (until end December 2031), accommodation, restaurants and catering services, house sales (below a certain price and floor surface), and some other recreational activities. Importantly, the reform protects fiscal incentives, creating carbon pricing through VAT differential[18] for renewable energy systems, including photovoltaic, thermal, heat pumps, among others, to support the transition to clean energy, by applying the reduced 9 percent VAT rate. The reforms also introduce the payment of health contributions for a number of sectors that had been exempted, which employ over one million people, namely, agriculture, construction, and food processing. Finally, the reforms introduce PIT to the previously exempted IT sector for salaries above around €2,000 per month and increase the excise tax rate of alcohol and tobacco products.

39. **Those tax reforms, supported by this DPL, aim to generate additional revenue of about one percent of GDP to the budget annually.** The measures implemented so far represent an important step towards the fiscal consolidation efforts of the government, laying the foundations for further tax policy reforms. These will be critical, considering that the pension reform will imply additional costs of around 1.7 percent of GDP in 2025. While the government has taken measures to improve tax administration, mainly through digitalization, this will not be sufficient to cover the cost of the pensions and still support fiscal consolidation. Therefore, further tax policy measures are expected to be introduced in 2025.

PA#3. To incentivize green transportation and increase revenue collection, the Borrower has adopted measures to increase excises for fossil fuels, as evidenced by the approval of the Emergency Ordinance no. 115/2023.

PA#4. To incentivize green transportation and increase revenue collection, the Borrower has introduced a new tax policy for vehicles in accordance with the "polluter pays" principle, which includes a new distance-based toll system for heavy duty vehicles (trucks), as evidenced by the enactment of the Law no. 226/2023.

40. **PA#3 & PA#4: Transport is a key polluting sector in Romania, with rising emissions, and undertaxed compared to the EU.** Transport remains the third-largest source of GHG emissions in Romania. Within land transport, road transport is the largest sub-sector in terms of GHG emissions.[19] From a fiscal perspective, environmental taxation revenues in Romania represent 1.96 percent of GDP, compared to the EU27 average of 2.25 percent. The revenue gap is particularly pronounced within transport sector taxes, which represent just 0.16 percent of Romania's GDP, compared to the EU-27 average of 0.41 percent.

41. **To enhance fiscal incentives to support green transition and fiscal consolidation, PA#3 increases excises for fossil fuels and PA#4 introduces a new distance-based charging system for heavy duty vehicles.** The Government has increased excises for fossil fuels, starting from January 2024, and a further round of increases is planned for July 2024, to facilitate the transition to electric transportation and also to support fiscal adjustment. Furthermore, excises for energy products, in general, have been increased as well, including for heating oil, liquified gas, natural gas, kerosene, coal, coke, and electricity. In addition, starting in 2026, Law 226/2023 introduces an electronic road tolling system (TollRO) for all registered heavy duty vehicles (i.e., trucks) with a maximum authorized mass greater than 3.5 tons, depending on the distance covered on a certain infrastructure and the type of vehicle, in accordance with the "polluter pays" principle.

42. **The reforms are expected to boost domestic revenues while providing incentives to shift to alternative modes of transport or cleaner fuels.** Excises for gasoline and diesel will increase in two stages in 2024, from Lei 2,704 per ton in

[17] E.g. access to museums, botanical gardens.
[18] P. Agnolucci, C. Fischer, D. Heine, M. Montes de Oca Leon, J. Pryor, K. Patroni, S. Hallegatte, "Measuring Total Carbon Pricing," the World Bank Research Observer, September 2023.
[19] Within road transport, passenger cars accounted for 50 percent of emissions, heavy trucks and buses 35 percent, light trucks and buses 15 percent and motorcycles less than one percent in 2016.

2023 to Lei 3,640 in July (for gasoline) and from Lei 1,931.6 to Lei 2,584 in July (for diesel). These increases would bring important revenues to the budget and help accelerate the transition to a decarbonized economy. The introduction of the distance-based toll system is expected to raise revenues by around Lei 1,500 million (c. €300 million) by end-2026.

PA#5. To mobilize resources for green public investment, the Borrower has adopted the framework for sovereign green bonds, as evidenced by the approval of the Government Decision no. 83/2024.

43. **PA#5: The green transition will require significant investment by the public and private sectors.** While the private sector is expected to play a significant role, including supported by measures in this operation, there are investments needed from the public sector. These can range from transmission networks, public goods, and other climate or environmental expenditures.

44. **To support the financing of the green transition in Romania, the Government has adopted the green bond framework.** Approved by an inter-ministerial committee in December 2023, the framework is a reference document for the issuance of green bonds at the sovereign level to finance the expenses related to projects that contribute to meeting Romania's climate, environmental, and sustainable development objectives. By issuing green bonds, the Ministry of Finance (MOF) aims to promote the transition to a greener economy, further diversify the investor base for government securities, and attract investors interested in financial instruments that contribute to climate change mitigation and adaptation and generate a positive impact on the environment or a beneficial social impact.

45. **The reforms are expected to mobilize resources for climate investments, including from private markets.** The issuance of the sovereign green bonds is expected to reach at least €2 billion (about 0.5 percent of annual GDP).[20] Based on the experience of other countries, their issuance can also be expected to catalyze green bonds by the private sector. The forthcoming green budgeting methodology will be instrumental in establishing the green budgeting taxonomy needed for apportioning and tracking the proceeds of green bonds and other green transition financing instruments.

46. ***Pillar I - Next steps:*** **Anchored in the NRRP, the Government plans to initiate further reforms (some of which have been already launched), aimed at generating more revenue, strengthening the fiscal management system, and greening the budgeting and public investment framework.** More tax policy reforms are envisaged for boosting revenues by at least 2 percent of GDP in 2025, including by removing further tax exemptions and preferential treatments. Also, a comprehensive, medium term tax administration reform has been launched, with focus on the digitalization of the Tax Administration Agency. Public sector wage reforms have been launched, with technical support from the World Bank, to address inequities and inefficiencies in the sector. Furthermore, a green budgeting methodology is expected to be approved in the next period, to be followed by a comprehensive green public investment taxonomy.

<u>Pillar II: Promote private financing for the green transition</u>

47. **Measures under Pillar II aim at fostering decarbonization and climate change adaptation of key sectors, through incentivizing private sector resource mobilization for the green transition.** The reform program is informed by the CCDR and CPSD (see Annex 6), and builds on the measures supported under the previous DPL series (including flagship reforms such as transition away from coal). Out of US$356 billion investment needs by 2050 in key decarbonizing sectors, 68 percent are expected to be raised by the private sector and 8 percent to be provided by EU funds. The measures supported under this pillar aim at diversifying energy sources through mobilizing private investments and increasing the absorption of EU funds –including contributing to unlocking coming instalments under the NRRP– for renewables and other green, climate resilient infrastructure. In addition, the reforms promote private investments for climate action in hard-to-abate sectors (particularly industry) by supporting investments in energy efficiency. While these measures target climate mitigation action, they also contribute to the climate adaptation agenda, especially through diversification of the energy generation mix from sources more prone to climate risks in Romania (e.g., hydropower or nuclear).

[20] The first green bonds were issued successfully in February 2024.

PA#6. To enable and incentivize the development of offshore wind farms for the production of renewable electricity in the Romanian exclusive economic zone of the Black Sea, the Borrower has adopted the relevant legislation, including the establishment of the applicable procedures, institutional roles, and the rights and obligations of developers and stakeholders, as evidenced by the enactment of Law no. 121/2024.

48. **PA#6: The diversification of energy sources in the electricity sector is key for the adaptation to climate change and the decarbonization of the energy sector, which is responsible for two-thirds of the GHG emissions in the country and is central to the green transition of the economy.** The Romania CCDR identifies that climate change will particularly impact hydrological cycles in Romania, altering the timing, frequency, and intensity of precipitation. Diversifying the electricity mix is key not only to decarbonize but also to offset the potential negative impact of climate change in electricity generation technologies sensitive to water availability, like hydropower and nuclear. Romania has committed to contributing to the European energy and climate targets by 2030 and 2050, by setting a target of 34 percent share of renewable energy (RE) sources in the gross final energy consumption by 2030, out of which wind energy is foreseen to contribute with over 37 percent. Moreover, the REPower EU initiative identifies renewable energy as key contributor to energy independence, security of supply, and job creation in the EU. The 2020 EU Strategy to harness the potential of offshore renewable energy for a climate neutral future set offshore wind capacity objectives at 60 GW by 2030 – subsequently increased to 79 GW by 2030 in the 'Fit-for-55' package– and 300 GW by 2050, with the Black Sea as one of five key sea basin developments contributing to this target. In its NRRP, Romania has committed to increasing the share of RE in the national energy mix, including the introduction of a new dedicated framework for offshore renewable plants.

49. **The adoption of a specific legal framework is the cornerstone for achieving Romania's current diversification and decarbonization targets with significant mobilization of public and private resources.** The Offshore Wind Law (no. 121/2024) aims at creating an enabling framework for the deployment of offshore wind in the Romanian exclusive economic zone of the Black Sea, including provisions regarding the introduction of support schemes, determination of competent authorities, authorization and licensing process, and concessional regime. A robust regulatory framework and setting of short-term and long-term targets for offshore wind will create more visibility and predictability for future investors. The design of appropriate support schemes would make such projects economically feasible and attractive for the private sector, enabling the mobilization of private capital.

50. **PA#6 will enable the installation of offshore wind generation capacity in the Black Sea.** The development of offshore wind farms may take 8-10 years; hence this operation will capture the first stages of implementation, namely the identification of areas in the Romanian exclusive economic zone of the Black Sea compatible with Offshore Wind Law requirements, eligible to be tendered out to the private sector for the development of offshore wind farms with an aggregated capacity of 1,500 MW by 2026 (from the current baseline of 0).

PA#7. To improve the bankability of new renewable energy projects, the Borrower has developed the secondary legislation defining the governance and functioning of contracts for differences for low-carbon technologies for electricity production, as evidenced by the approval of the Government Decision no. 318/2024.

51. **PA#7: Enabling private investment in new renewable energy electricity generation capacity is key for achieving the decarbonization objectives in the electricity sector.** The CCDR estimates that about US$33.5 billion will need to be invested in new electricity generation capacity for renewable energy by 2050 to decarbonize the energy sector, out of which US$17.3 billion should be mobilized by 2030. The private sector is anticipated to contribute 62.1 percent of the total investment, while 8.1 percent would come from EU funds and 29.9 percent from national public funds. Therefore, enabling private sector investment and the absorption of EU funds would be instrumental to mobilize funds at scale and meet the investment and renewable energy capacity addition goals.

52. **Limiting uncertainty in the revenue stream for renewable energy projects would enable private investment by increasing the bankability of these projects and private sector appetite to invest.** Renewable energy projects are more capital intensive than conventional technologies, and thus are more exposed to revenue variability. While capital costs represent about 30-50 percent of total costs to generate electricity in conventional thermal technologies (about 40-60

percent are fuel cost), capital costs represent about 80-90 percent of total electricity generation costs in renewable energy projects. Therefore, renewable energy projects require a more stable revenue stream to repay capital costs, usually financed with bank loans. Price volatility in electricity markets is one of the main sources of variability in the revenue stream of renewable energy projects, potentially jeopardizing their bankability.

53. **PA#7 sets up the regulatory framework for contracts for difference,[21] a financial hedging mechanism to improve the bankability of renewable energy projects by limiting their exposure to electricity price volatility.** Whereas the Romania First Programmatic Inclusive and Green Growth DPF (P178912) supported amendments to the Law on Electricity and Natural Gas to support renewables and private sector participation in the sector by, among other measures, enabling hedging and bilateral contracts that protect renewable energy developers from market price volatility, PA#7 supports the development of the secondary legislation defining and regulating this instrument.

54. **This reform is expected to enable renewable energy capacity additions in an amount of 950 MW by improving the bankability of these projects.** The Government has set an objective of installing 950 MW of new renewable energy capacity by 2026. Meeting this objective would require the mobilization of private investment at scale and ensuring the bankability of renewable energy projects.

PA#8. To incentivize investments in the production of green hydrogen, the Borrower has approved a state aid mechanism to support investments in electrolyzers for the production of green hydrogen, as evidenced by the adoption of the Order of the Minister of Energy no. 923/2023.

55. **PA#8: Green hydrogen is a promising fuel to decarbonize hard-to-abate sectors in the economy, such as heavy industry, in the regionally (EU) committed net-zero scenario.** The Romania CCDR recommends a two-phase strategy for the full decarbonization of the economy by 2050. The first phase would entail the decarbonization of the power sector and the electrification of the economy in those sectors where low-carbon technologies are commercially available and competitive. The second phase would focus on hard-to-abate sectors where low-carbon technologies are currently nascent and would need to develop and gain scale to become commercially competitive. For major industry consumers and applications such as district heating, the development of alternative fuels, such as green hydrogen, would be critical in meeting national commitments in the EU framework and in producing low-carbon goods for export markets.

56. **To develop nascent low-carbon technologies, like green hydrogen, an enabling regulatory framework and incentives for first movers should be deployed.** While investments in low-carbon fuels at scale are expected to take place in the second phase of the decarbonization agenda, the Romania CCDR recommends setting up an enabling regulatory framework and start developing mechanisms to support the first phases of development of these technologies, when they may not be commercially competitive. Similarly to the evolution of renewable energy for electricity production, incentives in early stages of development are expected to result in progressive reductions in technology costs, to ultimately become competitive with other conventional technologies without public support.

57. **PA#8 supports the adoption of a state aid mechanism to incentivize private investments in electrolyzers for the production of green hydrogen.** PA#8 will help mobilize private investments to produce green hydrogen. The size of the state aid mechanism is about €150 million and it establishes limitations of support to eligible expenses and thresholds by electrolyzer's technology. PA#8 thus complements and develops relevant policy action initiated in the Romania First Programmatic Inclusive and Green Growth DPF (P178912), which supported the creation of a regulatory framework to define quality and security standards for green hydrogen and other low-carbon fuels.

[21] Contracts for difference is a financial hedging agreement between an electricity supplier and an offtaker, which establishes cap and floor electricity prices. If the electricity market price is above the cap price, the supplier will compensate the offtaker with the difference between the market price and the cap price (or a percentage of it), while the offtaker would compensate the supplier when the electricity market price is below the floor price. Contracts for difference thus reduce the volatility of electricity prices for both the supplier and the offtaker without negatively impacting the liquidity of electricity markets, therefore increasing the stability of the revenue stream for renewable energy projects and improving their bankability.

58. **This reform is expected to support investments in green hydrogen with a total electrolyzer capacity of 100 MW.** Under the RRP and the National Energy and Climate Plan (NECP), the Government has committed to developing green hydrogen production capacity. By 2026, it aims at installing 100 MW of new electrolyzer capacity to produce green hydrogen, to which PA#8 contributes.

PA#9. To facilitate investments in energy efficiency of industries and public institutions through energy service companies (ESCOs) and to develop the ESCOs' market, the Borrower has: (i) established the framework for energy service contracts to increase transparency and ensure energy savings and final customers' rights; and (ii) created the national registry of ESCOs that identifies energy service providers by beneficiaries of energy services, as evidenced by the approval of the Government Decision no. 1329/2023.

59. **PA#9: The decarbonization of Romania's energy mix needs to be accompanied by a significant reduction of the energy demand, and the participation of the private sector would be key for achieving this objective.** In the draft of the revised NECP, Romania has set an objective to achieve a 45 percent reduction in final energy consumption by 2030, compared to the PRIMES[22] reference scenario. To achieve this goal, the energy consumption in buildings and the energy intensity of Romania's industry need to be reduced through energy efficiency measures. Romania's Long-Term Renovation Strategy (LTRS) aims at a gradual increase of the renovation rate of the building stock to 3.39 percent per year by 2030. Secondly, the Romanian industry represents about 27 percent of total final energy consumption and almost 46 percent of the country's total electricity demand. Its decarbonization will be critical to achieving both climate goals and green competitiveness. Romania introduced in its NRRP a reform for the development of a sustainable mechanism to boost energy efficiency in industry. The LTRS estimates total investment needs in the renovation of the building stock in the amount of €12.8 billion by 2030, of which 61 percent should be channeled from private sources–the NRRP allocates €2.2 billion to the renovation of the building stock. The draft revised NECP estimates investment needs for decarbonization measures in the industrial sector at around €63 billion for the period 2023–2030.

60. **The creation of a market of Energy Services Companies (ESCOs) would facilitate and accelerate investments in energy efficiency.** Attracting private investment to energy efficiency projects is key for the decarbonization of the industrial and building sectors, the optimization of the energy demand, and the reduction of production costs and households' energy bills. However, industries, especially Small and Medium Enterprises (SMEs), and the residential and public sectors usually lack technical capacity to identify, design, and implement potential investments in energy efficiency, and often have budget restrictions to invest. ESCOs provide holistic services covering the whole process from identification of investments, energy audits, financing of projects, implementation of energy efficiency measures, and operation and maintenance services. In developed ESCO markets, ESCOs work under energy performance contracts, by which the ESCO undertakes all the works and collects revenues over a determined period of time as a percentage of the savings in the energy bill resulting from the energy efficiency investments undertaken. In the public sector, energy efficiency investments may be undertaken by private companies and convert the investment into energy performance contracts. The ESCO market in Romania is currently underdeveloped, mostly due to regulatory barriers and difficulties for ESCOs to access financial resources.

61. **PA#9 aims at creating a transparent playing field for ESCOs by standardizing and regulating their services and energy-performance-based contracts, and creating a national database of ESCOs to ease the identification of well-performing ESCOs by prospective clients.** Introducing long-term ESCO contracts (energy-performance-based contracts) and regulating ESCOs' services would create more transparency and predictability for market players and would incentivize industries and the public sector implementing energy efficiency projects. Moreover, the creation of a national database of ESCOs would increase the transparency of ESCOs compliant with the relevant regulation and with a soundtrack record, facilitating their identification by prospective customers and the contracting.

[22] PRIMES refers to the Price Induced Market Equilibrium System Model used in EU Member States.

62. **PA#9 will result in the creation of a National ESCO registry with at least 20 ESCOs registered by 2026.** While the creation of an ESCO market may take time, the creation of the National ESCO registry will increase transparency and standardization of the services provided by these companies. At least 20 firms are expected to be registered by 2027.

PA#10. To increase mobilization of private investment for energy efficiency in the industrial sector, the Borrower has established the standards for financial instruments supporting energy efficiency in industry, as evidenced by the approval of the Emergency Ordinance no. 119/2023.

63. **PA#10: Achieving the net zero scenario by 2050 would require massive investments, especially from the private sector; mobilizing a large amount of private investment will require specific sectoral measures and broader financial instruments, especially in areas such as energy efficiency.** While specific sectoral solutions, support schemes and policies will be required, more general financial instruments covering different sectors and types of investments will be needed. The latter would facilitate the aggregation of projects and reduce transaction costs for financial institutions, incentivizing the adoption of these instruments. A good example is the renovation of the building stock to improve energy efficiency, which would require investments in the amount of US$85.3 billion by 2050 (CCDR). In this sector, the excessive reliance on grants has so far exacerbated demand volatility and distorted the willingness of households to pay for building renovations. In addition to grant programs for the poorest households, financial instruments would offer an opportunity for leveraging private investments, increasing the efficiency in the use of scarce public funds, and providing more sustainability and predictability to these sectors.

64. **PA#10 supports the creation of standards for financial instruments dedicated to supporting energy efficiency.** The development of new standards for financial instruments for energy efficiency are expected to be key enablers for local banks to design relevant financial instruments specific for energy efficiency to ultimately attract private investment.

65. **The result of PA#10 is expected to be reflected in an increase of loans signed for energy efficiency to firms from current €69 million to over €170 million by 2026.**

PA#11. To increase private capital mobilization in infrastructure, the Borrower has: (i) removed the upper limit for the amount of co-financing by public partners in public-private partnerships (PPP) co-financing structures, as evidenced by the enactment of the Law no. 7/2024; and (ii) simplified the requirements for pre-feasibility and feasibility studies for PPPs and concession arrangements, as evidenced by the approval of the Government Decision no. 1116/2023.

66. **PA#11: PPPs are a crucial instrument to mobilize private capital to finance public investment, but are only viable if supported by a sound regulatory framework.** Scaling up investments is crucial for climate change adaptation and mitigation as well as for delivering social services. The 2023 SCD Update notes that the provision of high-quality public infrastructure services – potable water, sanitation, energy – remains low, especially for the poor and rural residents. The 2023 Romania CPSD identifies private sector investment opportunities through PPPs in renewable energy and sustainable transport. Attracting private investors to deliver these services under long-term contracts requires a sound regulatory framework. In recent years, due to limitations in the legislation, no PPP investments have been made in Romania.

67. **The new PPP legislation simplifies key procedures to improve their efficiency and lifts public co-financing limits, with concrete benefits to increase the potential for more green investments from IFC and other private sector players.** Prior to the legislative changes, Romania's legal framework for PPPs limited private investment due to cumbersome feasibility and pre-feasibility study requirements and limitation on government co-financing. Firstly, the legislative amendments introduce a framework content for feasibility and pre-feasibility studies for PPPs and concessions specifically (before, the public procurement processes applied). The new framework allows for PPP bidders to propose innovative technical and financial solutions as part of their bids, rather than having to respond to fully specified requests for proposals. It also streamlines the procedure, increasing competition and reducing the fiscal cost, while managing risks in the eventual project evaluation. Secondly, the new legislation eliminates the maximum threshold of 25 percent in the co-financing of investments by the public partner, including EU funds and national sources. The upper limit to public and grant resources is replaced by identification and qualification of fiscal risks associated with PPPs and provision for these

risks, consistent with modern governance practices that maximize the benefits of the fiscal contribution to PPPs. The removal of the upper limit for co-financing unlocks opportunities for green and social infrastructure PPPs, among others.

68. **Measures supported by PA#11 are expected to accelerate PPP investments, especially in climate mitigation and social infrastructure.** Those changes particularly enable implementation of the specific PPP projects under consideration, with potential for more climate-related investments from IFC and others (energy efficient hospitals[23], municipal waste-to-energy facilities and water projects, renewable energy projects, among others). While the legislation of PPPs is not restricted to specific sectors, the overarching EU and national legal framework prevents investments in polluting technologies, including the Decarbonization Law, which bans investments in coal-fired power plants, and the European Green Deal, which sets ambitious decarbonization targets. As PPP deals are complex with commensurate preparation time, this operation will capture the first stages in its implementation, with at least one PPP project to be initiated[24].

69. ***Pillar II - Next steps:*** **Following the commitments toward the European Green Deal, Romania will keep undertaking reforms to mobilize investments to meet its targets of carbon neutrality by 2050.** Romania is committed to accelerating the decarbonization of the energy sector by: (i) designing new programs to support additional 2,000 MW of renewable energy through Contracts for Differences, (ii) deepening the phasing out of coal-fired capacity, (iii) supporting the development of over 1870 km of hydrogen-ready distribution networks, (iv) supporting programs to add highly-efficient gas cogeneration and district heating projects, and programs to install 240 MWh of battery storage, and (v) supporting programs and setting up a fund for energy efficiency in the industrial sector. All these efforts require the adaptation of the regulatory framework and the implementation of support programs and mechanisms to attract private investment.

Table 5. DPF Prior Actions and Analytical Underpinnings

PA#1: Romania Pensions Capacity Building RAS (P177723) and Support for the Operationalization of Social Protection Reforms in the National Recovery and Resilience Plan RAS (P178551). Key findings: policy and analytical guidance and capacity building for the preparation of the new public pension law and the reform of the special pensions.
PA#2: Improving the Tax Framework in Romania in the context of the National Recovery and Resilience Plan RAS (P178899). Key findings: assessed the quality of the tax policy framework in Romania and provided recommendations and hand-on guidance for tax reforms.
PA#3 &PA#4: Support for the Operationalization of the Resilience and Recovery Plan of Romania TF (P177798). Key findings: new tax policy for vehicles in accordance with the "polluter pays" principle. Improving the Tax Framework in Romania in the context of the National Recovery and Resilience Plan RAS (P178899). Key findings: recommendations for increasing carbon taxes.
PA#5: TA provided via Bank budget by the Treasury and the Finance, Competitiveness, and Innovation Global Practice. Key findings: helped the Government to set up the sovereign green bond framework, i.e. identifying projects labeled as green and defining the process of evaluating and selecting eligible expenditures for green bond financing, ensuring that the funds raised are directed exclusively to eligible expenditures with a positive impact on the environment. The Framework presents the procedures for managing the funds raised and the parameters adopted for monitoring, measuring, and publishing reports on the allocation and impact of the funds raised, as well as the possibilities for external evaluation.
PA#6: Joint IBRD/ IFC elaboration of the Romania Offshore Wind Roadmap under the ASA Energy Market and Energy Transition in Romania - (P175774); support to the Ministry of Energy in designing the Romania Offshore Wind Roadmap, which has informed the new Offshore Wind Law and the structure of competition framework.
PA#7: Report on "Competition Assessment of Electricity and Gas Sectors" under the ASA Energy Market and Energy Transition in Romania - (P175774); support to the Ministry of Energy, the Competition Council and the Regulatory Authority (ANRE) in analyzing the competition environment in the energy sector, recommending the use of contracts for differences, as mechanism to reduce the financial risk of PPAs without negatively impacting liquidity of electricity markets.
PA#8: Technical guidance note and workshop on hydrogen under the ASA Energy Market and Energy Transition in Romania - (P175774); support to the Ministry of Energy and the Regulatory Authority (ANRE) in approached to incentivize hydrogen investments and to create standards and the regulatory framework.

[23] As per experiences with PPP advisory contract on hospitals, the projects will support energy efficient and climate resilient design.
[24] The proposed definition for number of PPP/concession projects initiated – number of pre-feasibility or feasibility studies initiated according to Annex 3.1 (outlining the content framework for pre-feasibility studies for PPPs/concessions) or Annex 4.1 (outlining the content framework for feasibility studies for PPPs/concessions) of Government Decision 907 for projects with an investment value higher than €10 million.

PA#9: Technical Assistance Facility to Support Renovation Wave under Cohesion Policy in Select EU Member States (P177061); support to the Ministry of Energy in identifying good international practices and providing technical inputs and recommendations to the ESCOs and Energy Performance contracts' regulatory framework.
PA#10: Technical Assistance Facility to Support Renovation Wave under Cohesion Policy in Select EU Member States (P177061); support to the Ministry of Energy in identifying good international practices and providing technical inputs and recommendations to the regulation of green financial instruments for energy efficiency in industry.
PA#11: Joint IBRD/IFC TA on draft PPP legislation; Romania CPSD (WB, 2023, IFC 606682); CCDR (WB, 2023, P179052); Romania Whole of Economy Climate Action Support Programmatic Advisory Services and Analytics (P180446), and IFC Upstream advisory. Key findings: Romania CCDR (2023) estimates that two-thirds of Romania's development and climate change investment needs in key decarbonization sectors will have to be financed by the private sector. Romania CPSD (2023) indicates the potential of private sector to invest significantly in renewable energy and sustainable transport.

4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

70. **This DPL is aligned with the Romania CPF FY19-23.** The reform program is aligned with the CPF's three focus areas: (i) ensure equal opportunities for all; (ii) catalyze private sector growth and competitiveness; and (iii) build resilience to shocks. As a country above the IBRD Graduation Discussion Income (GDI) level,[25] the operation also meets the CPF filters for WBG financing, namely maximizing finance for development, including catalyzing private sector investment or leveraging additional resources (e.g., better use of EU funds); and/or contributing to regional and global public goods (climate change action). The first pillar supports structural reforms to improve the Government's fiscal position, and inclusion more broadly. The second pillar supports decarbonization and private sector growth, particularly in renewables and energy efficiency. These activities will enable Romania to build resilience to climate related shocks. The program presents a strong sectoral and thematic continuation to the FY22-FY23 series of two DPFs, 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' extensive RAS and TA support in energy, transport, and fiscal and financial management. The program supported by this DPL stems directly from the recommendations of the CCDR, CPSD, PFRs and other analytics.

71. **The DPL, through an extensive WB-IFC collaboration on the reform agenda, champions a One WBG delivery, contributes to the Knowledge Bank and to tackling multiple global challenges, advances partnerships with the private sector and other development partners, and aligns results with the New Corporate Scorecard, in line with the Evolution Roadmap and the new WBG mission of ending extreme poverty and boosting shared prosperity on a livable planet.** Specifically, the reform program contributes to tackling the global challenges of Energy Access, Climate Change Adaptation and Mitigation, as well as Water Security and Access. The DPL is aligned with the CPF, with considerations for the linkages and cross-sectoral issues in an advanced economy with a rapidly aging population, at the global frontier of climate action. On the decarbonization agenda, the DPL presents a sizeable contribution to the Bank's knowledge agenda on global challenges, with potential for spillovers, particularly on partnering with the private sector. In addition, the reform program supported by this DPL presents significant complementarities with other development partners, it helps unlock sizeable funds from the EU. As reflected in the World Bank's portfolio across RAS, TA, and lending, the World Bank has been deeply engaged in fiscal sustainability and green transition over the past years, in close partnership with the EC. Results supported by this operation contribute to several WBG results outlined in the Corporate Scorecard, including tax collection, GW of renewable energy capacity enabled, and net GHG emissions per years.

72. **This DPL is aligned with the WBG's commitment on gender, climate, and private capital mobilization (PCM).** Pension reforms include measures to help close gender gaps by revising pension contributions during maternity leave, pensionable age, and aim at closing gender gaps. PAs 3-11 support the climate mitigation and/or adaptation agenda by helping scale up – particularly private sector – investments in greening the energy mix, energy efficiency, and supporting greening of transport; and improving the energy system's resilience to the impacts of climate change. Seven out of 11 PAs

[25] While Romania's Gross National Income per capita has risen above the IBRD Graduation Discussion Income (GDI) threshold, the country continues to face structural challenges that require WBG technical and financial support.

are expected to be tagged as MFD-E and/or PCE (PA#5, #6, #7, #8, #9, #10, and #11)[26]. The framework for sovereign green bonds (PA#5), together with the TA provided by the World Bank Treasury, led to the issuance of €2 billion bond issuance in February 2024, which is counted as PCM under the World Bank Treasury's TA. The DPL is expected to be gender tagged, and yield sizeable Climate Co-Benefits.

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

73. **Romania's policy making process is broadly consultative and inclusive.** The Government generally follows a consultative policymaking process with policies going through public scrutiny. Policies are screened for compliance by relevant public bodies, such as the Legislative Council or the Constitutional Court, by regulatory agencies or by consultative bodies, such as the Economic and Social Unit of the Fiscal Council, and extensive public consultations with relevant stakeholders are carried out in general prior to their adoption. The EC holds regular exchanges with the Government on the status of the implementation of the NRRP. The reforms supported by this operation have gone through prior consultations with relevant stakeholders. Measures supporting fiscal reforms and energy transition were also extensively discussed with the EC and the communities impacted.

74. **Coordination with development partners and a strong partnership with the EC.** Collaboration between the IMF and the World Bank staff is effective with regular consultations on macroeconomic, debt management, financial sector, and structural issues. The World Bank has recently completed extensive consultations with the government, development partners, private sector, Non-Governmental Organizations, and broader public on the upcoming CPF, SCD Update, CCDR and CPSD, whose recommendations inform the reform program. Another development partner closely engaged in the policy areas supported by this DPL series is the EC. The World Bank and the EC coordinate in the areas of fiscal reforms and the green and digital transition.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

75. **PA #1, PA #5, PA#9, PA#10, and PA #11 are expected to have a neutral or positive impact on well-being and/or equity in the short term, with positive welfare impacts in the long run.** PA#1—encompassing the elimination of the pension correction index, the increase of the retirement age for women up to that of men, and modifications to service pension regimes—is expected to enhance gender equality (especially if accompanied by measures to foster female participation in the labor force), reduce inequalities in the pension system, and have a likely neutral impact on poverty in the short run and positive welfare impacts in the long run. The framework for green bonds (PA#5) is not expected to directly impact welfare in the short term, but could have positive long-term effects, especially for the poor. The regulation of energy service contracts (PA#9) and the mobilization of private capital for energy efficiency (PA#10) are expected to have a neutral effect on well-being in the short run, with the potential to reduce energy poverty in the long run. Amending the PPP legislation (PA#11) is not expected to have an impact on welfare in the short or medium term but has the potential to benefit lagging regions in the long run (see Annex 4 for more detail).

76. **Fiscal consolidation measures under PA#2 are not anticipated to have major impacts on poverty or inequality.** Increasing the preferential VAT rates is expected to enhance VAT progressivity and slightly reduce inequality since most rate increases apply to goods and services more likely to be consumed by high-income households, with the preservation of lower rates for food and firewood, mitigating the burden on low-income households. Changes in excise taxes on tobacco and alcohol is expected to be modest, with only limited short-term poverty impacts (Annex 4, Table A1) and potentially sizeable long-term benefits on public health. Eliminating certain PIT exemptions in the IT sector is projected to enhance fiscal revenues, without exacerbating inequality or poverty (Annex 4, Table A2). Conversely, introducing healthcare contributions in previously exempt sectors could reduce the disposable income of certain vulnerable households, but the poverty impacts are expected to be contained (less than 1 percentage point), as only a small share of the poor (6.1 percent)

[26] PAs#5, #9, and #10 are expected to be tagged as MFD-E; PAs#6, #7, #8, and #11 are expected to be tagged as MFD-Ee and PCE.

are affected by this policy, and the policy leads to a reduction in disposable income for affected households only by 5.5 percent. Between 2021 and 2024, various fiscal policy measures have been implemented, including adjustments to the Social Reference Indicator (SRI), affecting family support allowances and unemployment benefits, and the introduction of the single anti-poverty program, the Minimum Inclusion Income (VMI), which will help mitigate these potential negative impacts. Expanded social transfers and tax relief measures also contribute to a more pro-poor and redistributive fiscal system. Simulations show these policy changes reduce the at-risk-of-poverty rate from 24.3 percent to 21.9 percent, mainly due to expanded direct transfers (Annex 4, Figure A1).

77. **Long-run welfare impacts from the remaining PAs are expected to be neutral or positive, albeit with some uncertainty of the short-term impacts.** A new tax policy for heavy-duty vehicles (PA#4) and higher excises on fossil fuels (PA#3) are expected to have positive impacts on health in the long run, particularly for those without health insurance (currently, 11 percent of the population, mainly among poor and marginalized groups). However, potentially pricier goods and services due to higher transportation costs might affect the poor in the short run. The development of offshore wind farms (PA#6) is set to boost welfare through investments, job creation, and a more stable energy supply, but potential short-term increases in energy prices can negatively impact the poor. Similarly, actions to support low-carbon electricity generation (PA#7) and the production of green hydrogen (PA#8) are expected to have a positive social impact in the long run by mitigating climate change, but potential resulting hikes in energy prices (if high costs are passed on to consumers) would disproportionately affect low-income households. Mitigating such risks will require targeted government action, especially if electricity price caps were phased out. The government has introduced home heating aid for low-income families; enhanced means-tested social transfer programs, such as the VMI; and adjusted the indexation of the SRI, to cushion the related benefits from inflation. The heating subsidy is highly progressive but has had a muted impact due to its small size. A 40 percent rise in energy prices could increase energy poverty by 2.3 percentage points, disproportionately affecting vulnerable groups. Further financing from the Social Climate Fund, operational since June 2023, could increase incomes.

5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

78. **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 frameworks for 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 permissions and the Environmental Impact Assessment (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. Please see Annex 4 for more details.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

79. **Romania's public financial management (PFM) is assessed as adequate to support this operation.** The PFM system has been modernized over the last 20 years. The Government is expected to continue initiatives to strengthen strategic planning and program budgeting, tax policy and revenue administration, and public investment management. Program-based budgeting has advanced with the 2024 state budget containing the programs of the institutional strategic plans of all ministries transposed into the budget and informing the Medium-Term Expenditure Framework for 2024-2027. Green budget tagging is planned to be piloted for the preparation of the 2025 state budget. The most recent IMF Fiscal Transparency Evaluation found that Romania performs well in the Fiscal Transparency Code benchmarking, and the

evaluation recommended strengthening budget planning and policy orientation.[27] Similar findings were identified by the Organisation of Economic Cooperation and Development (OECD) assessment conducted in 2022.[28] The Government's budget is publicly available in print and on the MoF's website.[29] Budget formulation and execution are generally well-organized, with clear guidelines, regulations, and timelines, but these should be applied more consistently and predictably; moreover, there is potential for streamlining and further automating of procedures supported by more effective preventive controls. Reporting and accounting functions are based on comprehensive policies, including a unified budget classification and chart of accounts; however, despite implementing a national reporting system in 2016, Romania still manually collects, verifies, and validates financial information, which limits timely operational outputs and analysis. Further upgrades and integration of the PFM-supporting IT systems are planned in the coming years. While internal public auditing is well regulated and staffed, its effectiveness is hampered by capacity constraints, particularly at the local level. External public auditing is being reformed to fully observe international standards and contribute to strengthening of PFM. The Romanian Court of Accounts, the country's supreme audit institution, adopted new audit methodologies in 2023 and plans to update its legislative and operational framework, strengthen performance audits, further digitalize audit processes, and better communicate audit findings to stakeholders; these priorities are reflected in its institutional development strategy for 2023–2028.[30] An updated Public Finance Review is being prepared by the Bank in 2024 to support the Government's agenda for fiscal consolidation through better revenue collection and more efficient public spending.

80. **Over the past 10 years there have been important improvements in the functioning of the public procurement system in Romania, including an improved e-procurement system, centralized procurement, the development of a web-based guide and a monitoring mechanism, and the design and delivery of professionalization agenda, including an extensive capacity building program.** However, the Romanian public procurement legislation has undergone multiple changes, which generates an unpredictable environment. Also, the current policy and legal framework for strategic public procurement are not yet fully developed and well-understood by contracting authorities and suppliers. There is a lack of confidence in the system of remedies, and the use of centralized procurement in Romania is low compared to many other EU member states. Although the e-procurement system is a good foundation for transparency, EU scoreboard data shows a continued high proportion of negotiated procedures without prior publication (23 percent in 2022) and a high single bidder rate (42 percent in 2022). To address these issues, a new National Strategy on Public Procurement was adopted by the Government in June 2023 with the main objective to promote the use of public procurement as a strategic tool to contribute to Romania's economic resilience and recovery, including by ensuring the social, environmental, and innovative benefits and increased access of SMEs to the public procurement market. Going forward, focus on centralization of procurement, professionalization of procurement staff, and improving competition would further strengthen cost efficiency, accountability, and competition.

81. **The proposed loan will follow the WB's standard disbursement procedures for DPLs.** It will be disbursed in a single tranche (prorated in the event of partial withdrawals of the single tranche) to the foreign currency national budget account at the NBR, which forms part of the country's foreign currency reserves and budget management system. Disbursements will not be linked to specific purchases; no evidence or procurement requirements will be needed for disbursement. The loan proceeds will be used in line with the public debt legislation and the requirements of the Loan Agreement. If loan proceeds are used for purposes defined as ineligible in the Loan Agreement, the WB, upon notice, will require the Borrower to refund such amount, and such amount will be canceled. NBR's control and oversight framework can be relied upon to account for the WB loan proceeds from DPLs. Per the 2014 update of the 2011 IMF Safeguards Assessment, the NBR's safeguards framework remains robust. The NBR continues to publish its audited financial statements as part of the annual reports and maintains strong controls over management of foreign reserves, government

[27] IMF. 2015. *Romania: Fiscal Transparency Evaluation*. Link.
[28] Mathot, A. and A. Park (2022), "Budgeting in Romania 2022", OECD Journal on Budgeting, vol. 22/3, https://doi.org/10.1787/24877232-en.
[29] Budgets are available at Ministry of Finance. Link.
[30] The strategy was prepared with WB's support under the Strengthening the Institutional Capacity of the Romanian Court of Accounts RAS (P171014).

banking, and vault operations (particularly relevant in the context of the post-pandemic fiscal consolidation). The latest publicly available audit reports had an unmodified (clean) opinion on the preparation and presentation of the NBR's financial statements for 2018–2022.[31]

82. **The World Bank will not require an audit for the proposed operation.** The Borrower will provide confirmation to the World Bank on the amounts deposited in the foreign currency account within 30 days of receiving the funds. The front-end fee for the loan will be covered from the Borrower's own resources.

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

83. **The 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 since November 2019. In addition, data is generally available through the MoF and the central bank's 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 played a similar monitoring role in the past.

84. **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.

85. ***Grievance Redress*.** Communities and individuals who believe that they are adversely affected by specific country policies supported as Prior Actions or tranche release conditions under a World Bank Development Policy Financing may submit complaints to the responsible country authorities, appropriate local/national grievance mechanisms, or the Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed to address pertinent concerns. Project affected communities and individuals may submit their complaint to the Bank's independent Accountability Mechanism (AM). The AM houses the Inspection Panel, which determines whether harm occurred, or could occur, as a result of Bank non-compliance with its policies and procedures, and the Dispute Resolution Service, which provides communities and borrowers with the opportunity to address complaints through dispute resolution. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit *http://www.worldbank.org/GRS*. For information on how to submit complaints to the Bank's Accountability Mechanism, please visit *https://accountability.worldbank.org*.

6. SUMMARY OF RISKS AND MITIGATION

86. **The overall risk rating is moderate.** Among the risk categories, macroeconomic risks are deemed substantial; 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 (Table 6).

87. **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 and headline fiscal deficits, whose consolidation this operation supports. Pressures for increasing public spending in the context of the elections are significant in 2024 and are expected to push the fiscal deficit to at least 6.9 percent of GDP this year, with risks on the upside due to further unforeseen expenditures. These include unplanned wage increases in the public sector, mainly in education, health, and defense. While some of these wage hikes may be justified, they were not included in the initial budget program for 2024. Furthermore, the budget deficit would remain elevated over the medium term in the absence of compensatory fiscal

[31] NBR. 2023. *Annual Reports*. Link.

measures. Such measures, nevertheless, can be identified, as the fiscal consolidation process needs to trim over 4 percent of GDP for the medium term, in order to bring the budget deficit to below 3 percent of GDP. 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 reduce 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 WB's existing and planned engagements will support the implementation of reforms.

Table 6: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	Moderate
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Low
5. Institutional Capacity for Implementation and Sustainability	Moderate
6. Fiduciary	Low
7. Environment and Social	Moderate
8. Stakeholders	Low
9. Other	
Overall	Moderate

ANNEX 1: POLICY AND RESULTS MATRIX

Pillar I: Strengthen fiscal management, inclusion, and green public investment				
SECTOR/AREA	**PRIOR ACTIONS**	**INDICATOR NAME**	**BASELINE (2023)**	**TARGET (2026)**
Pensions reform	**PA#1.** To improve the long-term fiscal sustainability and increase equity of the pensions system, the Borrower has: (i) taken measures to reform the general public pensions, including by ensuring that the pension point value increases by up to the average annual inflation rate plus fifty (50) percent of real wage increases, by eliminating the correction index, and by gradually increasing the retirement age for women to that of men, as evidenced by the enactment of the Law no. 360/2023; and (ii) revised the service pensions regimes to gradually align retirement age and reduce the replacement rate, as evidenced by the enactment of the Law no. 282/2023.	**RI#1.** Proportion of (women/men) pensioners getting old-age pension below or at the minimum pension (Percentage)	Women 29/ Men 13 (2022)	Women 25/ Men 11.50
Improve budget revenue collection	**PA#2.** To increase revenue collection, the Borrower has: (i) reduced the number of products and services to which the reduced value added tax (VAT) rates of five (5) percent and nine (9) percent apply; (ii) introduced the payment of health contributions for the economic sectors that were previously exempt (i.e. construction, agriculture, food) and the payment of personal income tax for the information technology (IT) sector; and (iii) increased excises for tobacco and alcoholic drinks, as evidenced by enactment of the Law no. 296/2023.	**RI#2.** VAT collection increase relative to baseline (Lei) **RI#3.** Additional revenue collected from the reduction of exemptions for constructions, agriculture, food industry and IT relative to baseline (Lei)	0 0	2,000 million *(c. € 400 million)* 4,000 million *(c. € 800 million)*
Decarbonize transport and increase revenues through carbon pricing	**PA#3.** To incentivize green transportation and increase revenue collection, the Borrower has adopted measures to increase excises for fossil fuels, as evidenced by the approval of the Emergency Ordinance no. 115/2023.	**RI#4.** Excises per ton of leaded gasoline (Lei)	2,704	4,000
	PA#4. To incentivize green transportation and increase revenue collection, the Borrower has introduced a new tax policy for vehicles in accordance with the "polluter pays" principle, which includes a new distance-based toll system for heavy duty vehicles (trucks), as evidenced by the enactment of the Law no. 226/2023.	**RI#5.** Revenues raised from the new distance-based toll system (Lei)	0	1,500 million *(c. € 300 million)*
Finance green public investment	**PA#5.** To mobilize resources for green public investment, the Borrower has adopted the framework for sovereign green bonds, as evidenced by the approval of the Government Decision no. 83/2024.	**RI#6.** Sovereign green bonds issued (cumulative, Euro)	0	€ 2,000 million

Pillar II: Promote private financing for the green transition				
Sector/Area	**Prior Actions**	**Indicator name**	**Baseline (2023)**	**Target (2026)**
Green the energy supply	**PA#6.** To enable and incentivize the development of offshore wind farms for the production of renewable electricity in the Romanian exclusive economic zone of the Black Sea, the Borrower has adopted the relevant legislation, including the establishment of the applicable procedures, institutional roles, and the rights and obligations of developers and stakeholders, as evidenced by the enactment of Law no. 121/2024.	**RI#7.** Offshore wind capacity ready to be tendered out to the private sector (MW)	0	1,500
	PA#7. To improve the bankability of new renewable energy projects, the Borrower has developed the secondary legislation defining the governance and functioning of contracts for differences for low-carbon technologies for electricity production, as evidenced by the approval of the Government Decision no. 318/2024.	**RI#8:** New renewable capacity for electricity generation installed (MW)	0	950
	PA#8. To incentivize investments in the production of green hydrogen, the Borrower has approved a state aid mechanism to support investments in electrolyzers for the production of green hydrogen, as evidenced by the adoption of the Order of the Minister of Energy no. 923/2023.	**RI#9:** New renewable capacity contracted for green hydrogen generation (electrolyzers) (MW)	0	60
Enhance energy efficiency	**PA#9.** To facilitate investments in energy efficiency of industries and public institutions through energy service companies (ESCOs) and to develop the ESCOs' market, the Borrower has: (i) established the framework for energy service contracts to increase transparency and ensure energy savings and final customers' rights; and (ii) created the national registry of ESCOs that identifies energy service providers by beneficiaries of energy services, as evidenced by the approval of the Government Decision no. 1329/2023.	**RI#10.** Number of private companies registered in the national database of ESCOs	0	20
	PA#10. To increase mobilization of private investment for energy efficiency in the industrial sector, the Borrower has established the standards for financial instruments supporting energy efficiency in industry, as evidenced by the approval of the Emergency Ordinance no. 119/2023.	**RI#11:** Loans signed for energy efficiency to firms, in amount (Euro)	69 million	170 million
Strengthen the PPP framework	**PA#11.** To increase private capital mobilization in infrastructure, the Borrower has: (i) removed the upper limit for the amount of co-financing by public partners in public-private partnerships (PPP) co-financing structures, as evidenced by the enactment of the Law no. 7/2024; and (ii) simplified the requirements for pre-feasibility and feasibility studies for PPPs and concession arrangements, as evidenced by the approval of the Government Decision no. 1116/2023.	**RI#12.** Number of PPP projects initiated (Number)	0	At least 1

DETAILED RESULTS FRAMEWORK

RESULTS INDICATORS BY PILLAR

Baseline	Closing Period
Pillar 1: Strengthen fiscal management, inclusion, and green public investment	
Proportion of (women/men) pensioners getting old-age pension below or at the minimum pension (Percentage)	
Dec/2022	Dec/2026
Women 29/ Men 13	Women 25/ Men 11.5
VAT collection increase relative to baseline (Lei) (Number)	
Dec/2023	Dec/2026
0	2,000 million
Additional revenue collected from the reduction of exemptions for constructions, agriculture, food industry and IT relative to baseline (Lei) (Number)	
Dec/2023	Dec/2026
0	4,000 million
Excises per ton of leaded gasoline (Lei) (Number)	
Dec/2023	Dec/2026
2,704	4,000
Revenues raised from the new distance-based toll system (Lei) (Number)	
Dec/2023	Dec/2026
0	1,500 million
Sovereign green bonds issued (cumulative, Euro) (Number)	
Dec/2023	Dec/2026
0	2,000 million
Pillar II: Promote private financing for the green transition	
Offshore wind capacity ready to be tendered out to the private sector (Megawatt)	
Dec/2023	Dec/2026
0	1500
New renewable capacity contracted for green hydrogen generation (electrolyzers) (Megawatt)	
Dec/2023	Dec/2026
0	60
New renewable capacity for electricity generation installed (Megawatt)	

Dec/2023	Dec/2026
0	950
Number of private companies registered in the national database of ESCO (Number)	
Dec/2022	Dec/2026
0	20
Loans signed for energy efficiency to firms, in amount (Euro) (Number)	
Dec/2023	Dec/2026
69	170
Number of PPP projects initiated (Number)	
Dec/2023	Dec/2026
0	1

ANNEX 2: FUND RELATIONS ANNEX

Romania—Assessment Letter for the World Bank

April 29, 2024

This letter provides IMF staff's assessment of Romania's macroeconomic conditions, prospects, and policies based on available information as of April 29, 2024. The assessment has been requested in relation to development policy loans by the World Bank.

Recent Developments, Outlook, and Risks

- **Context.** Romania has weathered the economic shocks from the pandemic, Russia's war in Ukraine, and the resulting surges in energy and food prices relatively well. Growth has been fairly robust, in part enabled by Romania's high degree of self-sufficiency in energy and limited trade and financial linkages with Russia and Ukraine, and HICP inflation peaked at lower levels than in regional EU peers. While the intake of refugees from Ukraine has been limited, Romania is playing an increasingly important role in the shipment of Ukrainian grain exports.

- **Growth.** Growth slowed in 2023 to 2.1 percent as consumption weakened due to real income erosion as a result of high inflation, and as external demand remained subdued. Public and private investment, on the other hand, have accelerated further. In 2024, growth is forecast to accelerate to 2.8 percent, driven by rising real wages and external demand, while investment, underpinned by Recovery and Resilience Facility (RRF) funds, remains strong.

- **Inflation.** Core and headline inflation declined to single digits during the second half of 2023, while the policy rate was prudently kept on hold since January 2023. Headline inflation is expected to return gradually to the target band by end-2025. However, ongoing double-digit wage increases (driven by tight labor markets, minimum wage hikes and wage increases for public sector employees), among other factors, can obstruct the normalization of inflation.

- **External.** The current account deficit started to narrow to 7 percent of GDP in 2023, as import price growth slowed down. International reserves rose further, and reserve coverage remains adequate. Going forward, the current account is projected to gradually decline but remain elevated; as in recent years, it is expected to be largely financed by EU funds and direct investments.

- **Fiscal.** The deficit in 2023 reached 5¾ percent of GDP, well above the budgeted level (4½ percent of GDP), mainly due to overly optimistic revenue projections. A newly enacted pension reform (November 2023) makes the pension system fairer and reduces spending in the long run but creates large additional fiscal costs of about 1½ percent of GDP in the coming years. While the fiscal deficit is projected to exceed 6 percent of GDP in 2024 and over the medium term, based on current policies, the authorities intend to reduce the fiscal deficit over the medium term, as expected under the new EU Economic Governance rules. Strong nominal GDP growth helps contain increases in public debt despite high deficits (public debt edged up to 51 percent of GDP in 2023). The last Sovereign Risk and Debt Sustainability Analysis (2023 Article IV) assessed the overall risk of debt distress as moderate.

- **Risks.** The main risks stem from the war in Ukraine, a re-emergence of tensions in Moldova, a possible prolonged weakening of activity across Europe, and an abrupt global slowdown which could undermine growth and capital flows to emerging markets. Continued strong wage growth could complicate monetary policy and further delay the projected fall in core inflation. Finally, in 2024—given the multiple elections—there are risks of unforeseen additional spending and of delays in meeting commitments under the National Recovery and Resilience Plan (NRRP), which could in turn delay the associated inflows of EU funds.

Policy Framework and Settings

- **Effective fiscal consolidation is needed to restore the soundness of government finances.** Fiscal deficits will need to fall below 3 percent of GDP over the medium term to stabilize public debt, which necessitates additional fiscal measures of at least 4 percent of GDP. Last year's fiscal package was a step in the right direction, but more is needed. Efforts to contain non-pension spending and improve tax administration efficiency are welcome, but their potential to contribute to fiscal adjustment is limited, especially over the short run. As Romania's tax revenue is well below the level of peers, there is no realistic way forward without substantial tax policy reform. Key options include reforms of the income tax, value added tax, property tax, and/or green taxes.

- **Tight monetary policy is warranted.** In light of upside risks to inflation from strong wage growth, the policy rate should not be lowered until headline and core inflation are on a firm downward path and on track to reach the tolerance band of the National Bank of Romania's target of 2.5 percent in a timely manner. To absorb external shocks and reduce overvaluation over time, exchange rate flexibility should be gradually increased over the medium term.

- **The banking system maintains strong capital, liquidity, and profitability positions.** Non-performing loans remain low both in international and historical comparison. Nonetheless, emerging financial sector risks—including the increased level of corporate FX borrowing—should be monitored closely.

- **The authorities should advance key structural reforms in line with the commitments under the NRRP.** In addition to fiscal structural reforms, the NRRP also envisages reforms to (i) improve governance, which would in turn help reduce informality and inequality; (ii) improve the management and monitoring SOEs to enhance efficiency and (iii) further the digitization of public administration.

- **Raising labor force participation (LFP) is important in light of Romania's ageing and declining population.** Romania's LFP is among the lowest in the EU. Closing the LFP rate gap to the EU average could ease labor shortages and raise potential GDP by about 6½ percent. Policies should focus on helping women work in the formal economy through better availability of childcare and part-time jobs. Investing in the quality of education—where Romania lags EU peers—would also help raise labor supply and productivity.

IMF Relations

- **Romania currently does not have an IMF-supported program.** A staff visit took place from January 29 to February 1, 2024. The next Article IV mission is expected in early 2025.

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Table 1. Romania: Main Economic Indicators, 2020–29

(Annual percent change, unless otherwise indicated)

	2020	2021	2022	2023 Est.	2024 Projections	2025	2026	2027	2028	2029
NATIONAL ACCOUNTS										
Real GDP (expenditure)	-3.7	5.7	4.6	2.1	2.8	3.6	3.8	3.8	3.6	3.5
Final domestic demand	-2.1	5.5	6.1	4.2	3.1	3.7	3.8	3.8	3.6	3.2
Consumption	-3.0	6.3	6.3	3.4	3.0	3.4	4.0	3.8	3.4	3.1
Private	-3.9	7.2	6.9	4.4	3.1	3.6	4.1	3.8	3.6	3.2
Public	1.1	1.8	3.1	-1.5	2.1	2.5	3.9	3.7	2.5	2.4
Gross fixed capital formation	1.1	2.9	5.6	6.9	3.4	4.8	3.2	4.0	4.0	3.5
Private	-2.7	5.7	5.0	2.7	5.8	5.2	3.6	5.8	5.1	3.9
Public	17.7	-7.3	7.7	24.0	-5.0	3.7	1.6	-3.0	-0.5	1.8
GNFS exports	-9.3	12.5	9.3	-0.3	4.4	6.9	6.2	5.4	5.3	5.3
GNFS imports	-5.2	14.7	9.9	-1.4	5.7	6.6	6.1	5.1	4.9	4.5
Contribution to GDP (percentage points)										
Final domestic demand	-2.2	5.8	6.5	4.5	3.4	4.1	4.2	4.2	3.9	3.5
Net exports	-1.6	-2.1	-1.3	0.7	-1.2	-0.5	-0.6	-0.4	-0.3	0.0
Inventories and statistical discrepancy	0.1	2.1	-0.6	-3.1	0.6	0.0	0.2	0.0	0.0	0.0
Investment (% GDP)	24.5	26.3	26.8	24.0	24.6	24.0	24.3	24.0	23.4	23.2
Public	5.1	4.7	4.9	5.8	4.7	4.8	5.2	4.4	4.1	4.1
Private	19.5	21.6	21.8	18.1	19.9	19.2	19.1	19.6	19.3	19.1
Gross national savings (% GDP)	19.6	19.1	17.6	16.9	17.5	17.1	17.5	17.6	17.3	17.1
Public	-4.5	-2.0	-0.9	0.1	-1.5	-1.7	-1.2	-1.8	-1.7	-1.7
Private	24.1	21.1	18.5	16.7	19.0	18.8	18.8	19.4	19.1	18.8
Potential output	2.9	3.0	3.1	3.1	3.1	3.4	3.6	3.8	3.6	3.5
Output gap (% potential GDP)	-1.6	-0.7	0.7	-0.2	-0.5	-0.4	-0.1	0.0	0.0	0.0
LABOR MARKET										
Labor force (15-64)	-0.4	-6.7	0.9	0.4	1.3	0.7	0.7	0.8	0.9	0.3
Employment	-1.8	-9.0	0.7	0.8	1.4	0.9	1.0	0.9	1.0	0.4
Wages (monthly)	6.4	7.1	11.3	24.9	10.0	7.5	7.0	7.0	7.0	7.0
Unemployment rate (% labor force)	6.1	5.6	5.6	5.6	5.6	5.4	5.2	5.1	5.0	4.9
PRICES										
Consumer prices (avg)	2.6	5.0	13.8	10.4	6.0	4.0	3.3	3.0	3.0	3.0
Consumer prices (eop)	2.1	8.2	16.4	6.6	4.7	3.5	3.0	3.0	3.0	3.1
Core CPI (eop)	3.3	5.8	14.7	8.4	6.6	3.9	3.1	3.0	3.1	3.1
GDP deflator (eop)	4.1	5.4	13.4	9.9	5.4	2.7	2.9	3.0	2.8	2.6
MACRO-FINANCIAL										
Broad money (nominal)	15.3	15.8	6.9	10.7	15.2	12.5	…	…	…	…
Credit to the private sector (real)	3.4	6.1	-3.6	-0.1	1.6	3.9	…	…	…	…
Corporations	3.1	10.7	2.1	3.5	1.5	3.9	…	…	…	…
Households	2.6	1.4	-10.4	-4.9	2.4	4.6	…	…	…	…
GENERAL GOVERNMENT FINANCES (% GDP) 1/										
Revenue	28.6	30.4	31.0	31.5	30.6	31.7	32.0	31.5	31.4	31.4
Expenditure	38.2	37.1	36.8	37.1	36.9	38.1	38.4	37.6	37.3	37.2
Net lending/borrowing	-9.6	-6.7	-5.8	-5.7	-6.3	-6.5	-6.4	-6.2	-5.8	-5.8
Structural balance	-4.9	-7.4	-5.7	-5.6	-5.6	-6.4	-6.4	-6.2	-5.8	-5.8
Structural primary balance	-3.6	-5.9	-3.7	-3.7	-3.4	-4.2	-4.3	-4.0	-3.6	-3.5
Gross debt	49.4	51.7	50.5	50.7	53.0	56.3	59.1	61.4	63.5	65.5
BALANCE OF PAYMENTS										
Current account (% GDP)	-4.9	-7.2	-9.1	-7.1	-7.1	-6.8	-6.7	-6.3	-6.1	-6.0
GNFS exports (% GDP)	36.9	40.6	43.0	39.4	39.0	39.8	40.3	40.8	41.3	42.8
GNFS imports (% GDP)	41.2	46.3	49.6	44.4	44.2	44.4	44.7	44.8	44.9	46.1
Capital account (% GDP)	1.9	2.2	2.5	2.2	1.8	1.8	1.9	1.3	1.3	1.3
Direct investment, net (% GDP)	-1.3	-3.7	-3.1	-2.0	-2.9	-2.8	-2.7	-2.8	-2.8	-2.8
International reserves (stock, bn €)	42.5	45.8	52.3	66.0	71.8	77.3	83.3	89.0	94.5	101.9
% of short-term external debt	127.8	119.9	119.5	146.0	159.0	158.6	164.8	163.7	162.0	162.3
Int'l investment position, net (% GDP)	-47.3	-46.7	-40.4	-40.3	-42.9	-45.5	-47.7	-49.8	-51.9	-53.9
External debt (% GDP)	57.5	56.5	50.3	52.8	54.7	57.0	58.7	60.2	61.7	63.5
MEMORANDUM ITEMS										
Nominal GDP (bn lei)	1,067	1,189	1,410	1,583	1,714	1,825	1,949	2,085	2,220	2,357
Nominal GDP (bn €)	221	242	286	320	343	363	385	410	434	458
Population (million)	19.3	19.2	19.0	19.0	18.9	18.8	18.7	18.6	18.5	18.3
GDP per capita ($)	13,005	14,885	15,791	18,159	19,611	20,964	22,426	23,978	25,513	26,636
Lei/€ (annual avg)	4.84	4.92	4.93	4.95	…	…	…	…	…	…
Real effective exchange rate	1.4	1.0	3.7	4.1	…	…	…	…	…	…

Sources: Authorities' data and IMF staff estimates and projections.

1/ Assumes implementation of additional fiscal measures (related to VAT reform) from 2025 onward.

ANNEX 3: LETTER OF DEVELOPMENT POLICY

MINISTRY OF FINANCE
MINISTER`S OFFICE

Letter of Development Policy

June 17, 2024

Mr. Ajay Banga
President
The World Bank
1818 H Street N.W., Washington D.C., 20433

RE: Romania Fiscal Management and Green Growth Development Policy Loan

Dear Mr. Banga,

The overarching objective of the Government of Romania is to accelerate the convergence of our country with the European Union in living standards and to ensure that all Romanians benefit from this complex but rewarding process. In this context, we would like to express our appreciation for the longstanding support of the World Bank Group to promote key reforms and investments which have greatly benefitted Romania in terms of reducing poverty, boosting productivity and the confidence of the investors in our country, and putting economic growth on a firm, sustainable and inclusive path. Thus, anchored in the process of EU membership, Romania's GDP has grown from 26.4 percent of the EU average (at PPS) in 2000 to 78 percent in 2023, representing one of the fastest convergence trajectories in the EU.

In spite of the strong headwinds triggered by the Russian invasion of neighboring Ukraine and of the adverse regional and global consequences of this aggression, with negative impact on the global prices, trade and growth, Romania has continued to grow, at 4.1 percent in 2022 and 2.1 percent in 2023. This has been achieved by maintaining a high level of public investment in the economy and through shielding, as much as possible, the purchasing power of households and the balance-sheets of companies through targeted measures.

The pandemic crisis and the Russian aggression have put substantial pressure on the budget. However, through dedicated measures, including on the tax policy and administration sides, we have gradually brought down the fiscal deficit from a peak of 9.4 percent of GDP in 2020 to around 6.6 percent in 2023 (ESA classification) and are determined to further reduce it to below 3 percent of GDP in the medium term. In this sense, in the coming period we will launch discussions with the European Commission to agree upon a trajectory for the reduction of the fiscal deficit in line with Romania's membership commitments and the provisions of the new EU Economic Governance Framework and the National Resilience and Recovery Program. In this respect, we are already working with the World Bank at technical level in order to identify the appropriate mix of tax reforms and their calendar for implementation in consistency with strengthening the macroeconomic framework.

Anchored in the NRRP, the Government has launched an ambitious program of structural reforms and investments, which should boost growth prospects in the short and medium term. With technical support from the World Bank and in coordination with the EU, we have implemented a bold public pension reform package to address inequities in the system and put the pension fund on a sustainable long- term path. We have also reformed the service pensions system so that replacement ratios and retirement age gradually converge towards the national pension parameters. While in the short run, the reforms will lead to higher budget expenditure, in the long run the new framework will bring important savings.

In order to collect more revenue to the budget and to address market distortions, starting with January 2024, we have implemented a comprehensive tax policy reform package, including by removing or reducing exemptions and preferential treatment. Reforms in VAT, PIT, health

contributions, excises for alcohol and tobacco, as well as other measures, are expected to bring additional revenue to the budget of at least one percent of GDP per year.

A key priority for the Government is to implement the decarbonization of the of the economy, including by increasing green public investment and putting in place measures to attract significant amounts of EU funds and private investment. Benefiting from technical support from the World Bank, we have designed a modern framework for sovereign green bonds, and, in February 2024, we have successfully issued the first bond in the international markets, raising Euro 2,000 million to finance green activities. We are also in advanced stages of adopting a best practice tagging methodology for green budgeting.

We are determined to decarbonize the energy sector by 2032, including by phasing out coal completely. To achieve this objective, we have taken measures to accelerate the adoption of renewables and target the installation of more than 7,000 MW of clean energy in the coming years. With support from the World Bank Group, we are supporting the development of new technologies. We have recently adopted a modern off-shore wind law, which opens large opportunities for investment in the Black Sea, and implemented a support scheme for investments in green hydrogen, to be expanded with resources from the Modernization Fund. In addition, we are encouraging large investments in energy efficiency for households and companies.

Promoting macroeconomic stability is a priority of our Government. In this respect, we have been working closely with the National Bank of Romania to gradually bring inflation down towards the target of the central bank over the medium term. As global energy prices retreat, we have brought inflation down from a peak of 16.8 percent in November 2022 to 5.9 percent in April 2024. Strengthening public finances is another key reform area. On top of the tax reforms implemented this year, we will continue with additional measures next year and over the medium term in a manner which will allow us to bring the fiscal deficit down to below 3 percentage points of GDP in a socially sustainable manner. To enhance fiscal discipline further, we are also gradually introducing performance-based budgeting, with technical support from the World Bank. In this respect, we have passed regulation so that, starting with 2025, all central government ministries and agencies will have to implement performance-based budgeting based on a unitary methodological framework aligned with best practice. To bring more revenue to the budget and improve the interaction with the taxpayers, we have launched a comprehensive, multi-annual reform of the Tax Agency Administration (ANAF), including through a complex digitalization program.

The Government is resolutely committed to promote the reforms presented above and we strongly believe that they will put Romania's economy on a firm, sustainable and inclusive growth path, boosting the converge with the EU in terms of productivity and living standards.

We will continue to work with the European Union and the World Bank to advance the comprehensive reform agenda outlined.

Yours sincerely,

Marcel-Ioan BOLOȘ

Minister of Finance
Government of Romania

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
		Operation Pillar 1
PA#1.	**Neutral impact**	Anticipated to have neutral or positive impacts on poverty in the short run, and positive welfare impacts in the long run. Existing provisions in the social assistance and pension system would mitigate risks faced by groups who may not have contributed long enough to benefit from the revised points structure.
PA#2.	**Neutral impact**	Negative but contained poverty and distributional impacts. Policy measures implemented between 2021 and 2023 are expected to mitigate negative welfare effects.
PA#3.	**Yes - positive**	Positive long-term impacts on wellbeing, with some potential short-term risk. The systematic indexation of social benefits and expansion of social transfers are expected to partially mitigate the effect of potential price increases.
PA#4.	**Yes - positive**	Positive long-term impacts on wellbeing, with some potential short-term risk. The systematic indexation of social benefits and expansion of social transfers are expected to partially mitigate the effect of potential price increases.
PA#5.	**Yes - positive**	Neutral impact in the short run, with potential positive impact on welfare in the long term.
		Operation Pillar 2
PA#6.	**Yes – positive,** with potential implementation-related negative effects managed through the existing legislation	Positive long-term impact, with some potential short-term risks. To mitigate energy price increases, the Government has introduced heating aid for low-income families. The systematic indexation of social benefits and expansion of social transfers provide further mitigation.
PA#7.	**Yes – positive,** with potential implementation-related negative effects managed through the existing legislation	Positive long-term impact, with some potential short-term risks. To mitigate energy price increases, the Government has introduced heating aid for low-income families. The systematic indexation of social benefits and expansion of social transfers provide further mitigation.
PA#8.	**Yes – positive,** with potential implementation-related negative effects managed through the existing legislation	Positive long-term impact, with some potential short-term risks. To mitigate energy price increases, the Government has introduced heating aid for low-income families. The systematic indexation of social benefits and expansion of social transfers provide further mitigation.
PA#9.	**Yes – positive**	Neutral impact in the short run, with potential positive impacts in the long term.
PA#10.	**Yes – positive,** with potential implementation-related negative effects managed through the existing legislation	Neutral impact in the short run, with potential positive impacts in the long term.
PA#11.	**Yes – positive,** with potential implementation-related negative effects managed through the existing legislation	Neutral impact in the short run, with potential positive impacts in the long term.

PSIA

PA#1: **Eliminating the correction index (PA#1) is expected to make the pension system more equitable, with a neutral or positive effect on poverty in the short term, likely positive welfare impacts in the long term, and contained risks for a small subset of pensioners.** The use of a correction index, combined with a substantial increase in the national gross average wage in 2018, has produced significant inequities in pension income across cohorts retiring at different points in time and contributed to a disincentive to contribute—specifically, to the benefit of those retiring after January 1, 2020. The reform will result in updates to pension payments over time, starting with recalculations for current pensioners. In the short term, the impact on poverty is expected to be neutral or positive—as the law prevents reductions to pensions that are already being paid out, and benefits for those with longer careers will increase. Over an extended time horizon, incentives for workers to extend their careers are expected to reduce aggregate pension

expenditures. Individuals who retire are expected to receive higher pension benefits, while those who remain in the workforce will likely see their incomes exceed pension levels, assuming that lifelong-learning initiatives and healthcare access remain robust. However, the updated pension structure may result in lower pensions for certain categories of new retirees, while certain workers currently eligible for early retirement would have to wait until closer to the statutory retirement age. Moreover, certain retirees with a short history of contributions (for example, due to extended periods of informal employment) might be entitled to a pension income that does not prevent poverty. Two existing provisions mitigate such risk: the minimum pension, for those who have reached the minimum contribution period, and the Minimum Inclusion Income, for those who have not. Effective coordination with social assistance programs will nonetheless be key. Finally, to counteract a potential long-term decrease in pension adequacy, pension reforms should be supported by measures to extend working lives and remove barriers to labor force participation, especially for older workers.

Equalizing the retirement age for men and women (PA#1) is expected to narrow the pension gap between them, fostering gender equality for future generations. Romanian women face a 24.0 percent gap in pension income relative to men, due to several factors: women, on average, have a shorter working life than men (27 years versus 35 years, also due to career interruptions related to family responsibilities, and earlier eligibility for retirement)[32]. Gender gaps in labor market outcomes also play a role.[33] Women also rely on pension income for longer because of their longer life expectancy. Thus, measures under PA#1 that equalize the age at which men and women can retire with full pension benefits, and explicitly account for periods away from the labor market due to childcare in the calculation of such benefits, are expected to help close the gender pension gap for future generations. Furthermore, the reform incentivizes longer careers, which should also contribute to increased pension entitlements for women. However, pension reform should be complemented by measures that incentivize and remove constraints to labor force participation among working-age women. Romania has the largest gender gap in labor force participation in the EU, as women often face barriers linked to caregiving responsibilities and unequal access to employment opportunities. Policies to promote affordable childcare, equal parental leave uptake, flexible working arrangements, and anti-discrimination measures can help boost women's earnings and retirement savings.[34]

Modifications to the service pension regimes (PA#1) are anticipated to facilitate the transition to a fairer pension system, with a neutral impact on poverty. Although specific data on service pension regimes is scarce, households receiving pensions reserved to special categories (e.g., the military, civil servants, as well as war veterans entitled to special indemnities), typically have incomes higher than the national average. Thus, it is unlikely that low-income households will be directly affected by this measure.

PA#2: Increases to certain preferential VAT rates under PA#2 are expected to enhance the progressivity of the VAT regime, contribute to a slight reduction in inequality, and have a muted impact on poverty, while generating health benefits in the medium term. The VAT reform aims to broaden the tax base and raise fiscal revenues, while maintaining reduced rates for certain items. Since January 1st, 2024, the standard VAT rate of 19 percent applies to most food products containing added sugar and to alcohol-free beer, up from 9 percent. The VAT rate for sporting facilities, tourism, and leisure-related transport services increased from 5 percent to 19 percent. The rate applicable to certain high-quality food products, new social housing, and the installation of high-efficiency, low-emission heating systems rose from 5 percent to 9 percent (following up on a previous equivalent increase in the rate on restaurant food and hotel accommodation). Books, newspapers, magazines, and entrance fees for cultural sites maintain a 5 percent VAT rate, while the rate applicable to most food products without added sugar stands at either 5 percent or 9 percent. The VAT regime is set to become less regressive with the reform, as measured by an increasing Kakwani index (from -0.047 to -0.033), since most rate increases apply to goods and services more likely to be consumed by high-income households. An especially low rate on firewood, in particular, will benefit low-income households, who often lack access to central or district heating. Moreover, items such as food, which represents a large share of the poor's consumption basket[35], will still be subject to a 9 percent reduced rate. The rise of VAT rates on specific food items with deleterious impacts on health (in particular, those with high sugar content) is anticipated to induce shifts in consumption patterns that will contribute to improved health outcomes—especially among poorer households, who are more likely to consume such products. The overall impact of the reform is expected to make the VAT slightly more equalizing (with the marginal contribution to redistribution increasing from -0.0076 to -0.0067 Gini points), with an overall limited impact on poverty: before and after the reform, the VAT still contributes to a 3.2 percentage point increase in poverty.

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[32] Source: https://eige.europa.eu/gender-equality-index/2023/domain/work/RO
[33] World Bank 2023a. Gender Assessment 2023 Link
[34] World Bank 2023a. Gender Assessment 2023 Link
[35] In Romania, the first decile allocates approximately 51 percent of its expenditure to food.

Changes in excise taxes on tobacco and alcohol under PA#2 are expected to have a contained impact on poverty in the short run, and positive health and economic effects in the long run. Due to the regressive nature of taxes on tobacco and alcohol, raising them may affect the welfare of low-income households in the short term. However, the impact on poverty and inequality is expected to be contained in the short term due to its relatively small size, relative to household income (Table A.1). In the long term, higher prices of alcohol and tobacco products due to larger excises can deter their consumption, particularly among price-sensitive individuals. This could have significant effects in Romania, where consumption of such products remains high and causes significant public health challenges. In addition to the intrinsic value of improved health and of the human lives saved, averting tobacco- and alcohol-related mortality and morbidity results in lower health expenditure, higher worker productivity, and longer working lives.

Table A.1. Simulated effects of excises on tobacco and alcohol

		Kakwani		Marginal Contribution to Poverty Rate		Marginal Contribution to Redistributive Effect	
Type of Fiscal Measure	Scenario	Baseline	Simulation	Baseline	Simulation (fix line)	Baseline	Simulation
	Excises on tobacco	-0.034	-0.034	-0.0027	-0.0022	-0.0005	-0.0004
Revenue- Based	Excises on alcohol	-0.192	-0.192	-0.0003	-0.0003	-0.0002	-0.0002

Note: The "baseline" values correspond to the simulated effects of changes in PIT exemptions and other tax allowances, VAT, social transfers (including state allowance for children and guaranteed minimum income (GMI), and implicit gas and electricity subsidies between 2021 and 2023, relative to the fiscal framework as of 2021. The "simulation" values consist of the baseline values, plus the simulated effects of changes to excises on tobacco and alcohol. The Kakwani index is commonly used to establish whether the effect of a specific tax or transfer is progressive and is defined as the difference between the concentration coefficient of the tax and the Gini for market income. the marginal contribution of a tax (or transfer) is calculated by taking the difference between the inequality (or poverty) indicator without the tax (or transfer) and with it. Source: World Bank estimates based on 2021 HBS and administrative data, per Commitment to Equity (CEQ) methodology.

Eliminating the PIT exemption for certain employees in the IT sector (PA#2) is expected to increase fiscal revenues, with a muted impact on poverty and inequality. The reform makes the tax system more progressive, as higher earners in the IT sector will contribute a fairer share of their income in taxes. Simulation results show that introducing PIT in the IT sector is expected to slightly increase progressivity as measured by the Kakwani index (increasing from 0.194 to 0.198). Since employees in the IT sector tend to have higher incomes than those in other sectors, the removal of the exemption is unlikely to push a significant number of individuals into poverty. Overall, the marginal contribution to poverty and inequality expected to be only marginally affected (Table A.2).

Table A.2. Simulated effects of removing PIT exemptions in IT sector

		Kakwani		Marginal Contribution to Poverty Rate		Marginal Contribution to Redistributive Effect	
Type of Fiscal Measure	Scenario	Baseline	Simulation	Baseline	Simulation (fix line)	Baseline	Simulation
Revenue- Based	Elimination of PIT exemptions for IT sector	0.194	0.198	-0.0061	-0.0061	0.0086	0.0089

Note: The "baseline" values correspond to the simulated effects of changes in PIT exemptions and other tax allowances, VAT, social transfers (including state allowance for children and GMI), and implicit gas and electricity subsidies between 2021 and 2023, relative to the fiscal framework as of 2021. The "simulation" values consist of the baseline values, plus the simulated effects of changes to the PIT exemption in the IT sector. Source: World Bank estimates based on 2021 HBS and administrative data, per Commitment to Equity (CEQ) methodology.

Requiring the payment of healthcare contributions by workers in previously exempt sectors (PA#2) may have an adverse but contained impact on poverty. The health insurance contribution rate stood at 10 percent from 2020 to 2023, with sectoral exemptions in construction, agriculture, and food processing.[36] CEQ analysis shows that health contributions are progressive and redistributive, but also increase poverty (with a marginal contribution to the poverty rate equal to 1.73 percentage points). PA#2 eliminated the abovementioned sectoral exemption, starting in November 2023. Introducing healthcare contributions in sectors where the working poor are overrepresented may reduce the disposable income of vulnerable households. However, the poverty impact is expected to be contained, as the measure affects a small portion of the poor population, leads to a moderate reduction in disposable income for the

[36] The exemption was applied from 2019 to employees in the construction sector earning less than lei 30,000 per month, and from 2022 to their peers in agriculture and food processing. In August 2022, the wage ceiling to qualify for the exemption dropped to lei 10,000 per month.

affected households, and causes a relatively small percentage of them to fall into poverty.[37] Simulations show that introducing healthcare contributions in exempt sectors would make such contributions slightly less progressive, and cause a modest increase in the poverty rate (Table A.3).

Table A.3. Simulated effects of removing exemptions from healthcare contributions

		Kakwani		Marginal Contribution to Poverty Rate		Marginal Contribution to Redistributive Effect	
Type of Fiscal Measure	**Scenario**	Baseline	Simulation	Baseline	Simulation (fix line)	Baseline	Simulation
Revenue- Based	Removing exemptions for health insurance	0.140	0.139	-0.0173	-0.0178	0.01115	0.01120

Note: The "baseline" values correspond to the simulated effects of changes in PIT exemptions and other tax allowances, VAT, social transfers (including state allowance for children and GMI), and implicit gas and electricity subsidies between 2021 and 2023, as well as of changes in health insurance exemptions between 2021 and October 2023, relative to the fiscal framework as of 2021. The "simulation" values consist of the baseline values, plus the simulated effects of removing health insurance exemptions. Source: World Bank estimates based on 2021 HBS and administrative data, per Commitment to Equity CEQ methodology.

Between 2021 and 2024, the Government enacted a range of fiscal reforms that, although not specifically designed for that purpose, could mitigate the poverty impacts of revenue mobilization measures under PA #2. The social protection system has been increasingly strengthened since 2022. The introduction of the Minimum Inclusion Income (VMI) is expected to enhance the adequacy of benefits and coverage of the poor, while administrative reforms are set to advance targeting efficiency. The use of the social reference indicator (SRI) for indexation purposes is reflected in the benefits tied to it—such as support allowances for families with children, guaranteed minimum income (GMI), and unemployment benefits—in terms of both income thresholds and benefit amounts. Moreover, tax allowances for employees have been expanded, with the maximum deduction ceiling rising by 39 percent, and the maximum deduction itself by 18 percent. Supplementary deductions were introduced for young employees and for parents. In 2022, social insurance contributions for workers in agriculture and the food industry dropped from 25 percent to 21.25 percent. PIT exemptions in IT, construction, agriculture, and the food industry remain, but only for low-wage workers. Finally, the statutory real minimum wage rose significantly. Overall, the fiscal system has become more pro-poor, and slightly more redistributive**.** The reforms considered in the DPL, combined with the abovementioned policy measures, are expected to slightly reduce inequality, with the Gini coefficient based on final income decreasing from 0.281 to 0.277. The poverty rate (measured by consumable income and the AROP line) is projected to decline from 24.3 percent to 21.9 percent—mainly due to the expansion of direct transfers, which nearly offset the burden of direct and indirect taxes for those at the bottom of the income distribution.

Figure A1. Poverty rates (AROP), before and after fiscal policy reforms of 2021-2024 (before=baseline, after=simulation)

Note: The "baseline" values reflect the fiscal system as of 2021. The "simulation" values consist of the baseline plus the simulated effects of policy reforms enacted between 2021 and 2024, including changes in PIT exemptions and other tax allowances, VAT, social transfers

[37] Approximately 1% of households are affected by the policy (i.e., are employed in sectors previously exempt and earn less than lei 10,000 per month), including 6.1 percent of poor households. The policy is anticipated to reduce the disposable income of all affected households (poor and non-poor) by 5.5 percent, but only 3.7 percent of non-poor households are expected to fall below the poverty line as a result.

(including state allowance for children and GMI), implicit gas and electricity subsidies, excises on tobacco and alcohol, and the removal of exemptions from health insurance contributions.

Source: World Bank estimates based on 2021 HBS and administrative data, per CEQ methodology.

PA#3-4: A new tax policy for heavy-duty vehicles (PA#3) and an increase in excises on fuel (PA#4) are expected to have positive effects on public health in the long run, with the potential for contained negative welfare impacts on the poor in the short term. By helping reduce air pollution, PA#3 and PA#4 may lead to improved public health outcomes and lower healthcare costs from respiratory and cardiovascular diseases in the long run. This would particularly benefit Romanians who lack health insurance (currently, 11 percent of the population), who mainly come from poor and marginalized groups.[38] In the short run, despite their progressivity, higher fuel excises have minimal effects on poverty and inequality, due to their small size. However, they may raise transportation costs and, in turn, the prices of certain goods and services, indirectly affecting low-income households. Moreover, the transport industry, which employs about 8 percent of the population, may experience job losses in the short run as a result of PA#3, particularly affecting low-skilled trucking workers.

PA#5: The framework for green bonds (PA#5) is not anticipated to directly influence welfare in the short term, but holds the potential for long-term positive effects, particularly for the poor. If the adoption of green bonds supports investments in environmental sustainability and climate change mitigation/adaptation, it may have a positive long-run impact on the poor—as the latter are often disproportionately affected by natural disasters, experiencing greater wealth and income loss, and suffering the consequences of lower resilience and coping capacity.[39]

PA#6: The development of offshore wind farms (PA#6) offers significant economic and welfare benefits, despite certain associated risks in the short run. This measure could boost the local economy and create skilled jobs across a variety of sectors. In the long run, as offshore wind farms become part of the energy mix, the energy supply could become more stable and affordable for low-income households. However, initial development costs can be high. If they were passed on to consumers, energy prices might increase in the short run, with a negative impact on the poor. Moreover, wind farms may displace fisheries (agriculture, fishing, hunting, and forestry concentrate 71 percent of the working bottom 20 percent), disproportionately affecting poor workers in this sector.

PA#7-8: Support to low-carbon electricity generation (PA#7) and green hydrogen production (PA#8) is expected to have a positive social impact in the long run, with some risk in the short run. PA#7 and PA# can contribute to mitigating climate change, with positive impacts on health and welfare in the long term—particularly for the poor, who are especially exposed to climate-related hazards. Steps to enhance the stability of electricity prices (PA#6) will be beneficial to both electricity producers and final consumers, reducing the impact of future energy crises. Greater financing of renewable energy technologies has the potential to boost employment and stimulate the local economy in the long run. However, low-carbon technologies may initially involve higher upfront costs than those based on fossil fuels. If such costs were passed on to consumers, electricity prices may rise in the short term, disproportionately affecting low-income households.

PA#9-10: The regulation of energy service contracts (PA#9) and the mobilization of private capital for energy efficiency (PA#10) are expected to have a neutral effect on wellbeing in the short run, with potential positive impacts in the long term. Approximately 25 percent of the Romanian population experienced some form of energy poverty in 2021, with households allocating about 8.7 percent of their expenditures to energy. In 2022, 15.2 percent of households struggled to maintain warmth, one of the highest rates in the EU. If the regulation of service contracts generates energy savings (PA#9), it may have a positive long-term impact on the poor, who are more likely to struggle to afford essential energy services. Moreover, attracting private investment to energy efficiency projects (PA#10) in the building sector can contribute to ultimately reducing households' energy bills, and have a positive impact on jobs.

PA#11: 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. The amendments are expected to have neutral impacts on welfare in the short term. In the long run, facilitating PPPs can enhance connectivity, create jobs, and stimulate economic activity—particularly in lagging regions, which suffer from infrastructure gaps largely due to inefficient public investment.[40]

Mitigating the potential rise in energy prices from PA#6, PA#7 and PA#8 requires additional, targeted measures from the Government, especially if electricity price caps are phased out. The Government has already put in place targeted heating subsidies,

[38] State of Health in the EU, Romania, Country Profile 2021, Link
[39] Hallegatte et al 2016.
[40] SCD 2018.

alongside means-tested social transfer programs (such as the VMI) and SRI indexation. The home-heating aid, in particular, is a means-tested cash support for low-income families during the cold season (from November to March).[41] It stands out as a highly progressive program, but its minimal size limits its distributional impact. While the potential extent of energy price increases from PA#6, PA#7 and PA#8 is uncertain, simulations show that a 40 percent rise in energy prices may boost energy poverty[42] by 2.3 percentage points on average—with vulnerable groups (e.g., households receiving municipal support or disability benefits, and elderly single-person households) affected the most. Although energy price caps have been enacted to protect consumers, they often benefit higher-income groups, are less effective than precisely targeted social assistance, and can strain fiscal resources. Simulation results show that targeted income-support approaches are more effective and cost-efficient at mitigating the impact of energy price increases and must be complemented with targeted energy efficiency measures. [43] The EU's Social Climate Fund regulation, effective since June 2023, is expected to help by explicitly targeting vulnerable households, microenterprises, and transport users in the EU affected by energy and transport poverty. [44]

ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

The Pillar I prior actions of this operation are expected to have neutral or positive effects on the environment, forests, and other natural resources.

- PA#3 introduction of a distance-based tolling system for heavy-duty vehicles aligns with the "polluter pays" principle and encourages a shift towards greener transportation methods. By imposing costs based on distance traveled, it incentivizes businesses to optimize routes and reduce unnecessary journeys, potentially leading to significant reductions in carbon emissions and other pollutants from one of the most emission-intensive sectors of the transport industry. This approach also encourages the adoption of more fuel-efficient or alternative fuel vehicles by increasing the cost of operating less efficient ones.
- PA#4 aims to reduce dependency on fossil fuels by increasing excise taxes on gasoline, diesel, and other energy products. This policy encourages the shift towards more sustainable energy sources and supports the adoption of electric vehicles through financial disincentives for using fossil fuels.
- PA#5, which involves the adoption of a framework for green bonds, aims to catalyze investment in sustainable projects by providing a reliable and transparent mechanism for raising capital. This financial instrument helps bridge the funding gap for large-scale environmental projects, supporting Romania's transition to a low-carbon, sustainable economy.
- All other prior actions under this pillar are expected to have neutral effects.

The Pillar II policy and institutional reforms have significant positive effects, while the implementation-related potential negative environmental effects in the medium- to long-term can be mitigated and dealt with by Romania's existing legal framework.

- PA#6 establishes a legislative framework to support the development of offshore wind energy in Romania, a crucial step towards diversifying and decarbonizing the country's energy mix. By facilitating the installation of offshore wind farms in the Black Sea, this prior action directly contributes to increasing the share of renewable energy sources in Romania's total energy consumption. Offshore wind farms are known for their high energy output and reliability compared to other forms of renewable energy. The large-scale deployment of this technology will significantly reduce greenhouse gas emissions, lessen dependency on fossil fuels, and enhance energy security. However, the development of offshore wind farms also presents environmental challenges: (i) marine ecosystem disruption: the installation of turbines involves significant undersea construction, which can disrupt seabed habitats. The noise and vibrations from drilling and placing turbine foundations may harm marine life, particularly sensitive species such as marine mammals and fish that rely on sonar navigation and communication. Turbines might also alter local currents and sediment transport, potentially leading to habitat loss for benthic organisms; (ii) noise pollution: the operation of offshore wind turbines generates continuous noise, which can extend many kilometers underwater. This persistent noise pollution can interfere with the acoustic environment essential for the survival of marine species. For instance, it can affect the breeding and feeding patterns of fish and marine mammals, reducing their ability to detect prey and avoid predators; (iii) birds at risk of collision with turbine blades, which spin at high speeds; while this is more often highlighted in onshore wind farms, offshore installations can also affect bird migration routes, particularly for coastal bird

[41] The benefit entitlement is subject to income and asset testing, and the amount is differentiated by type of heating–centralized system, natural gas or wood, coal, or oil fuel. For heating via centralized system, the benefit amount is calculated as a percentage of the heating bill.
[42] Measured as the share of households whose energy expenditure accounts for more than 10 percent of total expenditure.
[43] Romania Energy Poverty Assessment, forthcoming.
[44] Member States must submit their Social Climate plans by June 2025.

species. The cumulative impact on bird populations over time could be significant if not properly managed; (iv) end-of-life management: the decommissioning and disposal of offshore wind infrastructure could generate waste and have potential environmental impacts if not managed properly. To mitigate all these potential negative effects at the stage of actual investments, it is crucial to conduct thorough environmental impact assessments, consult and engage relevant stakeholders, and implement best practices for operation and end-of-life management of offshore wind infrastructure. Notably, Romania's Environmental Impact Assessment (EIA) regulatory system (to which these investments would be subject) already mandates appropriate mitigation measures including impact assessment, implementation of adequate waste management protocols and supervision, ex-ante identification of protected fauna and flora and impact mitigation plans during construction and operation. In addition, it will be important to implement regular monitoring and evaluation processes for offshore wind infrastructure to track their environmental performance, identify any unforeseen impacts, and adjust as needed.

- PA#7 facilitates the growth of renewable energy projects by establishing a framework for Contracts for Difference (CfDs). By encouraging investment in renewable technologies such as wind, solar, and hydroelectric power, this action directly contributes to a significant reduction in greenhouse gas emissions and dependency on fossil fuels. It supports the broader transition to a sustainable, low-carbon economy, enhancing energy security and promoting technological innovation in the energy sector. However, the implementation of CfDs and the consequent acceleration of renewable energy projects could lead to environmental trade-offs. The construction and operation of new energy facilities can impact local ecosystems, particularly if not carefully planned and managed. Ensuring that renewable energy projects undergo rigorous environmental impact assessments and applying strict ecological mitigation strategies are critical to minimizing these potential negative effects. All the above risks can be mitigated through careful planning and adherence to existing environmental regulations which are aligned with the environmental legal framework of the EU.
- PA#8's introduction of a state aid mechanism to support investments in electrolyzers for the production of green hydrogen represents a significant stride towards fostering a sustainable and low-carbon energy system. Green hydrogen, produced using renewable energy sources, offers a clean alternative to fossil fuels and can significantly reduce carbon emissions in hard-to-decarbonize sectors such as heavy industry and transportation. By providing financial incentives for the development of green hydrogen production facilities, this action not only promotes the adoption of cutting-edge low-carbon technologies but also helps diversify the energy mix and enhances energy security. Additionally, the shift towards green hydrogen could stimulate job creation in new and emerging sectors of the green economy. Despite its benefits, the production of green hydrogen can have potential environmental drawbacks. The process of electrolysis, necessary for producing hydrogen, is highly energy-intensive. If the electricity used is not sourced entirely from renewable energies, the overall reduction in carbon emissions may not be as significant. Furthermore, the construction and operation of new hydrogen production facilities can lead to land use changes, habitat disruption, and potential chemical leaks if not managed properly. Effective regulation, continuous monitoring, and ensuring that the energy used for hydrogen production is genuinely renewable are crucial to mitigating these potential negative impacts. All the above risks can be mitigated through careful planning and adherence to existing environmental regulations which are aligned with the environmental legal framework of the EU.
- PA#9 aims to significantly enhance energy efficiency in Romania by fostering the growth of the ESCO market and developing financial instruments to support energy efficiency projects. By incentivizing the operation of ESCO contracts, this action promotes private sector involvement in reducing energy consumption in both the industrial and building sectors. ESCOs facilitate projects that improve energy efficiency, leading to substantial reductions in energy use and greenhouse gas emissions. This contributes to the decarbonization of Romania's energy sector and aligns with international climate goals.
- PA#10 addresses the establishment of standards for green financial instruments and is designed to boost private investment in energy efficiency within the industrial sector. By creating a clear, standardized framework for these financial tools, the initiative ensures that funds are directed towards projects that significantly reduce energy consumption and greenhouse gas emissions in one of the most energy-intensive sectors of the economy. The improved energy efficiency can contribute to national goals for carbon reduction, aligning with global environmental targets such as the Paris Agreement. While the establishment of these standards is aimed at enhancing energy efficiency, the actual implementation of these projects could have unintended environmental consequences if not carefully managed. The disposal of old industrial equipment might contribute to waste management challenges if not properly handled. Ensuring that the lifecycle impacts of new technologies are considered and that recycling and proper disposal methods are integrated into the projects are vital to minimizing these negative effects. Proper waste management and disposal (legislation for which is in place) will, thus, be important to minimize environmental risks.
- PA#11 aims to significantly boost private investment in Romania's green and social infrastructure sectors. This facilitation of PPPs could accelerate the development of projects related to renewable energy, sustainable transportation, and essential public services like water and sanitation. These infrastructure improvements are vital for climate change mitigation and adaptation, offering substantial environmental benefits such as reduced greenhouse gas emissions, enhanced energy efficiency, and improved resilience to

climate impacts. However, the increase in construction activities associated with rapid infrastructure development could result in habitat disruption, increased pollution, and other local environmental disturbances if not properly managed. All the above risks can be mitigated through careful planning and adherence to existing environmental regulations which are aligned with the environmental legal framework of the EU.

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. Changes have been introduced to permitting and licensing to align the national system with the EU legislation. The relevant authorities have been reorganized and new legislation was introduced for integrated environmental permits. Currently, the existing regulatory framework covers all necessary aspects of conducting Strategic Environmental Assessment (SEA) and EIA in an integrated manner, including the preparation of environmental management plans along with the requirements on information dissemination and public participation in decision making. With the publication in December 2018 of the Law no. 292 on the assessment of the impact of certain public and private projects on the environment, which represents the transposition of EU Directive 2014/52, the mainstreaming of an EIA process into projects is fully harmonized with the EU directives on EIA.

The waste management sector has an advanced environmental policy and legal framework, smoothing the path towards sustainable development, but further strengthening of enforcement and monitoring are still needed. Romania has introduced many of the principles of modern waste management systems, despite the challenging additional tasks for the Government, municipalities, companies and individuals linked to the evolving nature of the EU environmental legislation and policy. Principles of prioritization of waste generation prevention and its reuse or recovery from disposal are anchored in the legal system but implementation needs to be strengthened. Also, weak enforcement and monitoring due to improper allocation of resources, absence of a long-term vision, shared responsibilities across government institutions, and low technical capacity of central and local governments, can undermine effectiveness. However, there are multiple ongoing efforts within the Government to accelerate the transition to a circular economy. Furthermore, Romania plans to use NRRP funds to further improve its waste management governance and accelerate the expansion and modernization of its waste management systems through investments on separate collection, prevention, reduction, re-use and recovery to comply with the applicable EU legislation and transition to the circular economy.

ANNEX 5: PARIS ALIGNMENT ASSESSMENT

Program Development Objective(s) The Program Development Objective (PDO) of the proposed operation is to support the Government of Romania's efforts to: 1) strengthen fiscal management, inclusion and green public investment; and 2) promote private financing for the green transition.	
Step 1: Taking into account our climate analysis (e.g., Country Climate and Development Reports or CCDRs), is the operation consistent with the country climate commitments, including for instance, the NDC, NAP, LTS, and other relevant strategies?	**Yes.** The operation is consistent with the findings of the Romania CCDR,[45] EU updated NDC to the Paris Agreement,[46] Romanian Energy Strategy 2022-2030[47] and the (draft) National Energy and Climate Plan (NECP), Romanian Long-Term Strategy,[48] Romanian Climate Change Adaptation Strategy 2023–2030/2050,[49] the National Energy Efficiency Action Plan[50] and the National Climate Change Strategy 2013–2020.[51] The proposed reforms in several prior actions address some of the main mitigation and adaptation priorities of the country and contribute to climate action.
Mitigation goals: assessing and reducing the risks	
Pillar I: strengthen fiscal management, inclusion and green public investment	Prior Actions 1, 2, 3, 4 and 5
Prior Action 1	To improve the long-term fiscal sustainability and increase equity of the pensions system, the Borrower has: (i) taken measures to reform the general public pensions, including by ensuring that the pension point value increases by up to the average annual inflation rate plus fifty (50) percent of real wage increases, by eliminating the correction index, and by gradually increasing the retirement age for women to that of men, as evidenced by the enactment of the Law no. 360/2023; and (ii) revised the service pensions regimes to gradually align retirement age and reduce the replacement rate, as evidenced by the enactment of the Law no. 282/2023.
Prior Action 2	To increase revenue collection, the Borrower has: (i) reduced the number of products and services to which the reduced value added tax (VAT) rates of five (5) percent and nine (9) percent apply; (ii) introduced the payment of health contributions for the economic sectors that were previously exempt (i.e. construction, agriculture, food) and the payment of personal income tax for the information technology (IT) sector; and (iii) increased excises for tobacco and alcoholic drinks, as evidenced by enactment of the Law no. 296/2023.
Prior Action 3	To incentivize green transportation and increase revenue collection, the Borrower has adopted measures to increase excises for fossil fuels, as evidenced by the approval of the Emergency Ordinance no. 115/2023.
Prior Action 4	To incentivize green transportation and increase revenue collection, the Borrower has introduced a new tax policy for vehicles in accordance with the "polluter pays" principle, which includes a new distance-based toll system for heavy duty vehicles (trucks), as evidenced by the enactment of the Law no. 226/2023.
Prior Action 5	To mobilize resources for green public investment, the Borrower has adopted the framework for sovereign green bonds, as evidenced by the approval of the Government Decision no. 83/2024.
Step M2.1: Are the Prior Actions likely to cause a significant increase in GHG emissions?	**No.** Prior Actions 1 and 2 from Pillar 1 are aimed at strengthening fiscal management and are not increasing GHG emissions. Prior Actions 3, 4 and 5 are aiming at increasing green investments and will contribute to decarbonization and reduction of GHG emissions. All Prior Actions are not likely to cause significant increase of GHG emissions

[45] World Bank. 2023. "Romania Country Climate and Development Report." Link.
[46] EC. 2020. "Submission by Germany and the European Commission on Behalf of the European Union and Its Member States." Link.
[47] https://energie.gov.ro/wp-content/uploads/2022/08/Strategia-2030_DGJRI_AM_12.08.2022_MU_Clean_25.08.2022-1.pdf
[48] Government of Romania. 2023. "Long-Term Strategy." Link.
[49] MEWF. "National Framework." Link.
[50] https://energy.ec.europa.eu/system/files/2023-07/ro_neeap_ro.pdf
[51] Government of Romania. 2013. "National Climate Change Strategy 2013–2020." Link.

	or introduce any persistent barriers to transition to the country's low GHG emissions development pathways.
Conclusion Pillar 1 (Prior Actions 1, 2 , 3, 4 and 5): The reforms within the Pillar 1 are not likely to cause a substantial increase of GHG emissions and are aligned with the mitigation goals of the Paris Agreement.	
Pillar II: promote private financing for the green transition.	Prior Actions 6, 7, 8, 9, 10 and 11
Prior Action 6	To enable and incentivize the development of offshore wind farms for the production of renewable electricity in the Romanian exclusive economic zone of the Black Sea, the Borrower has adopted the relevant legislation, including the establishment of the applicable procedures, institutional roles, and the rights and obligations of developers and stakeholders, as evidenced by the enactment of Law no. 121/2024.
Prior Action 7	To improve the bankability of new renewable energy projects, the Borrower has developed the secondary legislation defining the governance and functioning of contracts for differences for low-carbon technologies for electricity production, as evidenced by the approval of the Government Decision no. 318/2024.
Prior Action 8	To incentivize investments in the production of green hydrogen, the Borrower has approved a state aid mechanism to support investments in electrolyzers for the production of green hydrogen, as evidenced by the adoption of the Order of the Minister of Energy no. 923/2023.
Prior Action 9	To facilitate investments in energy efficiency of industries and public institutions through energy service companies (ESCOs) and to develop the ESCOs' market, the Borrower has: (i) established the framework for energy service contracts to increase transparency and ensure energy savings and final customers' rights; and (ii) created the national registry of ESCOs that identifies energy service providers by beneficiaries of energy services, as evidenced by the approval of the Government Decision no. 1329/2023
Prior Action 10	To increase mobilization of private investment for energy efficiency in the industrial sector, the Borrower has established the standards for financial instruments supporting energy efficiency in industry, as evidenced by the approval of the Emergency Ordinance no. 119/2023.
Prior Action 11	To increase private capital mobilization in infrastructure, the Borrower has: (i) removed the upper limit for the amount of co-financing by public partners in public-private partnerships (PPP) co-financing structures, as evidenced by the enactment of the Law no. 7/2024; and (ii) simplified the requirements for pre-feasibility and feasibility studies for PPPs and concession arrangements, as evidenced by the approval of the Government Decision no. 1116/2023.
Step M2.1: Are the prior actions likely to cause a significant increase in GHG emissions?	**No.** Prior Actions 6,7,8,9 and 10 from Pillar II are aimed at mobilizing private sector investments in climate action, predominantly addressing mitigation. The reforms are not likely to cause significant increase of GHG emissions or introduce any persistent barriers to transition to the country's low GHG emissions development pathways. **Potentially yes.** Prior Action 11 will incentivize PPPs and may cause increase in GHG emissions.
M2.2. Is the prior action likely to introduce or reinforce significant and persistent barriers to transition to the country's low-GHG emissions development pathways?	**No.** The main purpose of the reform under Prior Action 11 is to incentivize private sector participation in renewable energy and social services provision in Romania. No part of the reform will create favorable conditions for investments in carbon-intense sectors that could introduce or reinforce significant and persistent barriers for Romania's transition to low-GHG emissions development pathway. Moreover, all investments will

	be subject to the Decarbonization Law[52] to ensure alignment with the EU norms on mitigation and the mitigation goals of the Paris Agreement. Therefore, this reform will not introduce any persistent barriers to transition to the country's low GHG emissions development pathways.

Conclusion Pillar II (Prior Actions 6,7,8,9,10 and 11): The reforms within the Pillar II are not likely to cause a substantial increase of GHG emissions or introduce any persistent barriers to low-carbon development and are aligned with the mitigation goals of the Paris Agreement.
Conclusion Mitigation Goals for the DPO: The operation is aligned with the mitigation goals of the Paris Agreement

Adaptation and resilience goals: assessing and managing the risks	
Pillar I: Strengthen fiscal management, inclusion, and green public investment	Prior Actions 1, 2, 3, 4
Prior Action 1	To improve the long-term fiscal sustainability and increase equity of the pensions system, the Borrower has: (i) taken measures to reform the general public pensions, including by ensuring that the pension point value increases by up to the average annual inflation rate plus fifty (50) percent of real wage increases, by eliminating the correction index, and by gradually increasing the retirement age for women to that of men, as evidenced by the enactment of the Law no. 360/2023; and (ii) revised the service pensions regimes to gradually align retirement age and reduce the replacement rate, as evidenced by the enactment of the Law no. 282/2023.
Prior Action 2	To increase revenue collection, the Borrower has: (i) reduced the number of products and services to which the reduced value added tax (VAT) rates of five (5) percent and nine (9) percent apply; (ii) introduced the payment of health contributions for the economic sectors that were previously exempt (i.e. construction, agriculture, food) and the payment of personal income tax for the information technology (IT) sector; and (iii) increased excises for tobacco and alcoholic drinks, as evidenced by enactment of the Law no. 296/2023.
Prior Action 3	To incentivize green transportation and increase revenue collection, the Borrower has adopted measures to increase excises for fossil fuels, as evidenced by the approval of the Emergency Ordinance no. 115/2023.
Prior Action 4	To incentivize green transportation and increase revenue collection, the Borrower has introduced a new tax policy for vehicles in accordance with the "polluter pays" principle, which includes a new distance-based toll system for heavy duty vehicles (trucks), as evidenced by the enactment of the Law no. 226/2023.
Prior Action 5	To mobilize resources for green public investment, the Borrower has adopted the framework for sovereign green bonds, as evidenced by the approval of the Government Decision no. 83/2024.
Step A2: Are risks from climate hazards likely to have an adverse effect on the	**No.** The anticipated risks from climate hazards in Romania are unlikely to significantly impact the effectiveness of the reforms in Pillar I. Reform under Prior Action 5 are

[52] The Decarbonization Law no. 334/2022 –supported under *Romania Second Programmatic Inclusive and Green Growth DPF (P178912)*–, includes firm commitments to (i) ban the construction of new energy capacities for the production of electricity based on lignite or coal, (ii) phase out of lignite and coal-fired electricity generation, decommissioning and closing of the entire installed capacity of lignite and coal-fired power (4,920 MW), by December 31, 2032, (iii) stop lignite and coal extraction/production by December 31, 2032, and (iv) execute safety and shutdown works and greening for quarries and mines.

prior action's contribution to the Development Objective(s)?	mobilizing investments also in addressing climate vulnerabilities and are supporting adaptation and strengthening climate resilience.
Conclusion Pillar I (Prior Actions 1,2,3,4 and 5): All Prior Actions from Pillar I are aligned with the adaptation and resilience goals of the Paris Agreement.	
Pillar II: Promote private financing for the green transition	Prior Actions 6, 7, 8, 9, 10 and 11
Prior Action 6	To enable and incentivize the development of offshore wind farms for the production of renewable electricity in the Romanian exclusive economic zone of the Black Sea, the Borrower has adopted the relevant legislation, including the establishment of the applicable procedures, institutional roles, and the rights and obligations of developers and stakeholders, as evidenced by the enactment of Law no. 121/2024.
Prior Action 7	To improve the bankability of new renewable energy projects, the Borrower has developed the secondary legislation defining the governance and functioning of contracts for differences for low-carbon technologies for electricity production, as evidenced by the approval of the Government Decision no. 318/2024.
Prior Action 8	To incentivize investments in the production of green hydrogen, the Borrower has approved a state aid mechanism to support investments in electrolyzers for the production of green hydrogen, as evidenced by the adoption of the Order of the Minister of Energy no. 923/2023.
Prior Action 9	To facilitate investments in energy efficiency of industries and public institutions through energy service companies (ESCOs) and to develop the ESCOs' market, the Borrower has: (i) established the framework for energy service contracts to increase transparency and ensure energy savings and final customers' rights; and (ii) created the national registry of ESCOs that identifies energy service providers by beneficiaries of energy services, as evidenced by the approval of the Government Decision no. 1329/2023.
Prior Action 10	To increase mobilization of private investment for energy efficiency in the industrial sector, the Borrower has established the standards for financial instruments supporting energy efficiency in industry, as evidenced by the approval of the Emergency Ordinance no. 119/2023.
Prior Action 11	To increase private capital mobilization in infrastructure, the Borrower has: (i) removed the upper limit for the amount of co-financing by public partners in public-private partnerships (PPP) co-financing structures, as evidenced by the enactment of the Law no. 7/2024; and (ii) simplified the requirements for pre-feasibility and feasibility studies for PPPs and concession arrangements, as evidenced by the approval of the Government Decision no. 1116/2023.
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	**No.** The anticipated risks from climate hazards in Romania are unlikely to significantly impact the effectiveness of the reforms in Prior Actions 8, 9 and 10 of the Pillar II. **Not likely, but possibly.** The anticipated risks from climate hazards in Romania can impact the effectiveness of the reforms in Prior Actions 6, 7 and 11 of the Pillar II. However, as Romania is a member of the EU, all investments must be aligned with the EU Adaptation Strategy and are also subject to Floods Directive (Directive 2007/60/EC on the assessment and management of flood risks), which mitigate the risk of non-alignment with the adaptation goals of the Paris Agreement for these Prior Actions.
Conclusion Adaptation and Resilience Goals for the DPO: The operation is aligned with the adaptation and resilience goals of the Paris Agreement	
OVERALL CONCLUSION OF PARIS ALIGNMENT ASSESSEMENT: The operation is aligned with the goals of the Paris Agreement	

ANNEX 6: PROPOSED REFORM ACTIONS SUPPORTED UNDER THIS PROGRAM AND ROMANIA CORE DIAGNOSTICS

CCDR recommendations	Selected CPSD/SCD recommendations	Supported by this DPL
Leading narrative of the need for structural reforms to put Romania's growth on an economically and environmentally sustainable path	*CPSD cross-cutting priority#2/ SCD priority#3: Ensure fiscal sustainability*	PA#1-4 of this DPL support critical reforms for medium-term sustainability of key structural drivers of fiscal deficit (pensions) and aids fiscal consolidation through PAs to increase revenues.
Priority 1: Increase electrification and fuel shifts *(with narrative indicating that more than half of the green infrastructure – electricity, transports, and buildings - investments need to come from the private sector)*	CPSD Recommendation (joint for RE and Transport): Strengthen technical capacity and legislative base for project preparation and PPP management. CPSD Recommendation for RE: Encourage private investment in RE *(with specific recommendations to review regulatory and permitting constraints for investments in RES)*	PA#6-8 of this DPL support increasing renewable generation capacity, with increased participation from the private sector, further supported by the PA#11 on PPP framework. PA#3-4, by increasing excises on fossil fuels and introducing tax in line with "polluter pays" principle incentivizes shift to other fuels in transport.
Priority 2: Increase energy efficiency *(again, with focus on private resource mobilization)*	CPSD Recommendation for RE: Encourage private investment in RE *(with specific recommendation for draft policy for long-term contracting of ESCOs through PPP structures and adequate financial instruments*	PA#9-10 supports legislative framework for ESCOs and development of financial instruments for energy efficiency in buildings to attract private investment into energy efficiency.
Priority 3: Strengthen strategic management of water resources		Not supported by this DPO; but the energy PAs support strengthening the sector's resilience to water availability changes induced by CC.
Priority 4: Focus on building and protecting human capital		Not supported by this DPO.
Priority 5: Accelerate decarbonization of transport	CPSD Recommendation for transport: Improve transport infrastructure *(including through PPP pilots for sustainable transport).*	PA#3-4 supports measures to adjust fiscal incentives to support green transition in transport; PA#11 on supports enabling PPP developments, including in sustainable transport.
Priority 6: Improve alignment of fiscal incentives through efficient carbon pricing		PA#3-4 supports increasing excises on fossil fuels and new tax in line with "polluter pays" principle; PA#5 supports green bonds to support green public investment.
Priority 7: Deepen collaboration and coordination across all levels of government		PA#5 mobilizes private resources for public green investments; PA#6-11 by definition aim to mobilize more private investment, including through state aid schemes.

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