SYSTEMATIC COUNTRY DIAGNOSTIC *UPDATE*

ROMANIA

WORLD BANK GROUP

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Cover artwork:
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Photographies:
Photos on pages 12-13, 18-19 and 34-35: ©Nga Thi Viet Nguyen/World Bank. Photo on pages 58-59: ©Jutta Benzenberg/World Bank.

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KEY MESSAGES OF THE ROMANIA SYSTEMATIC COUNTRY DIAGNOSTIC UPDATE

This report is an update to the first comprehensive Romania Systematic Country Diagnostic (SCD), published in 2018, which identified a set of development priorities for Romania to achieve the twin goals of poverty reduction and shared prosperity. While the earlier diagnostic remains largely valid, several emerging themes have become prominent in recent years, bringing both challenges and opportunities for the country to reach the development goals in the medium and long term. These include impacts from the COVID-19 pandemic and Russia's invasion of Ukraine on Romania's economy and people, a drive toward the digital and green transformations, and access to sizable EU funds. Alongside these trends, challenges around demography, institutions, and governance continue to play a crucial role on Romania's development agenda. This report validates the relevance of priorities identified in the SCD 2018, revises the priorities and high-level outcomes based on new evidence, and provides the analytical underpinnings for the next Country Partnership Framework.

Romania continues its economic progress of growth and income convergence, yet the 'tale of two Romanias' persists. The SCD 2018 summarized the overarching narrative of the country's socio-economic development as *A Tale of Two Romanias*: one urban, dynamic, and integrated with the EU; the other rural, poor, and isolated. Five years on, the country has made some progress in addressing constraints to growth as well as in reducing poverty and inequality, despite several unprecedented shocks — such as the COVID-19 pandemic, and Russia's invasion of Ukraine. Romania's growth rate remains among the highest in the EU, boosting convergence in living standards with the average Europeans. However, Romania's poverty rate is still the highest in the EU. Inequality also remains relatively high compared with other EU countries, with sizeable disparities across Romania's regions.

Despite visible progress, several key constraints hold Romania back from ensuring growth that is more inclusive, and more sustainable economically and environmentally. This SCD Update groups them into six broad and interrelated topics:

- Weak institutions and low administrative capacity.
- Ineffective policy implementation and insufficient public expenditure, which contribute to poor and unequal development outcomes.
- A shortage of skilled workforce and labor market frictions, which constrain the labor supply.
- Poor connectivity, a shallow financial sector, and an unfavorable business environment that hold the private sector back.
- The challenges of climate change mitigation and the green transition.
- Low resilience to natural hazards and the effects of climate change.

This SCD Update identifies six High-Level Outcomes (HLOs) to expedite Romania's achievement of the twin goals. The HLOs, if achieved over the next five to ten years, would mark an improvement in the wellbeing of the population, and especially of the poorest and most vulnerable. These are:

(i) a predictable institutional and economic environment for people and businesses;
(ii) equal access to high-quality public services at the central and local levels;
(iii) better health and education outcomes for all;
(iv) favorable conditions for more and better private sector jobs;
(v) climate change mitigation for environmental sustainability of economic activity; and
(vi) resilience to shocks and adaptation to climate change, especially for vulnerable households.

The SCD Update identifies 17 priorities that are conducive to meeting the HLOs and tackling Romania's binding constraints. Multiple priorities can be relevant to different HLOs as the HLOs are complex and interrelated. Table KM.1 summarizes the priorities and their relevance to different HLOs. The reforms proposed in the SCD Update are aligned with those identified in the SCD 2018 but are grouped differently, to highlight their roles in improving the population's living standards and to allow environmental adaptation and mitigation a more visible role given the importance of the green transition and EU funds in national priorities.

TABLE KM.1 High-Level Outcomes and Priorities

High-Level Outcomes	Priorities
I. **Predictable institutional and economic environment for people and businesses**	1. Mitigate the impact of political instability through establishment of medium-to-long-term strategic and spending priorities [HLO2, HLO3, HLO4, HLO5, HLO6] 2. Improve citizens' trust in the state [HLO2, HLO3, HLO4, HLO5, HLO6] 3. Ensure fiscal sustainability [HLO2, HLO3, HLO4, HLO5, HLO6]
II. **Equal access to high-quality public services at central and local levels**	4. Enhance public sector human-resource management to improve public-service delivery [HLO1, HLO3, HLO4, HLO5, HLO6] 5. Increase effectiveness and efficiency of public-service delivery at central and local levels [HLO3, HLO4, HLO5, HLO6] 6. Improve access to quality public infrastructure and services (e.g., transport, digital network, water and sanitation, district heating, solid waste management, social benefits and social services) for the poor, the vulnerable, and those in rural areas [HLO3, HLO4, HLO5, HLO6]
III. **Better health and education outcomes for all**	7. Improve health outcomes and provide equitable access to healthcare services [HLO4] 8. Provide access to quality education for all [HLO4] 9. Strengthen lifelong skills formation, especially for vulnerable groups [HLO4]
IV. **Favorable conditions for more and better private-sector jobs**	10. Close the gaps in transport and other infrastructure for international and domestic connectivity [HLO2] 11. Increase financial intermediation and inclusion [HLO 5, HLO6] 12. Enhance market competition and innovation [HLO5, HLO6]
V. **Climate change mitigation for environmental sustainability of economic activity**	13. Accelerate decarbonization, improve regional interconnections, and ensure energy security [HLO2] 14. Reduce environmental degradation (water, land, atmospheric) [HLO2]
VI. **Resilience to shocks and adaptation to climate change, especially for vulnerable households**	15. Scale-up risk prevention/reduction, and improve preparedness for, response to, and recovery from natural disasters [HLO2] 16. Enhance financial resilience of the public and private sectors to natural disasters [HLO2, HLO4] 17. Safeguard water security, and ensure better prevention of and protection from water-related disasters [HLO2]

Note: Secondary HLOs in brackets.

ACKNOWLEDGEMENTS

This report was prepared by a World Bank Group team led by Nga Thi Viet Nguyen and Emilija Timmis (both Senior Economists), together with team members from across the World Bank Global Practices, the International Finance Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA). The main contributors to specific chapters and background notes are listed below.

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The team thanks Alexandra Calin, Camelia Gusescu, Corina Mirabela Grigore, and Ioana-Alexandra Irimia for their tireless support.

The work was performed under the overall guidance of Gallina Andronova Vincelette (Country Director); Anna Akhalkatsi (Country Manager); Ary Naim (IFC Regional manager); Salman Zaidi (Practice Manager); and Jasmin Chakeri (Practice Manager). The team received advice and support from Reena Badiani-Magnusson (Program Leader, World Bank); Rafael E. De Hoyos Navarro (Program Leader, World Bank), Andrea Liverani (Program Leader, World Bank); and Marc Sadler (Program Leader, World Bank). The team also benefitted from guidance and feedback from the SCD Central Team — Alexandru Cojocaru (Senior Economist) and Samuel Freije-Rodriguez (Lead Economist); and the Operations Policy and Country Services Team — Michael Geiger (Economic Adviser), Kamer Karakurum Ozdemir (Senior Economist), and Karima Saleh (Senior Operations Officer). The team thanks Donato De Rosa, Lars M. Sondergaard, and Emilia Skrok (all Lead Economists), Yeon Soo Kim (Senior Economist), and other colleagues for their insightful comments. Marcello Arrigo edited the report.

The team is grateful to public authorities across Romania for their excellent collaboration during the preparation of this report. Moreover, the team would like to express its gratitude for the great efforts of the Ministry of Finance in providing in-depth review of this report and consolidating feedback from other institutions and agencies on behalf of the Romanian Government.

The SCD Update reflects the views of a diverse range of members of the society across Romania that have shared inputs through an extensive consultation process, which relied on both qualitative and quantitative methods. Throughout 2022, the World Bank held over 50 in-person consultation sessions in Bucharest, other large cities, and smaller localities in Romania, including semi-structured interviews, roundtable discussions, town-hall meetings, and site visits. Over 500 representatives of the public sector — including central and local Government, Parliament, the Presidency, and the National Bank of Romania — as well as of the private sector, academia, donors, civil society organizations, International Financial Institutions, and UN agencies participated in consultations. A subsequent session of in-person consultations was held in Brussels, Belgium, in November 2022, in which the World Bank team met with NGOs, think tanks, foundations, and representatives of the European Commission and the Permanent Representation of Romania to the EU. Additionally, over 1,200 Romanian citizens shared their views through an online questionnaire composed of multiple-choice and open-ended questions. The questionnaire was published on a dedicated webpage entitled “Consultations: Romania Systematic Country Diagnostic Update 2023” and open to the public between September 9 – October 9, 2022. The questionnaire was promoted extensively through the World Bank’s social media channels and during in-person meetings between World Bank teams and stakeholders. The majority of the inputs collected through this extensive consultation process validated the findings of the SCD, and helped calibrate the report to better reflect the stakeholders’ first-hand experience on the ground.

ACRONYMS AND ABBREVIATIONS

ANAF	Tax Administration Agency
ANAR	National Administration “Romanian Waters”
ANOFM	National Public Employment Agency
ANRSC	National Authority for the Regulation of Public Utility Community Services
ATM	Automated Teller Machine
CAP	Common Agricultural Policy
CCDR	Country Climate and Development Report
CGA	Country Gender Assessment
CMU	Country Management Unit
CNAIR	National Company for Administration of Road Infrastructure
CoG	Center of Government
CPSD	Country Private Sector Diagnostic
CVET	Continuing Vocational Education and Training
DRM	Disaster Risk Management
EAPI	Energy Architecture Performance Index
ECA	Europe and Central Asia
ECEC	Early Childhood Education and Care
EGD	European Green Deal
EIB	European Investment Bank
ESIF	European Structural and Investment Funds
EU	European Union
EV	Electric Vehicle
FDI	Foreign Direct Investments
FDP	Forcibly Displaced People
FSPs	Financial Service Providers
FUA	Functional Urban Area
GDP	Gross Domestic Product
GHG	Greenhouse Gas
GNI	Gross National Income
GOR	Government of Romania
HLO	High-Level Outcome
HR	Human Resources
HRM	Human Resources Management
ICT	Information and Communications Technology
IFC	International Finance Corporation
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
ISP	Institutional Strategic Plans
IT	Information Technology
IVET	Initial Vocational Education and Training
LBEI	Local Business Environment Index
LPI	Logistics Performance Index
LULUCF	Land Use, Land-Use Change and Forestry
MFF	Multiannual Financial Framework
MIGA	Multilateral Investment Guarantee Agency
MSMEs	Micro, Small and Medium-sized Enterprises
NBFIs	Nonbank Financial Institutions
NBR	National Bank of Romania
NEET	Not in Education, Employment and Training
NGEU	Next Generation EU
NHIF	National Health Insurance Fund
NIS	National Institute of Statistics
NRRP	National Recovery and Resilience Plan
NUTS	Nomenclature of Territorial Units for Statistics
OECD	Organization for Economic Cooperation and Development
PHC	Primary Healthcare
PIM	Public Investment Management
PIT	Personal Income Tax
PMR	Product Market Regulation
POS	Point of Sale
PPP	Purchasing Power Parity
PPPs	Public-Private Partnership
R&D	Research and Development
R&I	Research and Innovation
RCOA	Romania Court of Accounts
RER	Regular Economic Report
SCD	Systematic Country Diagnostic
SILC	Statistics on Income and Living Conditions
SMEs	Small and Medium-sized Enterprises
SOE	State-Owned Enterprises
TEN-T	Trans-European Transport Network
TFP	Total Factor Productivity
TVET	Technical and Vocational Education and Training
UNHCR	United Nations High Commission for Refugees
VAT	Value-added Tax
VET	Vocational Education and Training
WDI	World Development Indicators
WHO	World Health Organization

EXECUTIVE SUMMARY

Context and emerging trends

Romania's growth rate remains among the highest in the EU, boosting convergence in living standards with the EU average. With annual economic growth averaging 3.8 percent over the past two decades, Romanians' living standards[1] more than doubled from US$12,179 in 2000 to US$30,777 in 2021. Correspondingly, Romania's income per capita (in Purchasing Power Parity) increased from 26.4 percent of the EU average in 2000 to 74.2 percent in 2021. Since the SCD 2018 — which this document updates — Romania's economic growth has showcased substantial resilience in the face of the COVID-19 pandemic, Russia's invasion of Ukraine, and other economic shocks.

Economic growth translated to impressive poverty reduction, but Romania's poverty rate is still the highest in the EU. Between 2014 and 2019, 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 30.0 percent to 11.3 percent, on the back of strong labor markets domestically and across the EU. Much of the poverty reduction stemmed from rising labor and pension incomes linked to tax, minimum wage, and pension reforms, although these measures also put increasing pressure on the public budget. The recent economic impacts of the pandemic, the associated human capital scarring, and the cost-of-living crisis have disproportionately impacted the more vulnerable segments of the population and are slowing down progress in poverty reduction. Today, Romania's poverty rate is still the highest in the EU by far, exceeding that of member states with similar or lower average income per capita — such as Bulgaria, Croatia, Hungary, and Poland.

Inequality in Romania also remains relatively high compared with other EU countries, with sizeable spatial disparities. With a Gini coefficient of equivalized disposable income of 34.3 in 2021, the level of income inequality in Romania is the fourth highest in the EU. About 70 percent of the country's poor live in rural areas. Large rural-urban disparities are visible across the board — from the quality and availability of transport infrastructure and public services to resilience to natural disasters and climate change. Notably, due to shortcomings in rural infrastructure and service delivery, as of 2020 Romania was the only EU country without universal access to piped water.

And so, the "tale of two Romanias" persists. The SCD 2018 summarized the overarching narrative of the country's socio-economic development as *A Tale of Two Romanias*: one urban, dynamic, and integrated with the EU; the other rural, poor, and isolated. Five years on, the country has made some progress in addressing constraints to growth as well as in reducing poverty and inequality, despite several unprecedented shocks — such as the COVID-19 pandemic, and Russia's invasion of Ukraine. However, sizable development gaps remain between urban and rural areas. A substantial improvement in outcomes for citizens and businesses across income groups and regions, aiming to catch up with European standards, will require significant effort.

To stay on the path of income convergence and poverty reduction, future growth needs to be sustainable economically and environmentally, especially as favorable base effects fade. Although rapid on average, Romania's economic growth has been highly volatile, mainly consumption-driven, and associated with major environmental externalities — such as high levels of air pollution in urban areas. Moreover, the supply-side constraints identified in the SCD 2018 continue to hamper Romania's potential. The productivity dividends from the reforms spurred by EU accession have dwindled and would benefit from a reinvigorated boost. Governance and quality of institutions remain the key cross-cutting constraints to productivity growth and better public-service delivery. In the face of limited prospects for sustainable growth and improved living standards, many Romanians — especially those with the skills to advance the country's prospects — left to pursue economic opportunities abroad. Consequently, emigration, labor market fundamentals, and an increasingly acute skills shortage affect the quantity and quality of labor, as well as productivity. Wage increases are decoupled from labor productivity growth, and thus unsustainable as a driver of poverty reduction. Despite more than 15 years of EU membership, infrastructure gaps remain wide relative to Romania's income level, constraining private investment and productivity in key sectors. All these factors can hamper the country's future growth, which faces the combined challenges of becoming more sustainable economically and environmentally, more inclusive, and more resilient to disasters and climate change.

Romania's socio-economic development over the next five to ten years will hinge on seizing opportunities for sustainable growth and job creation, while managing risks that could aggravate existing inequalities and constraints. Two ongoing negative external shocks — scarring from the COVID-19 pandemic, and the repercussions of Russia's invasion of Ukraine — will require continued policy interventions to mitigate their impact on the most vulnerable. In particular, Russia's invasion of Ukraine — in addition to causing security concerns and a humanitarian crisis — has prompted energy security considerations and recessionary pressures, while accelerating the cost-of-living crisis. On the opportunity side, the EU-wide green and digital transitions have the potential to boost productivity and environmental sustainability, but require substantial and efficient investments, as well as careful policy action to mitigate the impact of the transitions on those at risk of being left behind. Unprecedented levels of EU funding are available to help the country address both risks and opportunities but using it effectively will require greater institutional capacity.

Major constraints to sustainable growth and prosperity

Weak institutions and insufficient administrative capacity remain the key constraints. Ineffective public institutions, comparatively low civil-service capacity, and political volatility — including frequent, politically driven government re-organizations — hinder public-service delivery and slow down the pace of reforms. The implementation of key reforms of the public administration has suffered from limited planning and shifting political priorities. Relatively low trust in the state and in the ability of public institutions to deliver services can lower political civic engagement among the population and further hinder progress.

Ineffective policy implementation and insufficient public expenditure contribute to poor and unequal development outcomes. Poor cross-government coordination and lack of alignment between strategic priorities and investments undermine Romania's capacity to absorb EU funds and deliver better public services. Insufficient budget allocation and inefficient spending in health and education also lead to low human capital outcomes relative to other EU countries. Moreover, poor and vulnerable groups, such as those within Roma communities and in rural areas, suffer from major shortcomings in the provision of social services and infrastructure services — e.g., water, sanitation, transport, and energy. In addition, the social benefits system faces fundamental challenges in supporting poor and vulnerable population segments. Spending on social benefits in Romania is below the EU average, the coverage of means-tested social assistance programs is limited, and the impact of social transfers on poverty reduction is the lowest in the EU.

A shortage of skilled workers and other labor market frictions limit the supply of labor. Romania's active population is shrinking — largely due to emigration and low labor force participation — reducing the labor supply and, in turn, potential growth. Inefficiencies in the education system, unfavorable attitudes to lifelong learning, and ineffective vocational training and active labor market policies combined with brain drain cause skills shortages and mismatches, reducing innovation capacity as well as growth and earnings potential. The inequality arising from skills and broader labor market gaps is at risk of widening as a result of the digital and green transitions, which will boost demand for a higher-skilled workforce.

Low connectivity, a shallow financial sector, limited competition and innovation, and an insufficiently favorable business environment hold the private sector back. Infrastructure gaps — largely due to inefficient public investment stemming from institutional weaknesses — impede private-sector development both nationally and, in particular, in lagging regions. Underdeveloped financial markets and lack of capacity in the public sector limit the absorption of vast EU funds and hold back private sector growth and solutions. In addition, Romanian firms underperform their EU peers in product and process innovation, marketing and organizational innovation, R&D expenditure, patent applications, and ICT training. Finally, the business environment is often unpredictable, overregulated, and not conducive to innovation and competition.

Romania remains highly vulnerable to natural hazards and climate change. Although the country has made significant efforts in the last decade to strengthen its institutional framework for disaster response, more needs to be done to mitigate disaster risk and adapt to climate change, as the country remains vulnerable to a wide range of geophysical and climate change-induced disasters — e.g., earthquakes, floods, and droughts — as well as to epidemics/pandemics, and technological accidents. In particular, climate change exacerbates the risk of hydroclimatic hazards, but the country's readiness to adapt is low. The potential resulting damage to natural, physical, and human assets can curtail economic growth while deepening inequality, as poorer counties in Romania are disproportionately impacted by disaster risk.

As an EU member, Romania has committed to rising to the challenge of climate change mitigation and the green transition, while delivering on its development objectives. Romania is a signatory to the European Green Deal and has committed to its two key goals: (i) reducing net greenhouse gas emissions (GHG) by at least 55 percent by 2030, relative to 1990 levels ('Fit for 55'); and (ii) achieving net zero GHG emissions by 2050 ('Net zero'). Meeting these ambitious supranational targets within constrained timelines will require significant national policy action, particularly in key polluting sectors such as energy, transport, industry, and agriculture. The green transition provides an opportunity to place Romania's growth on a more environmentally sustainable path and enhance the country's competitiveness in Europe and beyond. Urban areas, with their concentration of people and economic activity, are expected to be at the forefront of a green, resilient, and inclusive model of development. While the transition would bring long-term benefits in the aggregate — such as improved air quality and fewer premature deaths from air pollution — it may also widen certain existing regional and income inequalities, requiring targeted policy action to ensure its fairness and mitigate its impact on those adversely affected. Considering the long-term approach and multisectoral challenges of the green transition, and the effort of implementing an inclusive economic development agenda, broad institutional strengthening will be paramount.

A way forward for Romania

This SCD identifies six High-Level Outcomes (HLOs) to expedite Romania's achievement of the twin goals — reduced poverty and shared prosperity. The HLOs, if achieved over the next five to ten years, would mark an improvement in the wellbeing of the population, and especially the poorest and most vulnerable. These are (i) predictable institutional and economic environment for people and businesses; (ii) equal access to high-quality public services at central and local government; (iii) better health and education outcomes for all; (iv) favorable conditions for more and better private sector jobs; (v) climate change mitigation for environmental sustainability of economic activity; and (vi) resilience to shocks and adaptation to climate change, especially for vulnerable households. While many HLOs are connected, HLO-1 — Predictable political and economic environment for people and businesses — is the most cross-cutting. This reiterates the key lesson from the SCD 2018: despite impressive economic growth, achieving shared prosperity and sustainable welfare improvements will remain a distant reality if Romania does not address its governance challenges.

The SCD Update identifies 17 priorities that are conducive to meeting the HLOs and tackling Romania's binding constraints. Table ES.1 summarizes the priorities and their relevance to different HLOs. The reforms proposed in the SCD Update are aligned with those identified in the SCD 2018 but are grouped differently, to highlight their roles in improving the population's living standards and to grant emerging priorities — particularly climate change adaptation and mitigation — a more visible role, given the prominence of the green transition (and the associated EU funds) in national and EU-wide policy goals. Each priority maps into and helps progress towards one or multiple HLOs, with mapping presented in Table ES.1.

TABLE ES.1 High-Level Outcomes and Priorities

High-Level Outcomes	Priorities
I. **Predictable institutional and economic environment for people and businesses**	1. Mitigate the impact of political instability through establishment of medium-to-long-term strategic and spending priorities [HLO2, HLO3, HLO4, HLO5, HLO6] 2. Improve citizens' trust in the state [HLO2, HLO3, HLO4, HLO5, HLO6] 3. Ensure fiscal sustainability [HLO2, HLO3, HLO4, HLO5, HLO6]
II. **Equal access to high-quality public services at central and local levels**	4. Enhance public sector human-resource management to improve public-service delivery [HLO1, HLO3, HLO4, HLO5, HLO6] 5. Increase effectiveness and efficiency of public-service delivery at central and local levels [HLO3, HLO4, HLO5, HLO6] 6. Improve access to quality public infrastructure and services (e.g., transport, digital network, water and sanitation, district heating, solid waste management, social benefits and social services) for the poor, the vulnerable, and those in rural areas [HLO3, HLO4, HLO5, HLO6]
III. **Better health and education outcomes for all**	7. Improve health outcomes and provide equitable access to healthcare services [HLO4] 8. Provide access to quality education for all [HLO4] 9. Strengthen lifelong skills formation, especially for vulnerable groups [HLO4]
IV. **Favorable conditions for more and better private-sector jobs**	10. Close the gaps in transport and other infrastructure for international and domestic connectivity [HLO2] 11. Increase financial intermediation and inclusion [HLO 5, HLO6] 12. Enhance market competition and innovation [HLO5, HLO6]
V. **Climate change mitigation for environmental sustainability of economic activity**	13. Accelerate decarbonization, improve regional interconnections, and ensure energy security [HLO2] 14. Reduce environmental degradation (water, land, atmospheric) [HLO2]
VI. **Resilience to shocks and adaptation to climate change, especially for vulnerable households**	15. Scale-up risk prevention/reduction, and improve preparedness for, response to, and recovery from natural disasters [HLO2] 16. Enhance financial resilience of the public and private sectors to natural disasters [HLO2, HLO4] 17. Safeguard water security, and ensure better prevention of and protection from water-related disasters [HLO2]

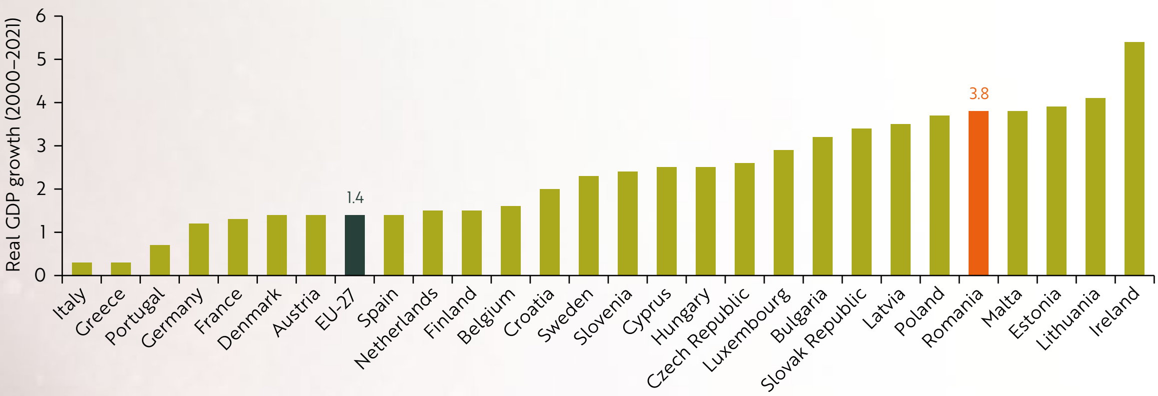
Note: Secondary HLOs in brackets.

1 UPDATED COUNTRY CONTEXT

1.1 RECENT DEVELOPMENTS IN GROWTH, POVERTY REDUCTION, AND SHARED PROSPERITY

Romania's growth rate remains among the highest in the EU, boosting convergence in living standards. With annual economic growth averaging 3.8 percent over the last two decades — nearly triple the EU average (Figure 1.1) — living standards (i.e., real GDP per capita in PPP 2017 international US$) more than doubled from US$12,179 in 2000 to US$30,777 in 2021. Romania's income per capita (in PPP) increased from 26.4 percent of the EU average in 2000 to 74.2 percent in 2021 (Figure 1.2). Growth has also proved resilient in the face of unprecedented external shocks: Romania had one of the shallowest COVID-19-induced recessions in the EU, and the recovery in 2021–2022 was rapid and sustained — even in the onset of the Russia's invasion of Ukraine.

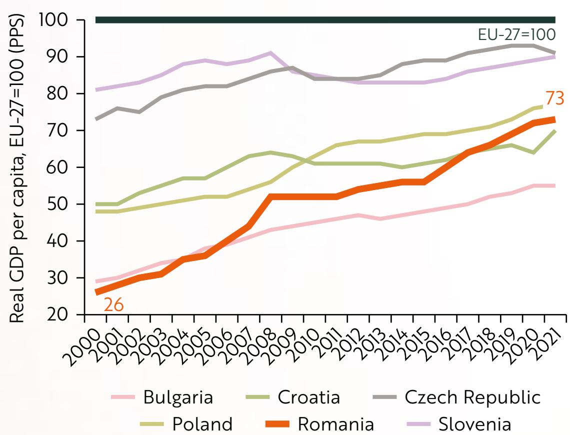
FIGURE 1.1 Economic growth has been among the highest in the EU...



Source: World Bank calculations using EUROSTAT data.

However, the country's growth has been among the most volatile in the EU, and its path and sustainability are in question. Growth remains largely consumption driven, with contributions from both investment (Figure 1.3) and productivity (Figure 1.4) subsiding substantially since the years leading to EU accession. Structural transformation has been shifting the sectoral contribution to growth, characterized by a declining role of agriculture and increased contributions from services. The ICT sector is one of the main contributors to growth and was the eighth largest in the EU as a share of GDP (6.3 percent) as of 2021. As noted

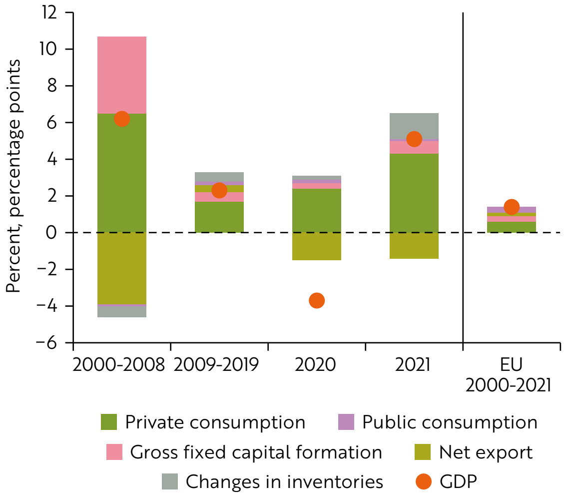
FIGURE 1.2 ...leading to a strong convergence in living standards with the rest of the bloc



Source: Eurostat.

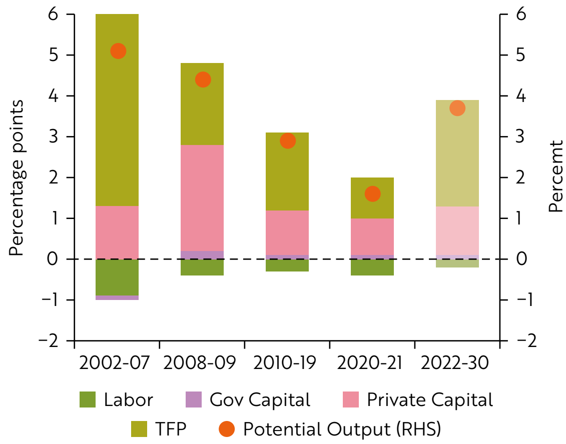
in the SCD 2018, Romania is on a growth path that entails widening macroeconomic imbalances. A procyclical fiscal policy and the narrow base of economic growth, which has been mainly driven by consumption and rising public-sector wages, have resulted in persistent twin deficits (i.e., fiscal and external). Fiscal policy, underpinned by relatively low taxation and limited redistribution, has played a limited role in addressing Romania's inclusion challenges.

FIGURE 1.3 Romania's growth has been largely driven by private consumption



Source: World Bank calculations using EUROSTAT data.

FIGURE 1.4 Productivity and capital accumulation have driven growth, with negative contribution from labor



Source: World Bank calculations and projections, World Bank EU Regular Economic Report 8 (2022).

The supply-side constraints identified in the SCD 2018 continue to limit Romania's growth potential. Governance and quality of institutions remain the key cross-cutting constraints to productivity growth and public-service delivery (see sections 2.1 and 2.2). Migration, labor market fundamentals, and skills shortages affect labor quantity, quality, and productivity (section 2.3). Wage growth is decoupled from productivity growth, while the country grapples with demographic challenges due to an aging, shrinking population and significant outward migration. Despite more than 15 years of EU membership and rising income levels, infrastructure gaps remain wide, constraining private investment and productivity in key sectors (section 2.4). Taken together, these factors have been limiting Romania's growth potential (Figure 1.4). Finally, the country's growth path needs to become more sustainable not only economically, but also environmentally (section 2.5), as well as more resilient to disasters and climate change (section 2.6).

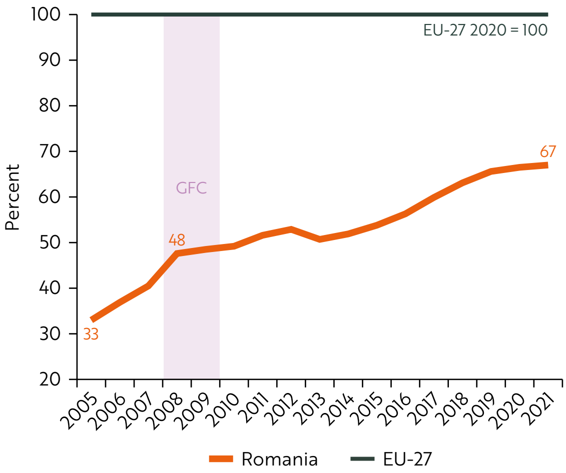
Although total investment levels — driven mostly by the private sector — are comparable to the EU average, they do not fully cover the country's significant investment needs. Romania invested 24.9 percent of its GDP on average every year between 2000 and 2021, with private-sector investment accounting for more than 80 percent of the total. Nevertheless, an unpredictable policy and business environment, alongside a shortage of appropriately skilled workers, has constrained long-term investment.[2]

While more investment is needed to accelerate the convergence with the EU and overcome the middle-income trap,[3] financial markets remain underdeveloped, limiting the private sector's investment potential. Notably, in the run-up to the COVID-19 crisis, the net investment rate of Romanian companies[4] was already four times lower than before the Global Financial Crisis (GFC) of 2008–09. Compounding that, the share of Romanian firms planning to revise their investments downward as a consequence of the pandemic is the largest in the EU (38.3 percent), according to a recent EIB survey.

Romania's labor productivity has been growing on average, but the output gap between micro/small and medium/large firms is the second largest in the EU. Labor productivity grew strongly before the GFC, helping the country reduce the gap with the EU (Figure 1.5), but it has slowed down since. A persistent challenge (despite significant progress) is the performance of micro and small firms, where value added per employee in 2019 amounted to 65 percent of the level recorded in large firms.[5] Companies with fewer than 50 employees account for 98.2 percent of Romanian firms and almost half of total employment, with most large firms clustered in the Bucharest-Ilfov region.[6] Thus, reducing the productivity gap between firms of different size would contribute to both strengthening economic growth, and addressing regional disparities. Annex 1, Box A.1 provides a brief analysis of firm-level productivity in the country.

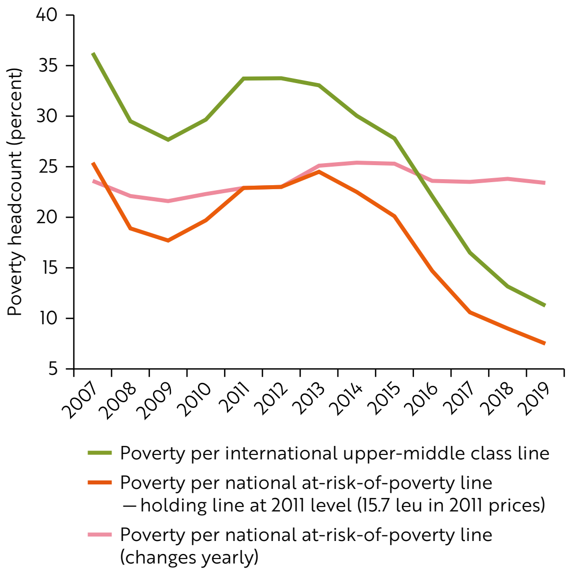
Robust economic growth has translated into impressive progress in poverty reduction, although Romania's poverty rate is still the highest in the EU. Between 2014 and 2019, the share of Romanians living on less than US$6.85 a day (2017 PPP) declined rapidly from 30.0 percent to 11.3 percent, on the back of strong labor markets domestically and in the wider EU (Figure 1.6). Yet, the country's poverty rate remains by far the highest in the EU, exceeding that of countries with similar or lower per capita incomes — e.g., Bulgaria, Croatia, Hungary, and Poland (Figure 1.7). As highlighted in the SCD 2018, the role of the government is crucial in achieving the twin goals — reduced poverty and shared prosperity. Romania's weak governance remains the key binding constraint to government effectiveness and efficiency, and to further progress in growth and poverty reduction (see section 2.1 for a discussion of governance and institutions).

FIGURE 1.5 Labor productivity has been catching up with the EU average, but a 33 percent gap remains



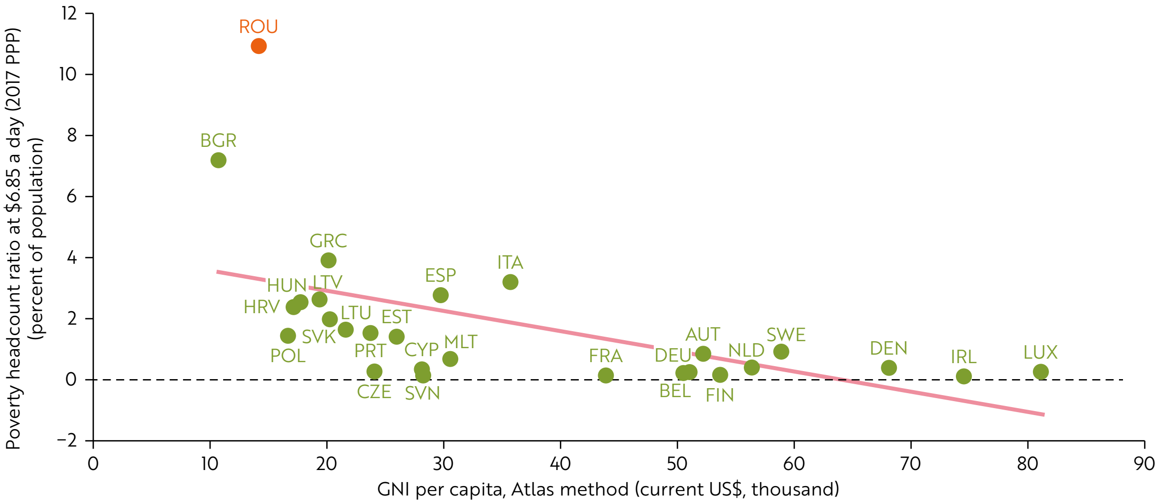
Source: Eurostat. Labor productivity per person employed and hour worked (EU27_2020=100).

FIGURE 1.6 Significant progress has been made in reducing poverty and inequality…



Source: World Bank calculation using EU Statistics on Income and Living Conditions (SILC) 2008–2020.

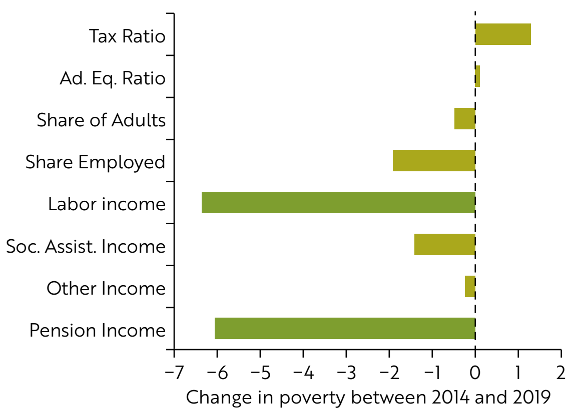
FIGURE 1.7 …but Romania's poverty rate is by far the highest in the EU



Source: World Bank calculation based on WDI and PIP data. Latest poverty rates for EU countries are from SILC 2020, except for Germany, France, Ireland, Italy, and Poland (from 2019). GNI per capita data is from 2021.

Moreover, the strategies that enabled past progress in poverty reduction are structurally unsustainable. Much of the poverty reduction recorded between 2014 and 2019 stemmed from rising labor and pension incomes (Figure 1.8), as a result of tax, minimum wage, and pension reforms. Namely, the flat personal income tax (PIT) rate, social security contributions, and value-added taxes (VAT) were reduced; the coverage of the PIT exemption was expanded; the minimum wage rose; and the pension system was restructured, with the combined effect of lifting many households out of poverty. However, these measures put increasing pressure on the public budget, aggravating its imbalances. In addition, the reductions in PIT and VAT contributed to increasing inequality, as most of the tax relief accrued to households at the top of the income distribution.[7]

FIGURE 1.8 Progress in poverty reduction between 2014 and 2019 was due to rising labor and pension incomes



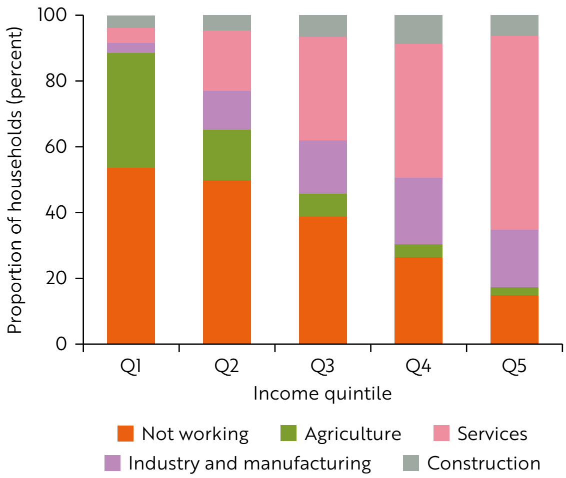
Source: World Bank calculation based on EU SILC 2020 and 2015 data (referring to 2019 and 2014 income years).

Note: Poverty rates are based on at-risk-of-poverty line anchored in 2011 to allow for comparison over time. Marginal contribution to change in poverty rate is in percentage points.

Romania's growth has not been inclusive, as a large share of those in the bottom 40 percent of the income distribution still depend on low-productivity subsistence agriculture. Many poor Romanians have not benefitted from the strong labor market driven by thriving sectors such as manufacturing, trade, and ICT. Nearly half of the adults in the poorest quintile of the income distribution did not work in 2020, while another 38 percent relied on subsistence agriculture (Figure 1.9). Agriculture and agribusiness remain the key sources of income for many poor and rural Romanians, but agricultural labor productivity is the lowest in the EU, and land productivity (measured in output per hectare) is the second lowest.[8] The minimum-wage increases enacted in recent years have also widened the income gaps between informal and formal workers.

The economy has bounced back from the pandemic-induced shock, but fiscal and financial risks remain significant. Romania experienced a sharp contraction in economic output in 2020 (3.7 percent), although the recession was less severe than the EU and ECA averages. The recovery was also swift, with real GDP climbing back to pre-pandemic levels in 2021. However, the crisis caused sizable increases in both the fiscal deficit[9] (9.2 percent of GDP in 2020) and the public debt (46.9 percent of GDP at the end of 2020). The deficit remains high (at 7.1 percent of GDP in 2021), and could push public debt to 50.2 percent of GDP in the medium term,[10] amid rising borrowing costs in a context of high inflation.[11] The banking system's non-performing loans ratio remained low in 2021, at 3.4 percent, although the sector is not immune from risk.[12] Capital flows dropped in 2020, but soared back well above pre-crisis levels at the end of 2021.

FIGURE 1.9 Most Romanians in the bottom income quintiles either do not work, or rely on low-productivity agriculture



Source: World Bank calculation based on EU SILC 2020.

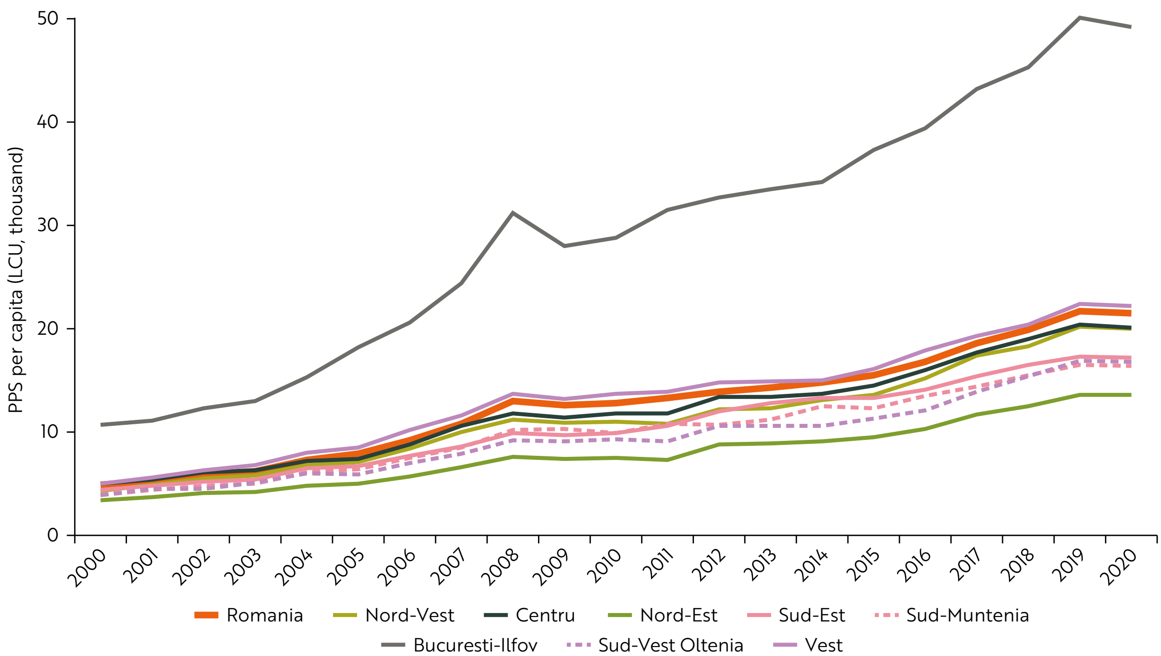
The COVID-19 crisis has disproportionately affected the poor and most vulnerable, and scarred Romania's human capital (see section 1.3 on scarring, and 2.3 on skills). Lower-earning workers, those on non-standard contracts, and women were more affected by employment stoppages during the pandemic. The crisis might also widen gender gaps in labor market outcomes, as Romanian women are over-represented in sectors negatively affected by the pandemic.[13] If not managed well, the pandemic's impact could increase poverty and vulnerability in the long run. In addition, while the pandemic and associated containment measures led to an 18 percent decline in annual sales across Romanian firms on average, the shock affected smaller firms disproportionately, as they had less access to public support and were slower to adopt digital technologies. The COVID-19 crisis could also induce severe losses in learning outcomes: estimates suggest the already high share of functionally illiterate students (41 percent pre-pandemic) may have increased by up to 10 percentage points,[14] thus affecting the future availability of skills in the labor market. Moreover, the crisis highlighted a pre-existing urban-rural divide in access to healthcare. Hospitals struggled to meet the additional need for healthcare services generated by the pandemic and have seen falling levels of admissions, especially among patients suffering from chronic diseases.

Romania faces significant challenges in the short and medium term. Russia's invasion of Ukraine and the ensuing international sanctions have prompted higher inflation, uncertainty, and supply-chain disruption, eroding Romania's short-term growth prospects. The country's capacity to absorb EU funds will be critical to a sustainable, green, and inclusive recovery. The sizable investment and reforms envisioned under the EU's Resilience and Recovery Facility, the multiannual financial framework for 2021–2027, and other EU-funded programs should partially mitigate the impact of higher interest rates and uncertainty on private investment. If implemented, these reforms can meaningfully boost growth and accelerate convergence with the EU (see section 1.3 for more details on EU funds).[15] Rising food and energy prices and declining remittances could entail a longer recovery process for vulnerable population segments. A protracted Russia's invasion of Ukraine may significantly weaken growth and heighten poverty in the short run. Once the recovery is firmly established, cutting down the fiscal deficit — a critical step to prevent a sharp increase in debt levels — will require reforms aimed at reducing inefficient expenditures and strengthening revenue mobilization.

1.2 A TALE OF TWO ROMANIAS

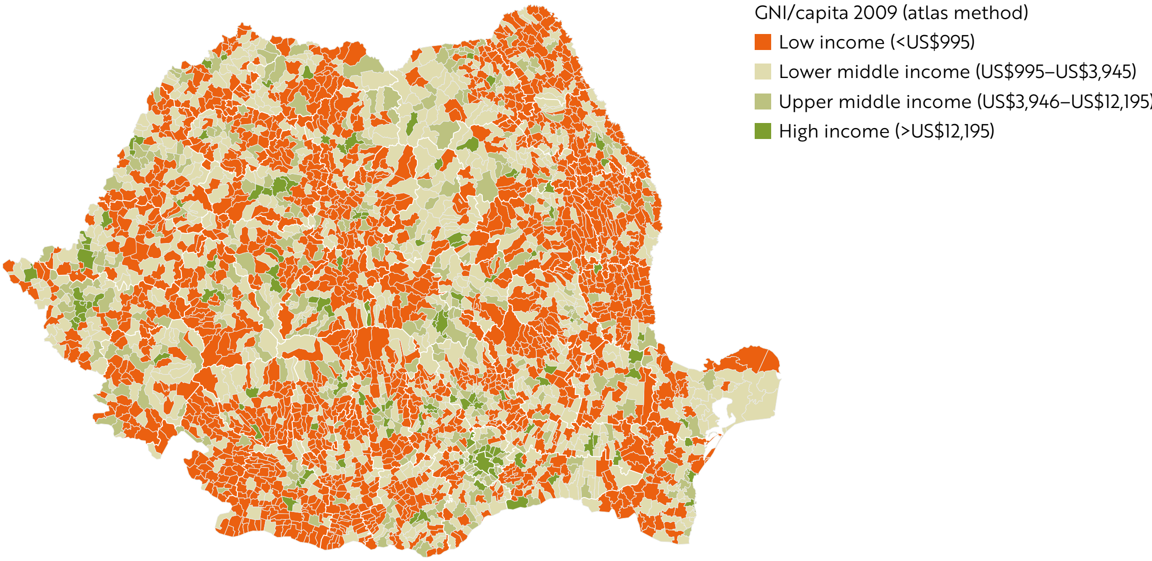
Romania's recent socio-economic development reflects a persistent "tale of two Romanias": one urban, dynamic, and integrated with the EU; the other rural, poor, and isolated as illustrated in the SCD 2018 (see Annex 1, Box A.2 for a summary of findings from the SCD 2018). While Romania is, overall, a high-income economy,[16] income levels vary widely across the country. On the one hand, Bucharest and the surrounding Ilfov county have experienced booming growth, with income per capita exceeding the EU average since 2007 (Figure 1.10). Other large and dynamic cities — including Brasov, Cluj, Constanta, and Timisoara — have also become prosperous centers for business, innovation, and culture. On the other hand, GNI per capita in vast rural areas, particularly those that are far away from a dynamic urban center, is on the level of a low-income country (Figure 1.11).[17] (See Annex 1, Box A.3 for the importance of urban areas and secondary cities).

FIGURE 1.10 Income per capita in the Bucharest-Ilfov region is by far the highest in the country



Source: Eurostat 2022.

FIGURE 1.11 Despite Romania being a high-income country, vast rural areas have low-income status

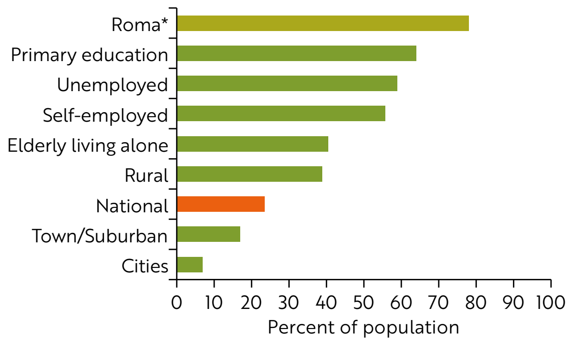


Source: NIS.

While the combined effects of taxes and social spending help to substantially reduce inequality in Romania, inequality remains relatively high compared with other EU countries. With a Gini coefficient of equivalized disposable income of 34.3 in 2021, Romania has the fourth-highest level of income inequality in the EU, after Bulgaria, Lithuania, and Latvia. Redistributive efforts through taxes and social spending are relatively large in Romania compared with developing countries, but lower than in other countries in Europe (with most of the reduction in inequality in Romania being achieved by pensions).[18] Inequality in income across population groups is also large: the unemployed, self-employed workers, and elderly people who live alone are significantly more exposed to poverty (Figure 1.12).[19] A growing sense of widespread poverty and inequality has been straining Romania's social contract: 76 percent of Romanians identify a lack of social rights as a serious problem, while 59 percent deem improving the standards of living the most important element for achieving social and economic development in the EU.[20]

Poverty is highly concentrated in rural areas, which host approximately 70 percent of Romania's poor. The national at-risk-of-poverty rates in rural areas are nearly six times higher than in cities (Figure 1.12). Disparities in living standards are large: in 2019, average income per capita in urban areas was more than 60 percent higher than in rural areas — a large gap that has remained stubbornly stable over the past decade.[21]

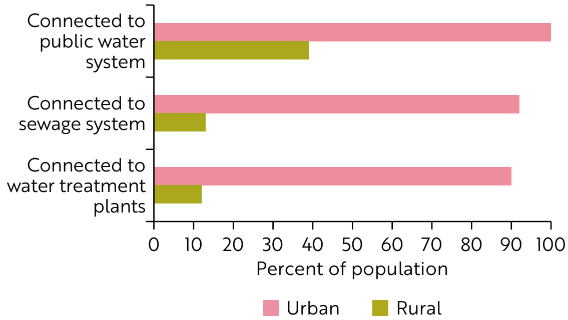
FIGURE 1.12 The at-risk-of-poverty rate is highest among people living in rural areas, unemployed, self-employed, elderly, or with low education



Source: World Bank calculation based on EU Statistic of Income and Living Conditions 2020; *Roma poverty is based on EU Agency for Fundamental Rights 2022, which might not be fully comparable to the national poverty rate based on EU SILC 2020.

The urban-rural divide is also visible in public services. As of 2020, Romania was the only EU country without universal access to piped water. While water services reach nearly 100 percent of the urban population, only 39 percent and 15 percent of the rural population is connected to the water supply and the wastewater system, respectively (Figure 1.13).[22] In terms of transport infrastructure, the 2019 Global Competitiveness Report indicates that despite large public investments boosted by EU funds, Romanian regions are poorly interconnected, with a transport infrastructure competitiveness index far below the EU average. Socio-economic resilience to disasters and climate change is also unequal, with the level of disaster resilience among the poor amounting to less than one-quarter the national average.[23]

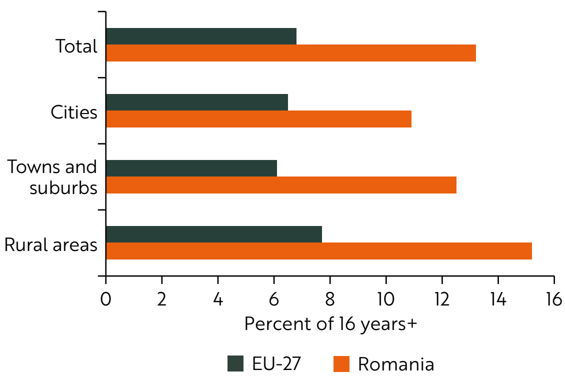
FIGURE 1.13 The urban-rural divide in access to basic water and sewerage services is stark



Source: INS Databases, 2021 and 2020.

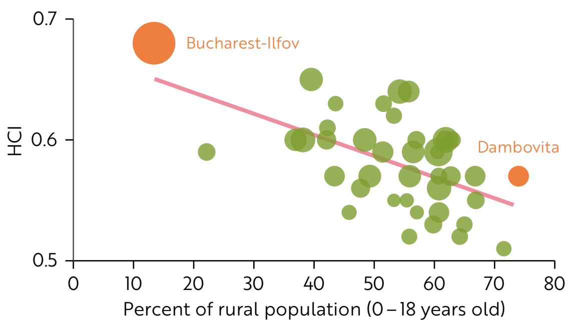
Stark inequalities in service delivery have caused disparity in human development outcomes. 15.2 percent of the population in rural areas reports having unmet medical needs, a significantly greater share than in cities (10.9 percent) (Figure 1.14). Health levels vary across income groups, with a higher prevalence of chronic diseases at the bottom of the income distribution: for example, the likelihood of high blood pressure is nearly twice as high among the poorest (19 percent) than among their better-off peers (10 percent).[24] According to the National Health Insurance House 2020, 15 percent of the country's population has no health insurance, and the share is larger in the lowest quintiles of the income distribution. The disparity in educational outcomes is also wide: to close the learning gap with their peers in Bucharest-Ilfov (as measured by harmonized test scores), students in the rest of the country would need, on average, more than two years of additional schooling.[25] In addition, the county-level Human Capital Index (HCI) score in Bucharest-Ilfov is 0.68, but drops to 0.51 in neighboring Giurgiu — indicating a nearly 20 percent gap in potential productivity between children born in the two counties (Figure 1.15).

FIGURE 1.14 Self-reported unmet needs for medical examination in rural, suburban, and urban areas, Romania and EU-27, 2020



Source: Eurostat, 2021.

FIGURE 1.15 Human Capital Index scores are positively correlated with the level of urbanization



Source: World Bank (2020).

Note: The size of the bubbles represents the total population (0 – 17 years old) in each county. R^2 = 0.3022.

Romania lags its regional peers on financial inclusion, particularly in rural areas. More than 30 percent of adult Romanians are unbanked (one of the highest percentages in the EU), and the share of underserved population is even higher in rural areas.[26] The payments infrastructure (e.g., ATMs and POS terminals) is underdeveloped, and digital financial services, while growing, are still nascent. Moreover, internal differences in business development opportunities are glaring: on the Local Business Environment Index,[27] Bucharest's score is nearly seven times as high as that of the lowest-scoring location, Vaslui.

1.3 EMERGING RISKS AND OPPORTUNITIES FOR SUSTAINABLE AND EQUITABLE GROWTH

Romania's socio-economic development over the next five to ten years will hinge on seizing opportunities for economically and environmentally sustainable growth and job creation, while managing risks that could aggravate existing inequalities and constraints. First, two ongoing negative external shocks — scarring from the COVID-19 pandemic, and the repercussions of Russia's invasion of Ukraine — will require continued policy interventions to mitigate their impact on the most vulnerable. Second, the EU-wide green and digital transitions have the potential to boost productivity and environmental sustainability, but require substantial and efficient investments, as well as careful policy action to mitigate the impact of the transitions on those at risk of being left behind. Unprecedented levels of EU funding are available to help the country adjust to such developments but using it effectively will require greater institutional capacity.

Scarring from the COVID-19 pandemic

The COVID-19 pandemic has left lingering economic and social scars. Although the pandemic-induced recession in Romania was one of the mildest in Europe, it has nonetheless left sizeable scars, especially on public finances and educational outcomes. Fiscal support to households and firms, while limited compared with EU peers, increased the fiscal deficits; in turn, the public debt rose significantly, from a relatively low 35.1 percent of GDP in 2019 to 48.9 percent of GDP in 2021. Pre-pandemic, the estimated functional illiteracy rate among 15-year-olds was 41 percent; post-pandemic, the new estimated rate is 50 percent, with a disproportionate impact on those already vulnerable. Moreover, nearly half of all households report increased financial difficulties, even with containment measures long lifted and an economic recovery underway.[28]

If not addressed and mitigated, these scars can jeopardize growth and inclusion. In a context of rising global borrowing costs, higher debt will limit fiscal space. At the same time, learning losses hinder skills formation among young people that will enter the labor force over the next decade, and risk holding back Romania's growth potential, its ability to benefit from the green transition, as well as hopes for reducing inequality. Concerns about future COVID-19 breakouts and potential containment measures remain, especially as the vaccination rate is among the lowest in the EU — 42.4 percent of the population has received the primary course (with virtually no uptake in many poorer counties), versus the EU average of 72.6 percent (see section 2.2 for further discussion of the economic impact of such scarring).[29] The inclusion challenges coming at the time of the fast-rising debt level highlight that fiscal consolidation is inevitable, but will need to strike a balance with preserving growth and mitigating negative impacts on the poor.

Impact of Russia's invasion of Ukraine

Flows of forcibly displaced people (FDPs) from Ukraine into Romania were largely transitory in 2022, but still require action from the government considering their unprecedented pace and size. Over a quarter of Ukraine's population is estimated to have fled their homes since February 24, 2022, making this the fastest-growing refugee crisis since World War II. About 8 million Ukrainian FDPs have been recorded across Europe, while the UNHCR estimates that Romania[30] has received the second-largest number of them (after Poland), with over 3.0 million arrivals — about 100,000 of which were still in the country as of February 2023.[31] [32] Most FDPs are women and children, and many suffer from serious health conditions or disabilities. A potential escalation of hostilities in Ukraine could swell the inflow of FDPs, testing Romania's capacity to accommodate them and adding to fiscal pressures. Over the medium term, the economic impact of the influx of FDPs will depend on their demographic characteristics. If they remain in the country, and appropriate action is taken to help them integrate and support host communities, Ukrainian migrants could boost the labor supply and bolster labor's contribution to growth.

Romania is among the more resilient EU member states on the energy front, due to limited reliance on Russian energy imports and the availability of domestic gas supplies. However, Romania has been a net energy importer since 2019 (see section 2.5). The country did set ambitious objectives for energy security, aiming to decrease its energy dependency (i.e., dependency on non-EU imports related to energy) to 68 percent by 2030, instead of the 77 percent previously aimed for under the Energy and Climate plan. Energy security objectives are aligned with green transition objectives in the medium term, although bridge measures that increase emissions might be necessary in the short term.

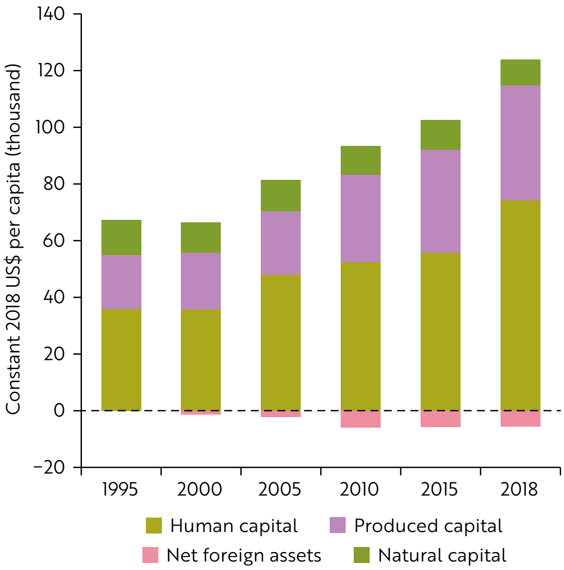
The spillovers of Russia's invasion of Ukraine have accelerated inflation, created additional fiscal pressures, and slowed down economic growth and poverty reduction. The poorest 40 percent of households already spent more than half of their income on energy, food, and housing prior to the recent rise in inflation, which is likely to weigh on consumption, increase poverty, and raise concerns about food security. The government has stepped in to limit the rise in energy tariffs for households and firms, but the measures (primarily price caps) have not been targeted, add to already elevated fiscal pressure, and might deter behavioral responses focused on energy efficiency and savings. Greater uncertainty which discourages investment, coupled with a slowdown in the European economy and domestic demand, tempers near-term growth prospects and increases the urgency of structural reforms to boost medium-term growth.

Green transition

As an EU member, Romania is a signatory to the European Green Deal (EGD), with firm decarbonization targets and timelines. The EGD has advanced regional ambitions for climate mitigation and adaptation measures, while highlighting the need for an equitable transition. At the heart of the EGD are the firm targets of (i) reducing net GHG emissions by at least 55 percent by 2030, compared with 1990 levels ('Fit for 55'); and (ii) achieving net zero GHG emission by 2050 ('Net zero'). Please see Annex 1, Box A.4 for an overview of the green transition.

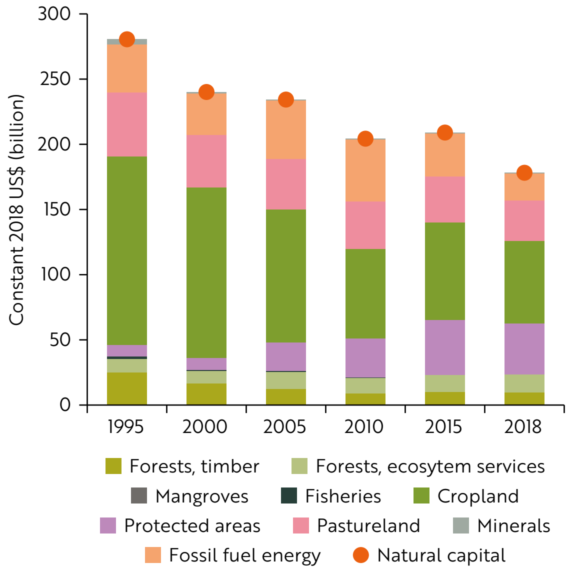
The green transition provides an opportunity to put Romania's growth on a more environmentally sustainable path. While the country's economic wealth has grown significantly over the past decade (Figure 1.16), its natural capital has been in steady decline (Figure 1.17).[33] Using resources efficiently has a direct impact on productivity and competitiveness. Over the last two decades, OECD countries have increasingly disentangled economic growth from energy intensity by investing in energy-efficient technologies. Although Romania is responsible for a modest and declining share of the EU's GHG emissions, reaching net zero requires substantial investments and broader policy action, at both the national and subnational levels (see section 2.5). Delivering on the decarbonization targets along with Romania's development objectives will also require substantial institutional strengthening and yet more focus on long-term planning.

FIGURE 1.16 While Romania's overall wealth has seen a robust upward trend…



Source: Calculations based on World Bank Changing Wealth of Nations (2021).

FIGURE 1.17 …its natural capital has declined over time, calling for a more sustainable growth model



Source: Calculations based on World Bank Changing Wealth of Nations (2021).

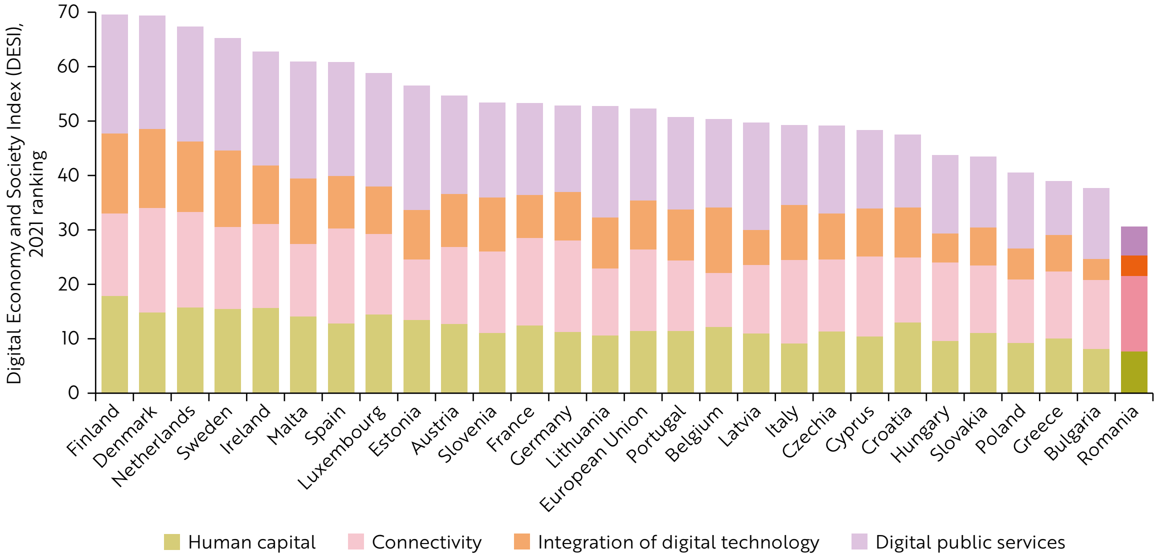
The green transition carries risks that may deepen regional and income inequalities, requiring policy action to protect those adversely affected and ensure that changes are managed in a just and equitable fashion. Climate mitigation action may disproportionately affect regions where polluting activities (e.g., the coal industry) are concentrated, as well as specific occupations, skills, or income groups, as the economy undergoes structural change. New, greener industries may require labor mobility and skills upgrading. The increase in carbon prices can have a broadly positive but uneven impact on employment, and an adverse impact on the poor,[34] requiring compensatory measures and Active Labor Market Policies (ALMP) to reskill the affected labor force.

At the same time, the increasing risk of natural hazards due to climate change makes it necessary to take adaptation action and build resilience. As articulated in the SCD 2018, Romania is at risk from a range of hazards, including natural disasters (e.g., earthquakes, floods, and droughts), epidemics/pandemics, and technological accidents. Higher temperatures and increasing rainfall variability cause more intense and frequent flood and drought events, affecting water supply, agriculture, energy, and transport. The potential damage to natural, physical, and human assets from natural disasters can curtail economic growth, jeopardize fiscal sustainability, and affect the well-being of Romania's population — especially in poorer counties. The financial sector is also significantly exposed to climate-related risks: about 50 percent of the loan portfolio of the country's banks is with companies affected by transition and physical risks, especially in the agricultural sector. See section 2.6 and the forthcoming Romania Country Climate and Development Report (CCDR) for a more detailed discussion.

Digitalization

Digitalizing the economy and public services — a priority highlighted by the COVID-19 pandemic — offers opportunities to raise productivity, create new jobs, and tap into novel global value chains. Digital platforms are reshaping relationships between citizens and governments, customers and businesses, workers and employers. At the same time, digitization has the potential to cause job displacements and losses, while leaving those ill-equipped to benefit from it further behind.

FIGURE 1.18 Romania is lagging the rest of the EU on digitalization



Source: DESI Eurostat

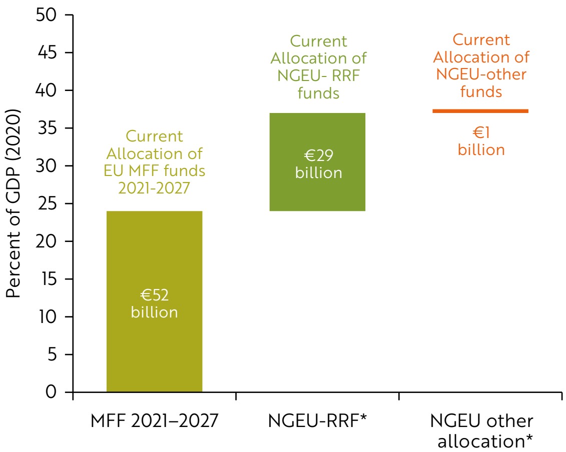
Romania is lagging the rest of the EU on digitization.[35] Digital connectivity is relatively good and above the EU average, due to the wide availability of fixed high-capacity broadband networks (see section 2.4). However, the national average hides large regional disparities: although urban areas enjoy 82 percent coverage by fast-broadband services (above 30 Mbps), and 49 percent of Romanian homes (mostly in cities) subscribe to ultrafast (at least 100 Mbps) broadband — the fifth-highest share in the EU — rural areas are trailing behind. Despite a relatively extensive network coverage, consumer uptake of broadband and use of internet services remain among the lowest in the EU, with 18 percent of individuals aged 16–74 having never used the internet (versus the EU average of 9 percent). Furthermore, those who use the internet mainly do so for communication and entertainment purposes, rather than for activities such as online banking or education. Overall, Romania ranks last in the EU on the Digital Economy and Society Index, which accounts for a range of indicators on digital skills, connectivity, integration of digital technologies in economic activity, and digital public services.[36]

Romania's digital deficit risks deepening existing inequality between regions and population groups, while limiting the country's ability to reap the benefits of digitalization. Less than a third of Romanians have at least basic digital skills (versus the EU average of 58 percent), with a considerable urban-rural wedge (see section 2.3). The adoption of digital technologies by Romanian firms is considerably lower than in most EU member states, especially among smaller companies: in 2021, Romania had the lowest share of SMEs with at least a basic level of digital intensity in the EU. [37] There are signs of positive change: the share of Romanian firms engaging in e-commerce is on par with the EU average (17.3 percent) and has more than doubled since the beginning of the pandemic.[38] However, a shortage of appropriate skills is a challenge. Among Romanian firms, adopters of Industry 4.0 (I4.0) technologies generate on average 8 percent more value added per hour worked than non-adopters, a gain equivalent to less than half the EU average. The limited size of productivity gains among I4.0 adopters in Romania suggests that a scarcity of skilled workers constrains the intensity in the use of such technologies, relative to regional peers.

EU funds — growing in scale and advancing in new thematic areas

To boost its growth, inclusion, and sustainability agenda, Romania has access to EU funds on an unprecedented scale, equivalent to about 37 percent of its GDP over the next five years. The regular allocation of structural EU funds from the Multiannual Financial Framework (MFF) for 2021–2027, under the bloc's cohesion and common agricultural policies, amounts to 24 percent of Romania's GDP (Figure 1.19) — a sizeable increase from 16 percent in 2014–2020 (Figure 1.20). In addition, Romania is eligible to receive the equivalent of 13 percent of its GDP — one of the highest shares in the EU — from the Next Generation EU funds (primarily distributed through the National Recovery and Resilience Plan), to support post-pandemic recovery as well as the digital and green transitions.[39] The latter allocation amounts to €29 billion, comprising €14.2 billion in grants and €14.9 billion in loans. Further funding is available through REPowerEU to boost energy security, as well as through additional instruments. See Annex 1, Box A.5 for more details.

FIGURE 1.19 Over the next 5+ years, available EU funding will effectively double and cover new thematic areas, further straining capacity

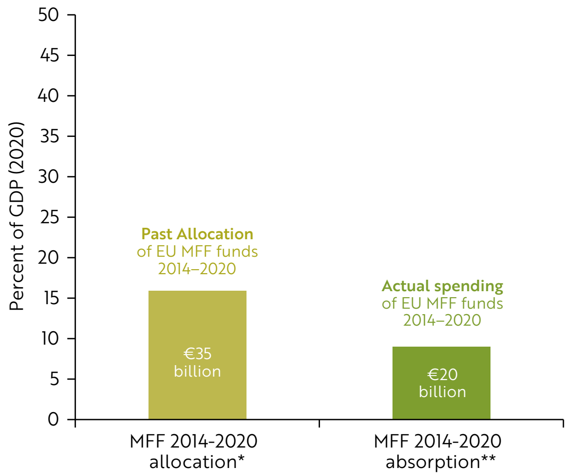


Source: World Bank, based on National and European Commission documents.

Notes: MFF refers to the EU Multiannual Financial Framework, and includes allocations under Cohesion Policy, Common Agricultural Policy. 'NGEU-RRF' refers to Next Generation EU Recovery and Resilience Facility (grants and loans); 'NGEU-other' includes Just Transition Fund and React-EU Facilities.

Legend: *computed as percentage of 2020 GDP.

FIGURE 1.20 Romania had access to substantial EU funding in the past but did not fully use it, partly due to capacity constraints



Source: World Bank, based on National and European Commission documents.

Notes: MFF refers to the EU Multiannual Financial Framework, and includes allocations under Cohesion Policy, Common Agricultural Policy.

Legend: *computed as percentage of 2020 GDP, ** as of December 2021.

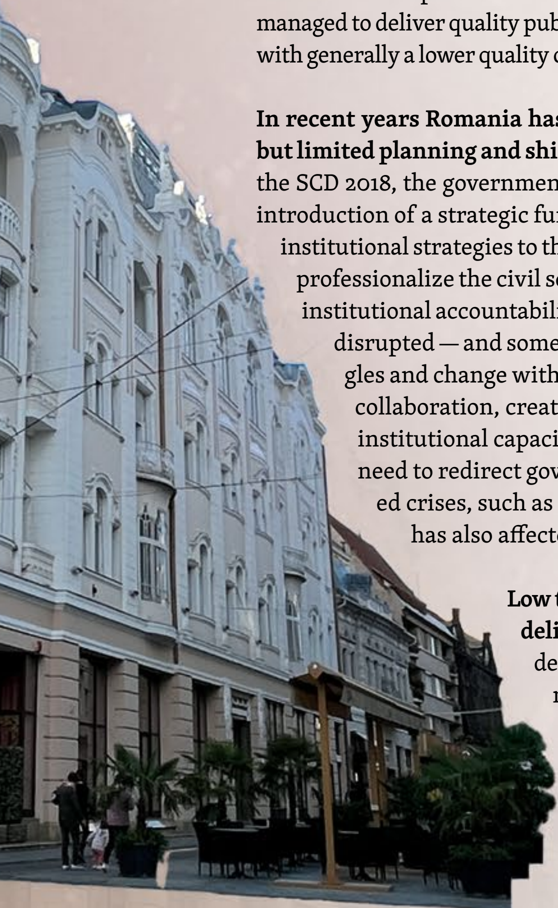
Provided it can bolster national and municipal institutional capacity to use such funds efficiently, Romania has an opportunity to boost all channels of growth. In particular, Romania is in a favourable position to: (i) equip citizens across the country with skills relevant for the labor market (through better active labor market policies), and update its education system accordingly; (ii) shape core infrastructure to connect people to markets in an environmentally sustainable fashion; and (iii) focus on reforms that can improve not only the quality of services (e.g., funding innovation and digitizing public services), but also their inclusivity (e.g., digitizing access to finance to help reach the unbanked in rural areas).

However, Romania's past track record in absorbing and using EU funds effectively highlights persistent challenges. Between 2014 and 2020, Romania was eligible for an overall funding envelope of €34.8 billion (16 percent of 2020 GDP). However, by the end of the programming period, it had only absorbed 56.7 percent of its allocation,[40] due to institutional bottlenecks (e.g., low capacity, especially at the municipal level), complex processes, and the extended time usually required for completing investment projects. With both new mechanisms (the results-based NRRP disbursements) and thematic areas (digital, green, just transitions) being introduced, the government will need to build additional institutional capacity to deliver both the structural programs for the 2021–2027 programming period, and the ambitious reforms and investments articulated under the NRRP. Fiscal consolidation will eventually limit the available fiscal space, underscoring the importance of a maximal absorption of EU funds to deploy public investments over the medium term.

2 CONSTRAINTS TO GROWTH AND PROSPERITY IN ROMANIA

2.1 WEAK INSTITUTIONS AND LOW ADMINISTRATIVE CAPACITY REMAIN KEY CONSTRAINTS

Albeit a high-income country with access to sizeable EU funds, Romania often struggles to meet its citizens' needs because of weak governance and poor administrative capacity. Almost five years after the SCD 2018, the tale of two Romanias persists, as the rural-urban divide and regional divergence have become even starker. Weak public institutions, low civil-service capacity, and political volatility — including frequent, politically driven government re-organizations — hinder public service delivery and slow down reform implementation, resulting in inefficient spending, inadequate public infrastructure and services, and social inequality. Romania has seen some progress at the subnational level: seven of the largest cities in the country ranked among the ten fastest growing in the EU between 2000 and 2019,[41] and with some local administrations managing to successfully respond to citizen's needs and deliver quality public services and investments. Some urban administrations, predominantly in larger cities, managed to deliver services such as public transport, solid waste management, maintenance of public spaces, public safety, or housing to citizen's satisfaction.[42] For example, over 90 percent of respondents from Cluj-Napoca, Oradea, Alba Iulia, Brașov, Drobeta Turnu Severin, Timișoara, and Sighișoara, indicated they were happy to live in the respective cities. There are also smaller towns and rural localities that have managed to deliver quality public services, but discrepancies to larger cities are significant, with generally a lower quality of public service delivery and poorer development outcomes.



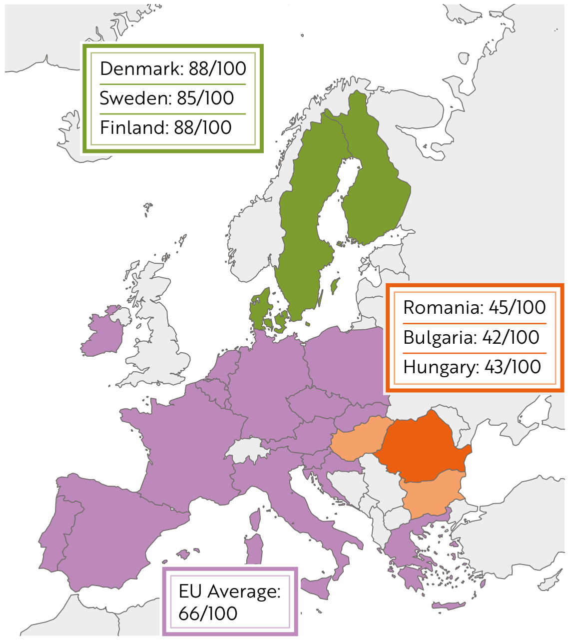
In recent years Romania has introduced key reforms in the public administration, but limited planning and shifting priorities have slowed their implementation. Since the SCD 2018, the government has enacted several important initiatives, including the introduction of a strategic function for cross-government coordination and for linking institutional strategies to the budget; human resource management (HRM) reforms to professionalize the civil service; digitalization measures; and reforms to strengthen institutional accountability. However, frequent changes in political leadership have disrupted — and sometimes reversed — early phases of progress. Internal struggles and change within ruling coalitions reduce appetite for cross-government collaboration, create vacuums, demoralize public servants, and diminish the institutional capacity for medium- and long-term reforms. Furthermore, the need to redirect government resources to respond to urgent and unanticipated crises, such as the COVID-19 pandemic and Russia's invasion of Ukraine, has also affected progress on necessary reforms.

Low trust in the state, and in the ability of public institutions to deliver services, further hinders progress. Romanians have a deep-seated distrust of the state, stemming from both its communist past and its more-recent inability to commit to a reform agenda and provide quality public services. In 2022, 67 percent of Romanians stated that they did not trust the government, a percentage that has remained broadly stable over time.[43] 60 percent of respondents rated the quality of public services as poor or very poor — a dissatisfaction rate among the highest in the EU. Instability in government and constant political gridlock fuel a perception that politicians prioritize their interests over those of the citizens they represent, while less than 15 percent of Romanians believe the government will deliver on its promises. The NRRP will provide the government with a medium-term horizon for major reforms on judicial independence, the rule of law, and anti-corruption which, together with on-going initiatives to bolster the Court of Accounts, could improve transparency and trust among citizens.

Distrust of the state is at the root of low civic engagement and poor response to public awareness efforts, including health campaigns during the pandemic. In 2020, only 32 percent of eligible voters participated in the national elections. A persistently strong perception of widespread corruption has hollowed out Romania's social contract, becoming more acute as a result of the pandemic: according to Transparency International's Corruption Perceptions Index 2021, 48 percent of Romanians believe that corruption increased between 2020 and 2021 (Figure 2.1). Only half of Romanians perceive courts and judges as independent from economic interests, the government, and politicians.[44] Lack of trust derails urgent public campaigns, as evidenced by Romania's poor uptake of COVID-19 vaccinations. Despite aggressive government efforts to make vaccines easily accessible, and ongoing campaigns to reassure the public about their efficacy and safety, uptake in Romania is among the lowest in the EU (42.4 percent of the population received the primary course), with less than 5 percent of vaccinated adults in certain parts of the country. Non-state communication through social networks has drowned out state-sponsored health campaigns, often spreading misinformation.

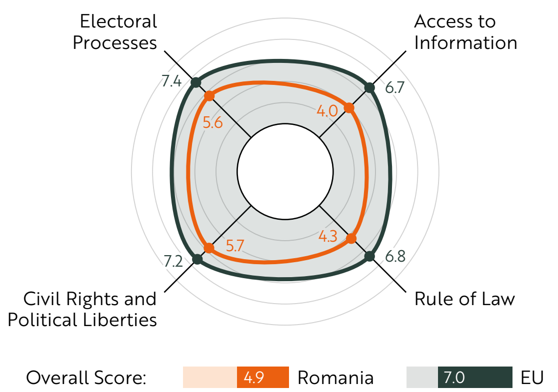
The public sector's lack of credible commitment to long-term reforms is partly responsible for low civic trust. Frequent government reshuffles hamper long-term plans to strengthen public institutions, while incentivizing an overuse of emergency ordinances. Recommended reforms tend to receive mixed political support, despite the need for strong political backing through completion and beyond. Notably, the government struggles to commit to counter-cyclical fiscal policies, which reduces the fiscal space available to react to economic shocks. Moreover, according to the Sustainable Governance Indicator 2022, the quality of the electoral process and the rule of law in Romania is worse than in its EU peers (Figure 2.2), although strengthening it has been a long-standing government priority.

FIGURE 2.1 Romania's ranking on the Corruption Perception Index is among the worst in the EU



Source: Transparency International, 2021.

FIGURE 2.2 Romania lags the EU average on quality of electoral processes, rule of law, access to information, and civil rights



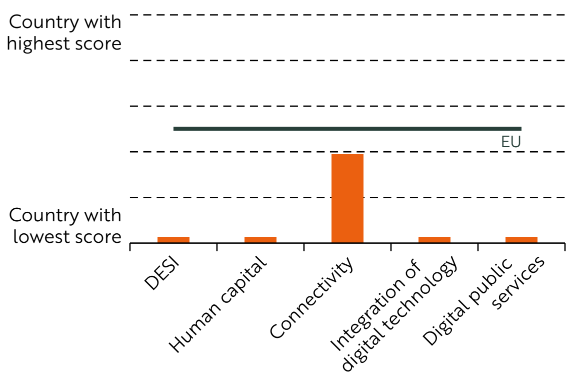
Source: The Sustainable Governance Indicator 2022, Bertelsmann Stiftung relies on a combination of expert qualitative assessments and quantitative data drawn from official sources such as the World Bank, the IMF, the OECD, and the World Economic Forum.

Weak institutional capabilities and HRM within public institutions further hamper reform implementation. The public administration faces challenges in attracting, retaining, and deploying talented public servants at all levels of government. HRM practices in the Romanian civil service remain highly fragmented and inconsistent across institutions. Moreover, clientelism and patronage undermine public sector capacity. Recent HRM reforms — such as a new Administrative Code that entered into force in 2019, the adoption of a new civil service recruitment model in 2020, and the inclusion of the National Contest for recruitment in the NRRP — signal the government's commitment to professionalizing the public service. However, the roll-out of such reforms is in its early stages, and their impact remains to be seen.

The digital transformation could offer an opportunity to transform service delivery and increase citizens' trust. Romania's bureaucracy, "paper-based culture", and outdated regulatory framework have resulted in inefficient government services that place a heavy burden on citizens and businesses. The digital transformation can enhance the accessibility, quality, and efficiency of public services, lowering transactional costs (in both time and money) for internal users as well as beneficiaries of public services. An effective digital transformation also fosters transparency by offering greater access to information, and builds trust in public institutions. The government has highlighted the digital transformation as a top priority in the NRRP and the 2021–2024 Government Programme, notably with the deployment of, and the migration of prioritized public services to, the Government Cloud infrastructure.

The COVID-19 pandemic evidenced many longstanding governance challenges and the urgency of the digital transformation. During the lockdown, public institutions urgently adjusted working modalities and adopted technological solutions to ensure the provision of critical services, but faced continuity challenges in working remotely and accessing data. Citizens could not access certain critical public services without breaching health-related guidelines, due to a lack of online services and the need to produce physical documents. Although Romania is well placed on connectivity, the availability and uptake of digital services are low (Figure 2.3).[45] The country ranked 46th out of 193 on the UN's 2020 e-Participation index, and the digital divide between urban and rural areas leaves much of the population underserved. The Romanian public sector's digital transformation faces major barriers, including a lack of strategic vision and institutional enablers (such as governance structures and mandates), weak inter-institutional coordination, limited digital awareness and skills, missing or outdated data governance policies and regulations (e.g., on interoperability frameworks, e-authentication, and e-signature standards), and shortcomings in key digital platforms (e.g., the national electronic identification system).

FIGURE 2.3 Romania ranked last in the EU on digital public services in the last four years

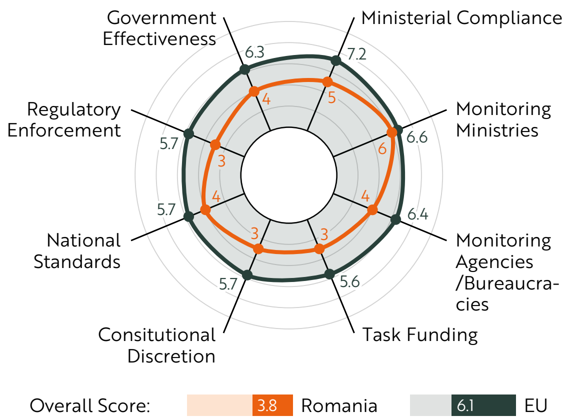


Source: International Digital Economy and Society Index, 2022.

2.2 INEFFECTIVE POLICY IMPLEMENTATION AND INSUFFICIENT PUBLIC EXPENDITURE CONTRIBUTE TO POOR AND UNEQUAL DEVELOPMENT OUTCOMES

Romania's weak governance hinders the country's overall development. According to the Bertelsmann Stiftung Sustainable Governance Indicators 2022, the Romanian government's effectiveness remains sub-optimal and well below the EU average (Figure 2.4). Moreover, inter-ministerial coordination and implementation capacity have deteriorated slightly in recent years, highlighting two challenges for the public administration: being able to implement policies, and operating as a unit.[46] While many countries used the COVID-19 pandemic as a catalyst to strengthen coordination mechanisms and align priorities, Romania made few changes in its approach. Arrangements for monitoring progress and evaluating results in the public administration are incomplete. At a higher level, the role of Parliament in the oversight of public spending is limited, as financial and performance audits are within the remit of the Court of Accounts (CoA).

FIGURE 2.4 Romania falls well below the EU average on efficiency and effectiveness of policy implementation



Source: The Sustainable Governance Indicator 2022, Bertelsmann Stiftung relying on a combination of expert qualitative assessments and quantitative data drawn from official sources such as the World Bank, the IMF, the OECD, and the World Economic Forum.

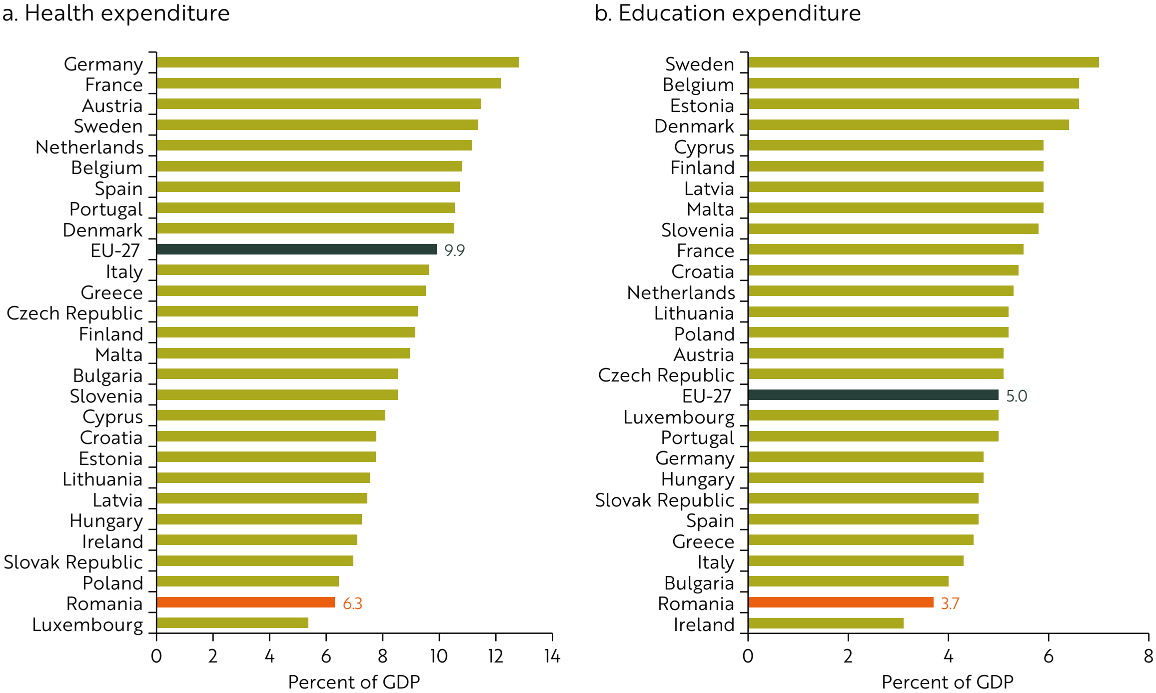
The pre-eminence of State-Owned Enterprises (SOE) in key sectors results in vast inefficiencies in service delivery, with large budgetary losses. Romania counts 1,400 operational SOEs, the largest number in the EU, including: Romgaz, one of the country's two main gas production companies; Transgas, the only gas transmission company; and Electrica, which controls three major electricity distribution companies. The presence of large state-controlled conglomerates and an inadequate regulatory framework deter private investment, inhibit competition, and compromise market efficiency (see also section 2.4). SOEs in energy, gas, postal services, and transport are the least efficient, with the latter generating the largest losses and requiring subsidies which accounted for nearly 7 percent of the Ministry of Transport's spending. District heating SOEs, which are mostly owned by municipalities, also suffer from financial distress and suboptimal management.

Limited cross-government coordination, and lack of alignment between strategic priorities and investments, undermine Romania's capacity to absorb EU funds and to deliver public services at EU standards. In the health sector, a lack of coordination among key stakeholders hinders the achievement of national goals on transparency, cost effectiveness, and quality of care. For example, the procurement of medical supplies and drugs occurs at the facility level, leading to fragmentation, a lack of economies of scale, and non-standardized quality; similarly, provider payment mechanisms do not incentivize quality of care. Moreover, although education policies promote high-quality school systems and learning outcomes, their implementation is largely uncoordinated, with poor transparency, accountability, and no integrated management framework for public investments.[47] In the water sector, the National Administration of Romanian Waters (ANAR) — the operational arm for water resource management — is underfunded and understaffed, and thus unable to properly maintain an aging infrastructure and implement investment projects. In addition, the implementation of land administration policies and strategies has been slow, particularly regarding the systematic registration of land (notably, more than 60 percent of the country's land is likely to be unregistered). Such delays have perpetuated land disputes, caused a loss of revenue to the state, complicated urban and spatial planning, and constrained investments in related sectors, such as agriculture and housing.

The provision of high-quality public infrastructure services — potable water, sanitation, energy — remains low, especially for the poor and rural residents. As of 2020, more than 20 percent of Romanians lacked a bath, shower, and indoor flushing toilet in their household — a rate far higher than in any other EU country. Among poor Romanians, this figure reaches a startling 56 percent. Moreover, 23 percent of poor Romanians cannot keep their home sufficiently warm, versus 6 percent of their non-poor peers.[48] As noted previously, Romania is the only country in the EU without universal access to piped water; achieving it would require investments for €6 billion. The rehabilitation of viable irrigation perimeters would require more than €1 billion, while important flood protection measures would cost an estimated €3.6 billion.[49]

Romania's human capital outcomes consistently lag the other EU countries, due to insufficient spending and inadequate health and education services. As of 2021, Romania's public investment in healthcare and education as a share of GDP was among the lowest in the EU (Figure 2.5). As a result, health outcomes have been lagging EU standards;

FIGURE 2.5 Government expenditure on health and education is among the lowest in the EU



Source: Eurostat 2022.

notably, Romania has the second-highest rate of preventable mortality[50] in the EU, behind Latvia.[51] In addition, the rate of participation in early-childhood development activities — the cornerstone of learning ability, and an enabler of female participation in the labor force — among Romanian children aged three and over is 78 percent, one of the lowest in the EU, and has been steadily declining since 2015.[52] Among disadvantaged children, such as those in the Roma community, the participation rate is merely 27 percent.[53] Furthermore, educational attainment differs vastly across geographical areas and income levels. Student achievement scores are lower in rural schools: in 2018, 40 percent of eighth-grade students in rural schools scored below the 5-mark level on the national evaluation. The share of early school leavers has only decreased slightly and stayed above government targets, with wide discrepancies between the share of early leavers in cities (4 percent) and rural areas (23 percent) in 2020.[54] The forthcoming Romania Country Gender Assessment (CGA) will also discuss the drivers of gender gaps in human capital outcomes.

An unsustainable financing model exacerbates issues in access to healthcare. A tax reform implemented in 2019 reduced the tax base of the National Health Insurance Fund (NHIF); as a result, only 6 million people — mostly wage earners — contributed to the NHIF in 2019–21. The estimated loss of contributions from pensioners and construction workers during this period — in total, around 6.5 million people — amounted to leu12.5 bn (€2.5 billion, or 40 percent of all health contributions in 2020). Therefore, every year, the state budget compensates for the NHIF's deficit through ad-hoc subsidies. Moreover, inefficiency in health spending is evident in the underfunding of cost-effective primary healthcare services, the decentralized procurement of medicines and medical supplies, the lack of innovative pharmaceutical policies, and the limited use of data to track spending. Access to services is obstructed by the uneven distribution of physicians and nurses between urban and rural areas, and between counties that host medical schools and those that do not.

BOX 2.1 Unequal access to shared opportunities in Roma communities

The Roma are the second-largest ethnic minority in Romania, and suffer from a high prevalence of poverty and material deprivation. According to estimates by the Council of Europe, the Roma make up between 6 and 12 percent of the Romanian population. The share of Roma at risk of poverty was 78 percent in 2021.[a] Poor housing quality, inadequate infrastructure, and lack of access to basic communal services remain major vulnerabilities for many Roma communities. About half of the Roma population lives in low-quality housing, versus 10 percent of the non-Roma.[b] 68 percent of Roma households lack tap water, and 80 percent lack a shower or bathroom.

Children from Roma communities are severely marginalized, and face disadvantages early on in life. Being a Roma attracts a strong social stigma in Romania, and spatial segregation and discrimination are severe. Notably, school segregation affects more than half of Roma children aged 6–14 in Romania. Moreover, Roma parents, guardians, and students have been increasingly experiencing discrimination from school authorities: 14 percent of Roma people reported being discriminated in 2021, up from 4 percent in 2016.[c]

Roma communities have limited access to health services and formal job opportunities. 58 percent of Roma adults are covered by basic health insurance.[d] While Romania's maternal mortality rate is already among the highest in the EU, it is more than 15 times higher for Roma women than for the non-Roma.[e] With low levels of human capital accumulation, Roma adults (women in particular) have scarce access to formal employment. In 2021, about 41 percent of the Roma indicated being in paid work, versus a national employment rate of 66 percent.[f]

Informality and a lack of legal documents hinder access to social services for the Roma, with civil society organizations trying to fill the gaps. During the pandemic, the lack of property and residence documentation and

IDs resulted in the most marginalized Roma not being eligible for emergency services. Although local NGOs have played an important role in delivering services and support, especially in well-connected communities, the civil society is not well organized within Roma communities, exacerbating gaps in access to services.[g]

The COVID-19 pandemic has deepened inequalities affecting the Roma. Overcrowded living conditions and lack of access to running water made it difficult to comply with hygiene and social distancing measures. As Roma workers are often employed in informal jobs, they were less likely to benefit from the government's labor support programs during the pandemic. Marginalized communities were severely affected by disruption to community health services and schools. In addition, the Roma have experienced increased isolation, stigmatization, and discrimination in connection with the pandemic.[h]

a. EU Fundamental Rights Agency, 2022

b. Carrera et al. 2019. Scaling up Roma Inclusion Strategies Truth, reconciliation and justice for addressing antigypsyism. European Parliament.

c. EU Fundamental Rights Agency, 2022.

d. EU Fundamental Rights Agency, 2022.

e. World Bank, 2014.

f. EU Fundamental Rights Agency, 2022.

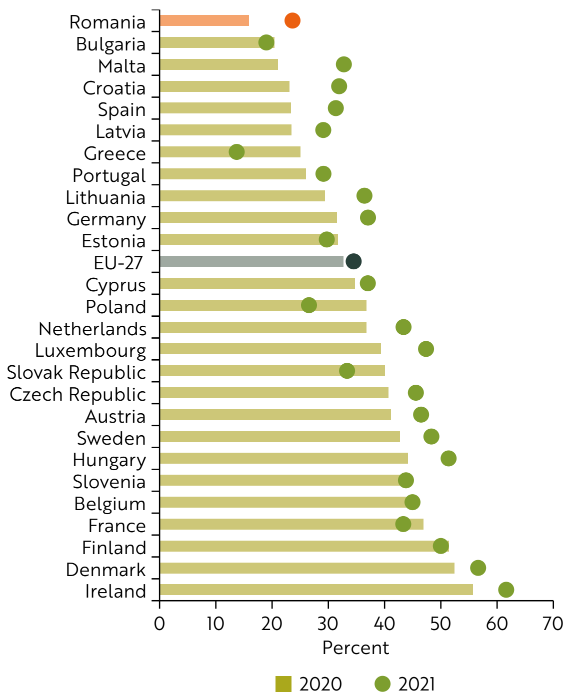
g. World Bank 2020. Romania Rapid Community Assessments.

h. World Bank 2020. Romania Rapid Community Assessments.

The coverage of the social safety net in rural areas, where the need is greatest, is limited. According to the European Commission's 2021 report on the adequacy of pensions, nearly two-thirds of the elderly in Romania cannot afford adequate care. In addition, one-third of rural communities and nearly half of all small municipalities (counting fewer than 2,000 inhabitants) have no public social assistance services.[55] The government has started several projects to introduce an integrated approach to community-level public services, including social assistance, healthcare, education, and employment, but they have suffered from delays and reported no substantial results.[56]

The social benefits system in Romania, and means-tested programs in particular, face fundamental challenges. In 2020, spending on social benefits — including universal, targeted, and means-tested benefits — stood at 1.16 percent of GDP, below the EU average of 1.36 percent of GDP. Only 0.15 percent of GDP (or 14 percent of total social assistance spending) goes toward means-tested social assistance programs — less than half the EU-27 average. The means-tested programs (Guaranteed Minimum Income, Family Support Benefit, and Heat Benefit) do not offer generous benefits, and their coverage is limited. In addition, the value of social benefits has not been systematically adjusted to inflation, despite the launch of the Social Reference Indicator in 2008. Overall, the impact of social transfers on poverty reduction in Romania is the lowest in the EU (Figure 2.6).

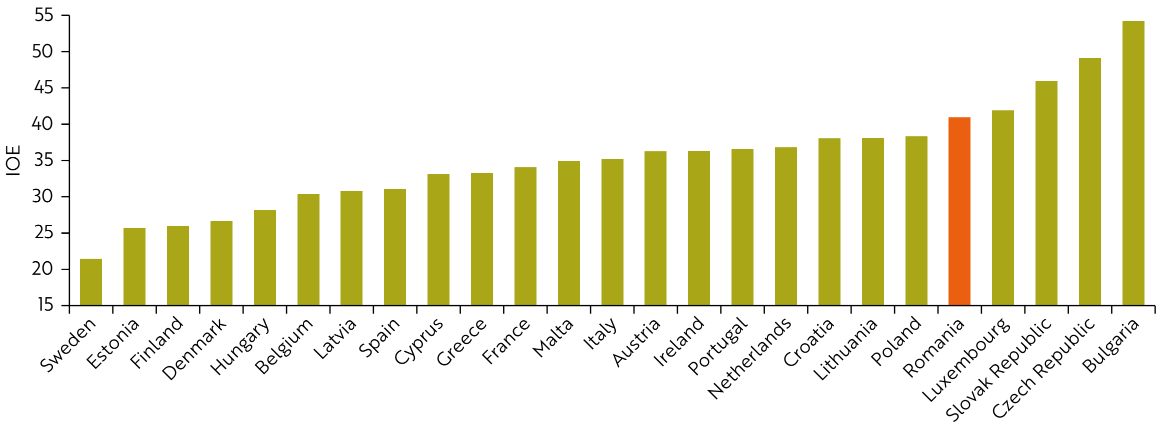
FIGURE 2.6 The impact of social transfers on poverty reduction in Romania is the lowest in the EU



Source: Eurostat 2022 (TESPM050).

Starkly unequal access to public services, and shortcomings in the social benefits system, entail that inequality of opportunity in Romania is high. Relative inequality of opportunity[57] in the country — i.e., the share of inequality that is due to circumstances beyond an individual's control, such as where they were born and their family's status — amounts to 40.5 percent. Such a level is the fifth highest in the EU and nearly double that of Sweden, the EU country where inequality of opportunity is lowest (Figure 2.7).

FIGURE 2.7 Inequality of opportunity in Romania is higher than in most of the EU



Source: World Bank calculation based on EU-SILC 2020 data.

The COVID-19 pandemic could exacerbate gaps in access to services and have long-term effects on poor and marginalized groups. Disruption in the already limited delivery of public services may place EU-level living standards further out of reach for rural Romanians. Temporary school closures disproportionately affected poor and marginalized students, especially Roma girls, partly due to their inability to access IT equipment and a stable internet connection.[58] Income losses due to COVID-19 will also test households' ability to keep children in school, boost the numbers of out-of-school youth and early leavers, and hinder the transition to tertiary education for many. Learning losses and reduced years of schooling for student cohorts affected by COVID-19 will lower their expected earnings by an estimated 3.6 percent — assuming that one year of schooling increases earnings by 8 percent on average — for a potential total economic loss of up to US$2 billion (2011 PPP) per year.[59] Moreover, the effects of the pandemic may put continued pressure on the already strained healthcare system, especially in rural areas.

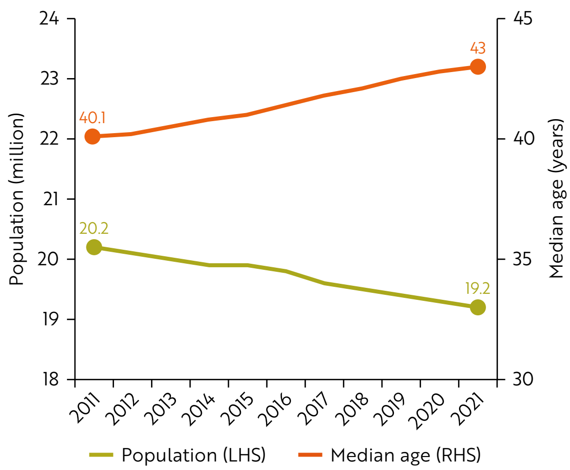
New technology and digital tools can improve the quality of healthcare and education, but without universal and affordable access to digital services, inequality may widen. Remote consultations for mild conditions could enable healthcare services to reach rural areas in a cost-effective way. In education, innovative, flexible, and interactive delivery of digital content can foster greater participation from students, parents, local communities, and technology providers. However, unequal access to digital channels will place vulnerable students at a higher risk of missing out on education opportunities. The experience of online schooling during the pandemic shed light on the acute effects of the digital divide: due to a lack of access to the internet and digital devices, the reading achievement gap between children in the poorest and richest quintiles — already equivalent to over three years of schooling — is expected to increase by a further 10 percent, although schools were closed for only three months.[60] This widening gap will have further adverse effects on job opportunities for poorer students later in life.

2.3 SHORTAGE OF SKILLED WORKFORCE AND LABOR MARKET FRICTIONS CONSTRAIN THE LABOR SUPPLY

Romania's active working-age population is shrinking — largely due to emigration and low labor force participation — reducing the labor supply and, in turn, potential growth. Inefficiencies in the education system, unfavorable attitudes to lifelong learning, and ineffective vocational training and active labor market policies combine with brain drain to cause skills shortages and mismatches, as well as reduced innovation capacity, growth, and earnings potential.

Largely due to emigration, both Romania's population and its labor force have been shrinking and aging. Romania's population fell from 22.8 million to 19.1 million between 2000 and 2021 (Figure 2.8), and is expected to further drop to 17.8 million by 2030.[61] Over the last 10 to 15 years, more than 2 million Romanians — nearly 20 percent of the labor force — emigrated, many on a permanent basis, resulting in skills gaps, labor shortages in key roles (e.g., medical doctors), distorted wage demands, and falling real labor productivity. As Romanian migrants tend to be younger and more educated than the remaining population, Romanian society has been aging and suffering one the most severe brain drains globally.[62] The fertility rate is below replacement level, at an estimated 1.8 in 2020,[63] while the median age in the country rose from 34.4 years in 2000 to 43.0 in 2021.[64] Regional variations are sizable, with Bucharest-Ilfov recording the country's lowest median age (41) and share of population over 65 (16.5 percent) — more than four years and 4.4 percentage points, respectively, below the levels of Sud-Vest Oltenia. Thus, demographic pressure points (for instance, greater demand for more complex healthcare for the elderly) are more acute in lagging regions, where service delivery is already challenging (see section 2.2).

FIGURE 2.8 Romania's population is shrinking and aging



Source: Eurostat (demo).

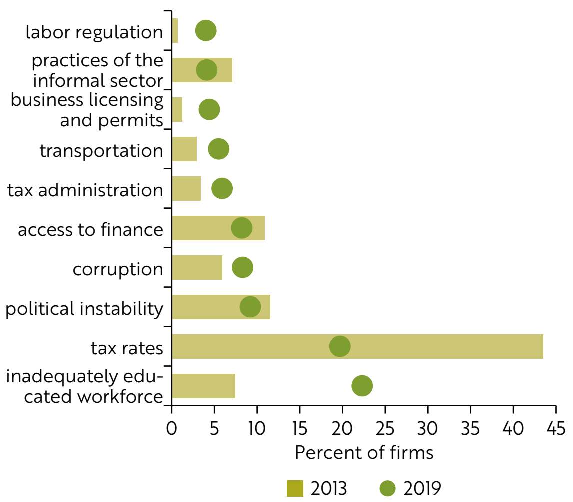
Although the country's labor market benefited from solid economic growth pre-pandemic, many Romanians still do not work, constraining the labor force. The Romanian labor market performed strongly before the COVID-19 crisis, with the unemployment rate in the 15–64 age cohort dropping to 4 percent in 2019, its lowest level in 20 years[65] and well below the EU average of 6.8 percent. However, the employment rate remains low (65.6 percent in 2020) relative to the EU average (67.5 percent). Romania's inactivity[66] rate (30.8 percent) is among the highest in the EU,[67] while labor force participation (69.2 percent in 2020)[68] is among the lowest,[69] constraining labor supply amid increasing demand from a growing economy.

The participation rate is particularly low among women, the young, and those with lower levels of education. As of 2020, the female labor force participation rate in Romania stood at 59.3 percent, 19.4 percentage points below the male rate, and 8 percentage points below the EU average for women — in line with low rates of enrollment in early-childhood education, and rigid societal attitudes towards female labor.[70] The youth labor force participation was even lower: 38.3 percent, far below the EU average of 58 percent. The share of young people between the ages of 15 and 24 not in education, employment, or training (NEET) stood at 14.7 percent — second only to Italy in the EU — with the starkest gender disparity in the EU (17.9 percent among women, versus 11.5 percent among men).[71] The labor force participation rate was highest among those who completed tertiary education (90.9 percent in 2020, and 89.1 percent for women), versus 71.8 percent and 47.7 percent among those who completed secondary and primary education, respectively. The gender gaps in the labor markets will be explored further in the forthcoming Romania CGA.

Labor force participation is especially low among the poor. Close to half of those living in households in the bottom 40 percent of the income distribution have no formal work, and a further 28 percent remain engaged in agriculture.[72] With rural areas suffering from higher poverty rates, a concentration of lower-skilled segments of the labor force, and a weaker labor market, this data highlights the linkages between lack of employment opportunities and poverty.

While the labor supply is shrinking, the demand for skills is growing, and shortages and mismatches are expected to intensify as the green and digital transitions progress. Skills shortages and mismatches, already considerable, are on the rise: the lack of adequate skills among the workforce was already the top constraint for businesses in Romania before the pandemic, according to the World Bank Enterprise surveys (Figure 2.9), and vacancy rates doubled between 2013 and 2019. A high proportion of people with tertiary education are either overeducated for their occupation (vertically mismatched), or working in a sector that does not match their field of education (horizontally mismatched).[73 74] Automated production processes and an increasingly services-dominated economy require more non-routine cognitive skills, such as critical thinking and socio-behavioral skills, as well as more digital skills (both basic, for the majority of workers; and advanced, for IT-related jobs). However, labor shortages have been recorded in both high and low-skilled occupations.[75] The forthcoming Romania Country Private Sector Diagnostic (CPSD) offers more detailed analysis on this topic.

FIGURE 2.9 A shortage of skilled workforce has become the top constraint for businesses



Source: World Bank Enterprise Surveys 2013, 2019.

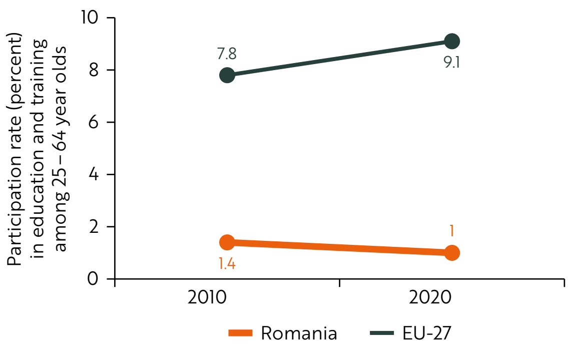
Skills deficits could hamper the green and digital transitions, while the concurrent adjustment in demand for skills may deepen inequalities across Romania's regions and population groups. Romania fares poorly on digital skills, ranking last in the EU on digital human capital. Less than one-third of those aged between 16 and 74 have at least basic digital skills (versus the EU average of 58 percent), and 35 percent have at least basic software skills (versus the EU average of 61 percent). Among urban areas in the EU, those in Romania rank last on digital skills; while among rural areas, those in Romania rank second-to-last. Emigration continues to take a toll: while Romania has a relatively high proportion of ICT graduates (5.6 percent of all graduates in 2020, versus the EU average of 3.6 percent), its share of ICT specialists in the labor force (2.2 percent) lags the rest of the EU (3.9 percent). Pockets of digital skills exist, but they often appear to service foreign markets: Romania is the only EU country among the top-20 suppliers of software development workers on English-language online labor platforms.[76] The overall lack of digital skills within the population is a clear impediment to the wider adoption of digital services by citizens and businesses, and may also slow down the transition to green jobs, which tend to require comparatively high skill levels.

Skills development and activation are low, with a deficient skills-supply system preventing Romania from responding to changing global circumstances. The education and training system is struggling to provide the skills the country needs, with a disconnect between employers, workers, and education and training providers causing the various stakeholders to act in isolation.[77] As a result, only about 20 percent of the labor market's current needs are covered. Before the outbreak of the COVID-19 pandemic, the education system was struggling to provide high-quality education to all students, and the country faced several challenges in human development (see section 2.2). The number of early school leavers, functional illiteracy rates, and the quality of tertiary education are all areas of concern. Romania performs particularly poorly relative to EU averages, with high numbers of early school leavers and NEETs.[78]

Romania has the lowest participation rate in lifelong learning in the EU, due to both cultural and systemic barriers. Around 1 percent of those aged 25–64 participate in adult learning activities, well below both national targets and the EU average of 9.1 percent (Figure 2.10). Lifelong learning does not usually unlock salary or career progression in Romania, nor is it valued on a personal level, especially among those aged over 40.[79] Vocational education and training (VET) has gained public attention over the last decade due to the country's labor shortages, but its quality is suboptimal. Soft skills are also in short supply, as neither the traditional education system nor the VET system focus on them.[80] Finally, Romanian firms invest comparatively little in skills formation, with only 21 percent of firms offering formal training to their employees, versus 31 percent in ECA and 36 percent in high-income countries.[81]

Low and relatively inefficient public spending on ALMPs contributes to the poor accessibility of information about labor market opportunities.[82] Despite adequate EU funds to support the expansion of labor-market programs, Romania is the EU country that spends the least in this area relative to its GDP[83] — just 0.09 percent of GDP in 2018, less than 10 percent of the average

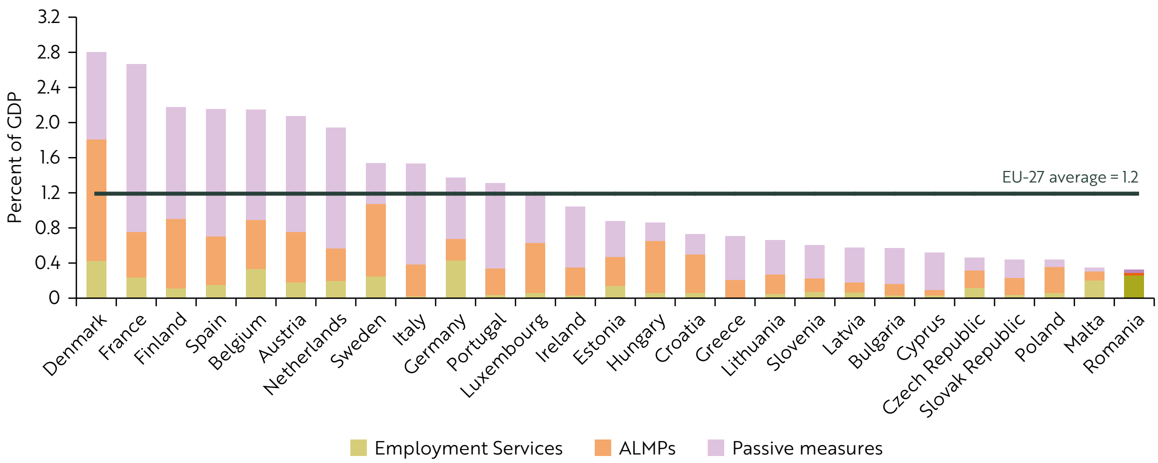
FIGURE 2.10 Share of population involved in lifelong learning is low



Source: Eurostat (TRNG_LFS_02), participation rate in education and training (previous 4 weeks).

spending in the EU-27 (Figure 2.11).[84] Moreover, 40 percent of the expenditure goes toward passive measures, rather than active measures aiming to boost prospects for gainful employment or earning capacity. Romania's public spending on social protection and social assistance is relatively low, compared with other EU members and other countries in ECA. Thus, in addition to experiencing inequality in access to services, the poor lack resources to invest in their human capital.[85]

FIGURE 2.11 Romania's spending on labor-market programs is the lowest in the EU



Source: Eurostat.

2.4 LOW CONNECTIVITY, A SHALLOW FINANCIAL SECTOR, AND AN UNFAVORABLE BUSINESS ENVIRONMENT HOLD THE PRIVATE SECTOR BACK

Several factors, in addition to skills shortages and mismatches (discussed in section 2.3), hold back private sector development in Romania. First, infrastructure gaps — largely due to inefficient public investment stemming from institutional weakness — are significant both nationally and, in particular, in lagging regions (section 2.1). Second, underdeveloped financial markets and lack of capacity in the public sector limit the absorption of vast EU funds and hold back Public-Private Partnerships (PPPs). Third, the business environment is unpredictable, overregulated, and unconducive to innovation and competition. The forthcoming Romania CPSD offers more detailed analysis on these topics.

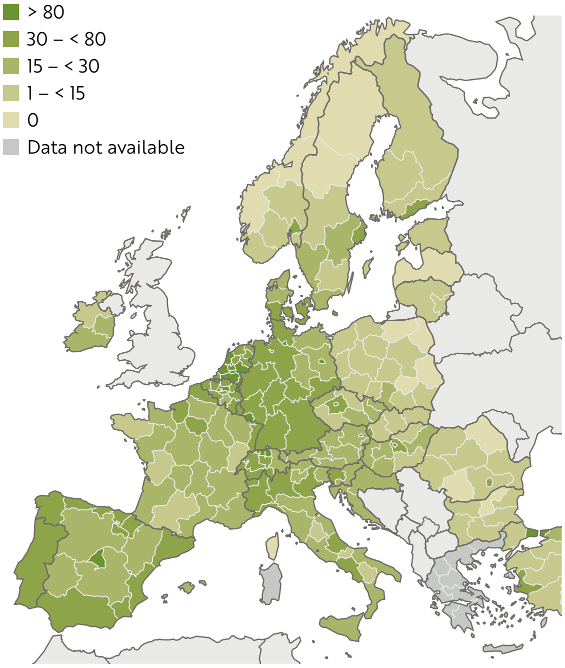
Despite significant public investment, quality and coverage of infrastructure remain below EU standards. The quality of overall infrastructure in Romania throughout 2008–2018 was the lowest in the EU.[86] According to the 2019 World Economic Forum's Global Competitiveness report, Romania ranked 55th globally on quality of overall infrastructure, behind countries such as Morocco and Mexico, and even lower on quality of roads (119th out of 141 countries). Key infrastructure sub-sectors need larger and more-efficient investments, including: transport (roads, railways, air, waterways and ports), energy (transmission network, renewables, and energy efficiency), digital (telecom networks and data centers), and municipal services (water, waste management, urban and peri-urban transport, and district heating). The major presence of SOEs in the infrastructure sector (especially in transport and energy) leads to underinvestment and/or crowds out the private sector (see section 2.2).

Romania's transport network is among the shortest and least dense in the EU. Romania is among the EU countries that have made the least progress on building out the Trans-European Transport Network (TEN-T), having completed only 35 percent of the length of the central TEN-T road network (886 km out of 2,544 km) and 23 percent of the TEN-T conventional central railway network (572 km out of 2,514 km). The densest motorway network is located around Bucharest and key economic hubs in the Centre and West of the country, with entire regions in the East and South lacking any motorways (Figure 2.12). Rail density is around the EU average (Figure 2.13), although the network needs urgent repairs and modernizations: less than 40 percent is electrified, with average speed in 2022 below 45km/h for passenger trains and 15km/h for freight trains. The inland waterway network has low density and is largely unused.

FIGURE 2.12 Motorway density in Romania is among the lowest in the EU

km of motorways per 1,000 km²

- > 80
- 30 – < 80
- 15 – < 30
- 1 – < 15
- 0
- Data not available

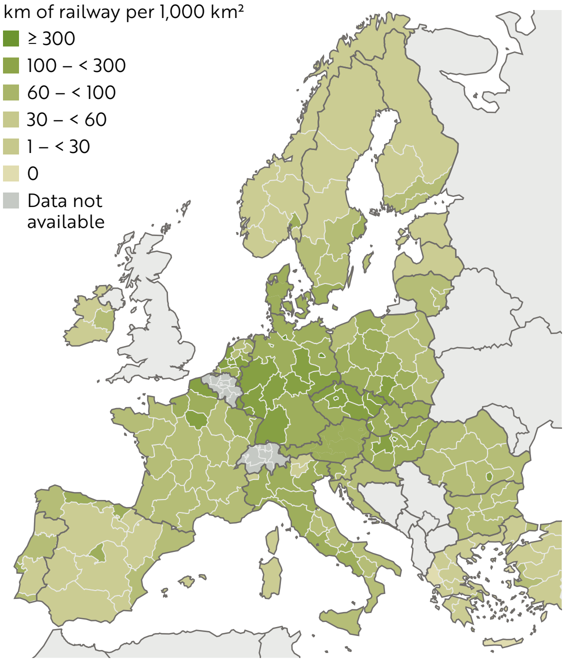


Source: Eurostat 2020.

FIGURE 2.13 Railway density is on par with EU average, but the network needs urgent repairs and modernizations

km of railway per 1,000 km²

- ≥ 300
- 100 – < 300
- 60 – < 100
- 30 – < 60
- 1 – < 30
- 0
- Data not available



Source: Eurostat 2020.

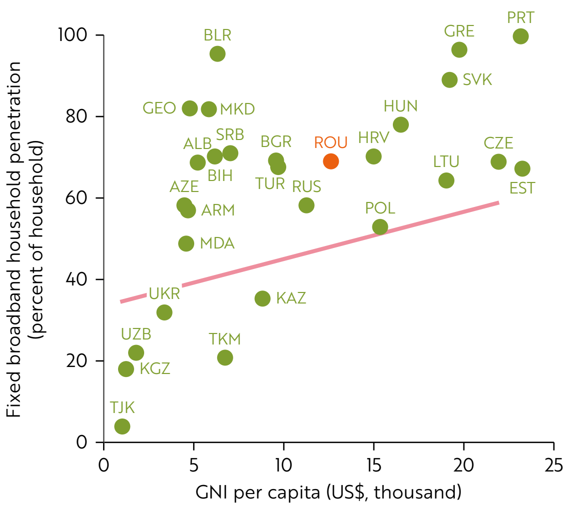
Better governance is key to achieving higher-quality and greener transport infrastructure.[87] Governance arrangements marked by instability and ineffectiveness in project delivery are, in large part, at the root of Romania's infrastructure deficit. Despite major investment needs and the availability of significant financial resources, the Ministry of

Transport routinely underspends relative to both original and rectified budget appropriations (by an average of 29 percent in 2015–2019). Romania is also missing on the opportunity to adopt the Public Private Partnership model, where suitable, to involve the private sector in financing, developing, upgrading, and operating key infrastructure assets — due, in part, to the lack of a sound legislative and regulatory framework.[88]

The insufficient coverage of transport infrastructure networks hampers competitiveness and job creation. Shortcomings in core transport infrastructure are oft-mentioned binding constraints to investment and private sector development,[89] and a major cause of persistent regional divides in economic performance. In a 2019 EIB survey, 73 percent of respondent SMEs mentioned inadequate transport infrastructure as a key barrier to expanding investments.[90] In addition, in 2017 the World Bank found a statistically significant correlation between road conditions and access to education (i.e., lower quality of roads goes hand in hand with less access to education).[91] Finally, a lack of metropolitan railways hinders labor mobility.

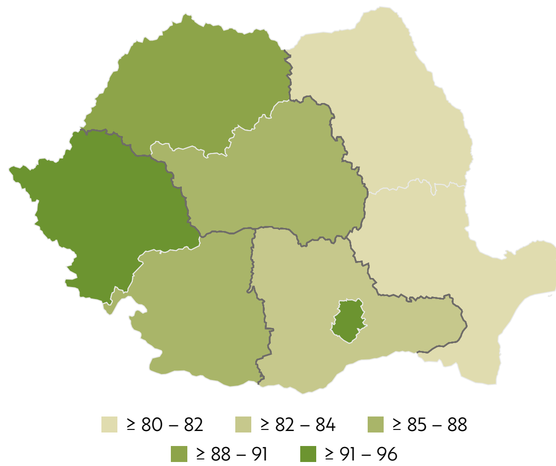
Romania performs relatively well on digital infrastructure, but regional differences are wide and skill levels insufficient. While 92 percent of households in Bucharest-Ilfov were connected to the internet (fixed and/or mobile) in 2020, the rate was only 77 percent in the North-East region (Figure 2.15). In addition, as discussed in section 2.3, metrics of digital skills and productive use of the internet remain poor.

FIGURE 2.14 The level of fixed-broadband household penetration is relatively high in Romania



Source: TeleGeography data 2021; ITU data 2020.

FIGURE 2.15 Regional differences in internet access (fixed and mobile) are wide



Source: Cartographic visualization using EUROSTAT Data.

Note: Access of households to the internet is measured as the percentage of households in which any member can access the internet from home.

Romania's energy sector has made strides since the country joined the EU, but much remains to be done on energy security and decarbonization. On the World Economic Forum's 2017 Energy Architecture Performance Index (EAPI),[92] which ranks 127 countries on their ability to deliver secure, affordable, and sustainable energy, Romania came

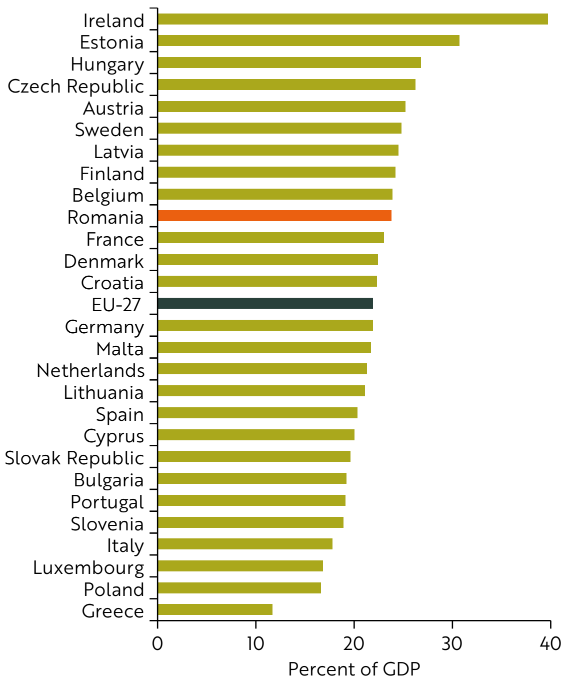
24th — a jump of 15 places from the 2009 EAPI — and 16th among EU members. According to the index, Romania outperforms the EU average with respect to the energy sector's ability to support economic growth and development, but underperforms it on environmental sustainability and energy access/security. Key challenges for Romania's energy security include: (i) making use of natural endowments that favor renewables (especially wind); and (ii) developing interconnectors, which would also boost the country's energy export potential. In 2020, the level of electricity interconnection in Romania was 9 percent,[93] below the target of 10 percent set by the EU. Heating infrastructure is old and inefficient: 80 percent of heat generation capacity is more than 30 years old, and the age of some installations exceeds 45 years. Greening the energy sector will be central to achieving Romania's decarbonization targets and ensuring energy security (see section 2.5 and the forthcoming Romania CCDR and CPSD for more details).[94]

Municipal infrastructure — including water, urban transport, street lighting, and solid-waste management — remains underdeveloped and requires significant investment. Urban transport faces challenges in many cities, with Bucharest ranked among the most congested in the world, and the transport sector has been responsible for the greatest share of the increase in GHG emissions in the country in recent years, primarily from daily commuting within metropolitan areas. E-mobility remains low. Romania is also lagging on waste disposal, relying on landfills — a polluting and inefficient solution — at the highest rate in the EU, while recycling rates, conversely, are among the lowest in the EU (0.392 tonnes per capita, versus the EU average of 2.304 tonnes per capita, per Eurostat).

Low, volatile, and inefficient public investment perpetuates infrastructure gaps. Public investment averaged 4.2 percent of GDP in 2000–2020, above the EU-27 average of 3.2 percent of GDP, but it was highly volatile.[95] The government's use of cuts to investment as an instrument to meet fiscal deficit targets has been a major contributor to volatility. Moreover, the impact of public investment has been weak, due to factors including insufficient institutional coordination, ineffective policy implementation and monitoring, politicized decision-making, and poor human-resources policies in the public administration. As a result, transport infrastructure remains poor in quality and insufficient in quantity, despite the availability of substantial EU funds.

Private investment has been relatively high in recent years, but an unpredictable business environment, a high degree of state control over the economy, and shallow financial markets constrain its growth. In 2020, business investment in Romania equaled 14.8 percent GDP, slightly above the EU average and higher than in most regional peers.[96] Foreign Direct Investment (FDI) inflows recovered after the pandemic, reaching €8.9 billion in 2021 and rising to €10.7 billion in 2022.[97] Frequent government reshuffles

FIGURE 2.16 Investment in Romania (as percent of GDP) is comparable to the EU-27 average (2019–2020), but the needs are much greater

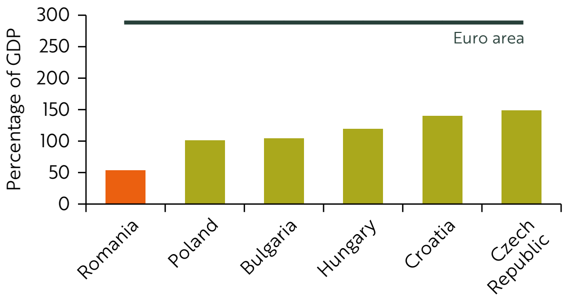


Source: Eurostat.

have left much of the reform potential identified in the SCD 2018 untapped. Progress on improving SOE governance and adjusting the scope of their activity has stagnated, while in certain sectors the state remains both the regulator and the owner of key corporate players.[98] Thus, Romanian firms across all sizes and sectors indicated in 2016–2021 that the political and regulatory climate was the main barrier to carrying out planned investment.[99]

Romania's financial sector remains underdeveloped compared with regional and income peers. Financial sector assets as a percentage of GDP stood at 77.1 percent as of end-2021. While banks dominate the sector,[100] their assets were equivalent to 53.5 percent of GDP in 2021 — less than half as in peer countries (Poland, Bulgaria, Hungary, and Croatia), and approximately one-fifth of the EU average.[101] Bank credit intermediation is shallow, limiting the supply of investment financing for firms. According to Finstats 2020, total credit amounted to 26 percent of GDP in 2020, significantly below the expected 25th percentile, and lower than the ECA average of 41 percent.[102] The supply of loans to enterprises stood at 12.9 percent of GDP in 2021, versus an average of 22.5 percent for Bulgaria, Croatia, Hungary and Poland.[103] Overall, bank lending is highly concentrated in the Bucharest-Ilfov region.[104] Moreover, the private sector receives limited financing from non-bank financial institutions (NBFIs) and capital markets, particularly for the long term. NBFIs are small — although they can play an important role for micro-entrepreneurs, as many are located in rural areas and small towns. Romania's capital markets remain the shallowest in Europe, and the institutional-investor base is narrow. Government bonds dominate the domestic debt market, while the corporate debt landscape remains underdeveloped. The Bucharest Stock Exchange has scarce liquidity and is significantly smaller than its regional peers: its main market counted only 83 listed companies as of September 2022, for a total market capitalization of €28.5 billion (or 11.9 percent of GDP).[105] Financing for venture capital and private equity is also limited.

FIGURE 2.17 Total assets of the banking sector as a share of GDP remain low (Q2 2021)



Source: ECB data warehouse.

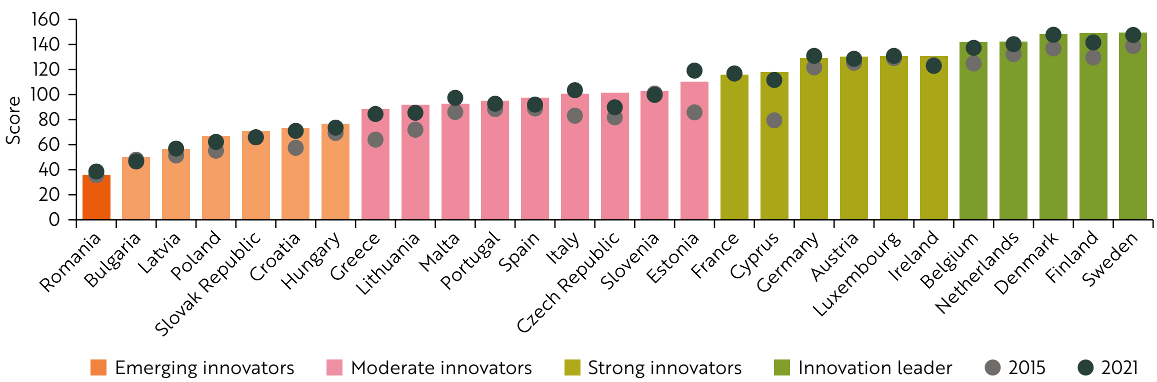
Romania has low levels of financial inclusion, including in account ownership and usage, access to finance, and use of digital payments. 69.8 percent of adults own a transaction account[106] — below regional and income group averages. Access to financial services is concentrated in the Bucharest region, with major gaps among rural, lower-income, and less educated consumers.[107] Account usage and savings are also lower than in regional peers. While card ownership and usage have been low historically, digital payments have increased significantly in recent years:[108] according to Global Findex 2021, over 63 percent of adults reported making or receiving a digital payment in the previous year.[109] The low level of financial inclusion is due to both demand- and supply-side constraints: poor financial literacy, mistrust of the financial sector, comfort with using cash, as well as a limited rural payments infrastructure, as physical access points in rural areas (such as ATMs and bank branches) have experienced steady declines.

MSMEs are poorly served by the financial sector. In 2019, MSMEs accounted for 53 percent of GDP and employed 66 percent of the labor force in Romania. However, outstanding SME loans from commercial banks amounted to 7.5 percent of GDP in 2020, the lowest share among regional peers except Poland.[110] The World Bank's Enterprise Surveys 2019 found that 36 percent of small enterprises and 46.6 percent of medium-sized enterprises had a loan/line of credit.[111] Less than one-third of firms rely on banks to finance investment (a lower share than in regional peers), while many firms count primarily on internal sources of financing.[112] Nevertheless, MSME themselves do not perceive access to finance as a significant obstacle to operations, according to both WB Enterprise Surveys and NBR surveys. Overall, MSME finance in Romania is constrained by both demand-side (undercapitalization of firms, informality, limited collateral, low financial literacy) and supply-side factors (deficiencies in the financial infrastructure). The forthcoming Romania CPSD offers a more detailed discussion of the enabling role of the financial sector for private-sector investment.

The economy in Romania is more heavily regulated and less competitive than almost anywhere else in the EU. State control is pervasive, with state ownership of companies and preferential treatment of SOEs greater than in any OECD or EU country.[113] The regulatory burden in Romania is also among the highest in the EU.[114] For example, rigid constraints to the provision of legal services hinder the ability of firms to access necessary inputs, while administrative requirements for start-ups were the second-most onerous in the EU (after Bulgaria) as of 2018.[115] Banks also consider the unpredictable legislative framework as a major risk factor, with a resulting negative effect on the degree of financial intermediation in the economy.[116]

The innovative capacity of Romania's economy is limited, mainly due to chronic under-investment and skills shortages. The EU Innovation Scoreboard considers Romania an "emerging innovator" and ranks it last in the EU, signaling a poor ability of Romanian firms to move up the value chain. The country has, by far, the lowest share of innovative enterprises in the EU — as 2019, only 10 percent of Romanian firms had introduced a new or significantly improved product or service in the previous 12 months. Romanian firms underperform their EU peers in product and process innovation, marketing and organizational innovation, R&D expenditure, patent applications, and ICT training.[117]

FIGURE 2.18 Romania ranks the lowest on the EU Innovation Scoreboard

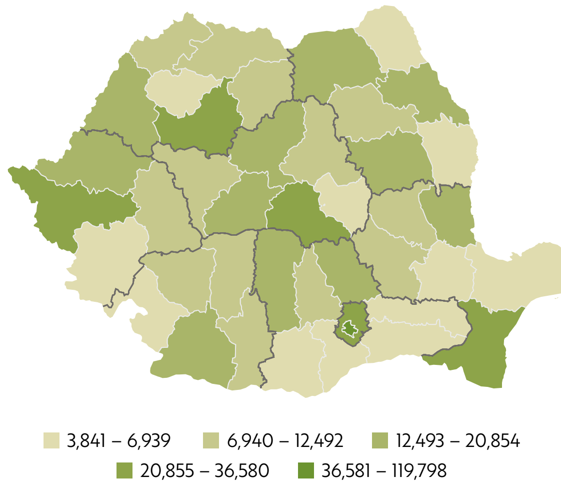


Source: European innovation scoreboard 2022.

The quality of the business environment is highly uneven across the country. The regional human capital index highlights stark disparities of opportunity for citizens across

Romania's municipalities.[118] The concentration of firms also varies substantially around the country. (Figure 2.19). The Local Business Environment Index by the Romania Aspen Institute rates and ranks Romanian municipalities based on four factors: local entrepreneurship, innovation, investment financing, and local public support. The score for Bucharest, the best-performing municipality, was nearly seven times as high as that of Vaslui, the worst-performing one. Past regional assessments, financial indicators, and other regional statistics paint a similar picture. The digital and green transitions may further deepen regional inequalities by exacerbating the digital divide, reducing business opportunities in regions with high-emission industries, or exhausting municipal capacity to absorb additional EU funds.

FIGURE 2.19 The number of firms varies substantially across county



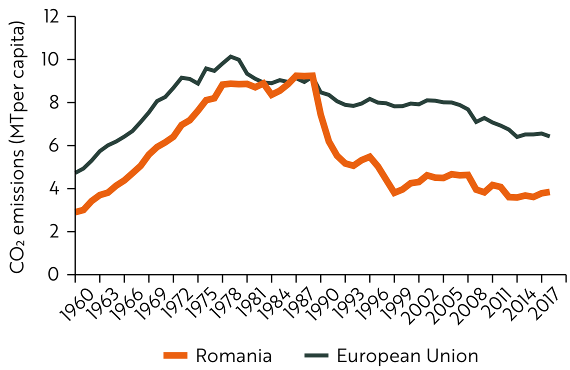
Source: World Bank using National Institute of Statistics data (2019).

An unpredictable business environment, shallow financial markets, weak institutions, lack of connectivity, and skill shortages hold back private sector development, with the contribution of MSMEs to the national economy smaller than in regional peers.[119] The gap in firm performance between the Bucharest region and the rest of the country is widening. As consequence of these challenges, 14 percent of Romanian firms had more liabilities than assets in 2018, one of the highest ratios of negative-equity firms in Europe.[120]

2.5 THE CHALLENGES OF CLIMATE CHANGE MITIGATION AND THE GREEN TRANSITION BECOME PROMINENT

Climate change presents both enormous opportunities and significant risks for Romania. The SCD 2018 outlined Romania's need to develop climate adaptation and resilience to natural hazards (see section 2.6). Since then, the EGD has emphasized equitable climate mitigation action through the green transition. The EGD also provides an action plan for EU member states to boost the efficient use of resources via a clean, circular economy, restore biodiversity, and cut pollution. The forthcoming Romania Country Climate and Development Report (CCDR) will discuss these issues in detail.

FIGURE 2.20 CO_2 emissions per capita (1962–2018)

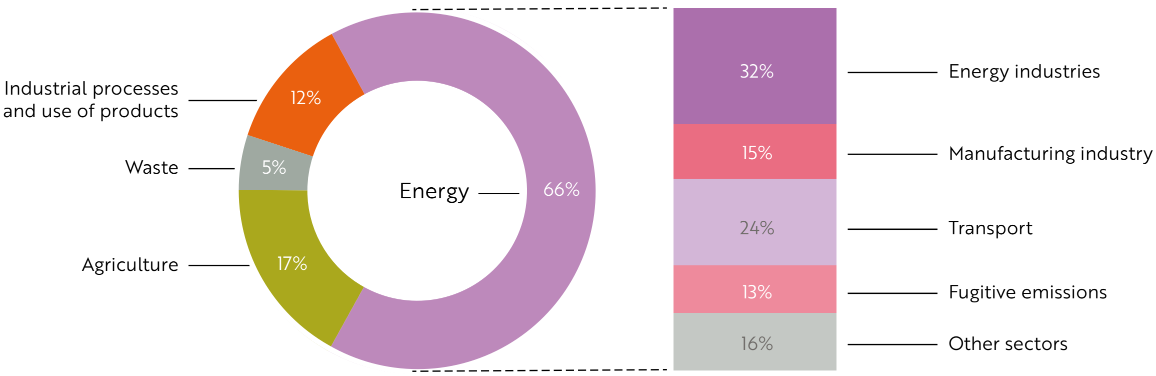


Source: World Development Indicators.

The EGD and Romania's national strategies set out ambitious goals, requiring considerable policy action. Romania's CO_2 emissions per capita are below the EU average (Figure 2.20). However, in the absence of policy action,[121] they are projected to increase, and risk compromising the achievement of targets set out in the Paris Agreement and the EGD.

The energy sector is the main contributor to GHG emissions in Romania, highlighting the importance of the energy transition. The energy sector accounts for 66 percent[122] of GHG emissions in Romania (and within the sector's emissions, 32 percent come directly from the energy industry, 24 percent from transport, and 15 percent from manufacturing activities), agriculture for 17 percent, industrial processes and use of products for 12 percent, and waste for 5 percent (Figure 2.21).

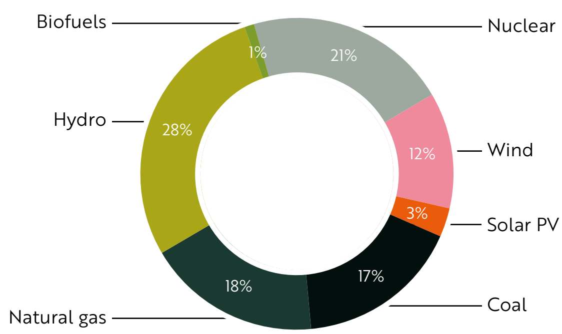
FIGURE 2.21 Romania's GHG emissions are concentrated in the energy sector



Source: Ministry of the Environment, Waters and Forests, National Inventory of Greenhouse Gas Emissions, 2018.
Note: Land use, land-use change, and forestry. Excludes LULUCF activities.

Transitioning to a greener energy supply and a more efficient energy consumption is key to meeting ambitious climate goals and enhancing energy security. Electricity generation in 2020 was heavily based on fossil fuels (36 percent), followed by hydropower (28 percent), and nuclear (20 percent) (Figure 2.22). Wind and solar made up approximately 16 percent of the energy mix. The last decade has brought significant structural changes in the energy sector: as the share of coal halved, renewables filled most of the gap thanks to their accelerated development in 2010–2015, and natural gas grew from 11 percent to 18 percent of the mix. However, with the gradual closure of coal-fired plants and no new investments in generation since 2015, Romania became a net importer of electricity in 2019, and its share of renewable generation remains well below the EU-27 average. Energy intensity in Romania, albeit above the European average, has been declining, while opportunities for energy efficiency remain largely untapped.

FIGURE 2.22 Electricity generation in Romania relies heavily on fossil fuel, hydropower, and nuclear



Source: International Energy Agency.

Energy decarbonization efforts need public investment (e.g., in transmission networks) as well as private investment (e.g., in renewable electricity and heating generation). In the NRRP, Romania has committed to a complete coal phase-out by 2032. Private-sector investment in renewable generation capacity has been scant since 2015, at a time when all coal-fired plants are set to be decommissioned. In addition, new transmission and balancing infrastructure, including smart grids, is needed to manage the substitution of coal units with variable electricity generation technologies, as well as to enable the decentralization of generation capacity and a more active participation of energy consumers in the system's management. In district heating, most existing generation facilities have been operating for more than 30 years, and upgrades will require investment for more than €300 million. In addition, district heating — along with the industrial and freight sectors — will need to shift from fossil fuels to cleaner alternatives such as green or blue hydrogen, biogas, or biofuels, which entails investment in their generation, transport, and in the refurbishment of equipment and facilities for end use. Finally, a renovation of the building stock is urgent, to reduce energy consumption and exposure to the volatility of international energy prices, and to improve the security and comfort of households. In this challenging context, the energy sector is struggling to attract private investment at scale, due to unstable regulatory and legal frameworks, limited capacity and resources in the public sector to manage the transition, and the excessive influence of SOEs on the sector. The forthcoming Romania CPSD and the CCDR assess these issues in more detail.

Decarbonizing transport will also be important to reaching net-zero emission targets, against a backdrop of overreliance on road transport and poor readiness for e-mobility. Transport is responsible for about 16 percent of the country's GHG emissions, and more than 90 percent of that share arises from road transport[123]; thus, the road sector has a major role to play in the transition. Romania's e-mobility sector is still in its early stages.[124] Electric vehicles (EVs) numbers are growing (in 2022, one in five cars sold in the country was either electric or hybrid) but still low as a share of the total car park (in 2022, the shares of EVs and hybrid vehicles stood at 0.25 percent and 1.2 percent, respectively), while more than one in four cars registered in the country is over 20 years old. Charging infrastructure is modest, and most charging stations are concentrated in Bucharest and other large cities. The ratio of plug-in EVs to charging points was 15 at the end of 2020, versus the EU average of 12.[125]

The intensity of Romania's GHG emissions from agriculture is among the lowest in the EU. This is due to the relatively low productivity of the sector, but emissions could increase in the absence of mitigation measures if agricultural productivity and efficiency improve. Romania's agricultural agenda is connected to the EU's Common Agricultural Policy (EU CAP), which provides a framework for mainstreaming climate change mitigation and adaptation activities. The next CAP programming period will be inextricably linked to the EGD, at the heart of which is the EU's Farm to Fork strategy. Direct payment schemes for greening activities will be further embedded to achieve environmental and climate objectives, with hard spending targets for climate change mitigation and adaptation measures in agriculture.

Romania is the EU member state least ready to achieve a circular economy. Multiple efforts are ongoing to accelerate the circular transition, including the development of a national circular economy (CE) strategy. A rich body of legislation is in place, but it mainly has a narrow focus on waste management. Furthermore, scarce enforcement and monitoring undermine the effectiveness of the National Waste Prevention and Management Plan. Key barriers to igniting a more profound transition include the absence of a long-term vision, scarce administrative and technical capacity in the central and local governments, insufficient monitoring and enforcement, poor and unreliable data, and scant cooperation between stakeholders.

Environmental externalities increase in lockstep with economic activity and prosperity in Romania's urban areas. Air pollution in urban areas frequently exceeds EU limits, driven by unsustainable residential heating practices, growing urban transport, a prevalence of polluting vehicles, and a broader increase in economic activity. Pollution levels are higher in the winter, due to the impact of residential heating. Rural areas struggle with forest management, including illegal logging and localized deforestation. Furthermore, nutrient and chemical pollution in water bodies, especially the Black Sea, are of increasing concern, not least due to their transboundary effects.

Cities, through their concentration of people and economic activities, are expected to lead a green, resilient, and inclusive development. To achieve the Paris Agreement and EGD objective of climate neutrality by 2050, and the intermediate Fit-for-55 target, the European Commission guides the cities to lead the change. The 100 Climate-Neutral Cities by 2030 Mission will allocate significant resources to 100 EU cities and to other "follower" cities, to achieve climate neutrality by 2030, serve as examples for other localities, and generate innovation that will speed up the transition to climate neutrality. In Romania, the cities involved are Sector 2 of Bucharest, one of the capital's administrative units; Cluj-Napoca; and Suceava.

Romania's shift to a sustainable growth model will require substantial action from the public and private sectors, as well as a shift in public perception. Three green fiscal measures will be critical to achieving the economic, social, and environmental objectives of the EGD: raising carbon taxes, eliminating fossil fuel subsidies, and — with support from EU funds — ramping up green public investment, especially to decarbonize the energy and transport sectors. Policy action will also need public support. Climate change is less of a burning issue for Romanian citizens than for the average European: only 7 percent of Romanians deem climate change the most serious global problem, versus an EU average of about 20 percent.[126]

Financial markets have a critical role to play in the green and digital transitions. Romania's green transition will require substantial investments.[127] EU and domestic public funds will contribute, but the financial sector will have to fill the gaps. Green assets make up about 3 percent of the portfolio of Romanian banks, less than half the euro area average, while the green borrowing potential of local companies is estimated at about €3 billion. At the same time, about 50 percent of the loan portfolio of Romanian banks sits with companies exposed to climate-related risks. On the supply side, limited institutional capacity is holding back lenders from engaging more in green finance, although banks are making progress towards developing tailored approaches. On the demand side, borrowers lack understanding of the risks and opportunities associated with climate change as well as the ability to develop transition plans, resulting in scarce demand for green investment, and poor bankability for the green projects that are submitted to lenders. While banks will be expected to finance the bulk of green private-sector investment in Romania, capital markets will also have a role to play. The government plans to set up its Green/Sustainable Bond Sovereign Framework in 2023 to issue ESG-themed bonds that will further help Romania's green transition.

The ability of the government to build a supportive environment for the green transition will determine the future competitiveness of the national economy. Governments may facilitate the green industrial transition by ensuring access to green inputs, such as energy, at competitive prices; supporting the efficient use of resources by industries and consumers; optimizing and targeting subsidies for green outcomes; designing carbon pricing frameworks conducive to a structural shift in the economy; ensuring the availability of human capital adapted to the demands of green markets; deepening financial markets and instruments to support the transition; and ensuring the public sector has clear long-term strategies, technical capacity, and an adequate institutional architecture. Failing to do so may erode economic competitiveness, reduce the market share of local companies in Europe, and shift exports to lower value-added markets. This topic will be explored in the forthcoming Romania CCDR, while the forthcoming Romania CPSD offers a brief analysis of Romania's strengths and opportunities in the solar, wind, and EV value chains. The design and implementation of the overall government program for the transition, and the relevant sectoral policies, will determine whether Romania can: (i) protect its natural resources without sacrificing growth and development; (ii) decarbonize the economy, while ensuring energy security; and (iii) protect the vulnerable from both the impact of climate change, and potential economic dislocation induced by the green transition. Addressing governance and institutional constraints to program implementation and crowding in the private sector will be key.

2.6 RESILIENCE TO NATURAL HAZARDS AND CLIMATE CHANGE IS LOW

Romania is prone to a range of geophysical and climate change-induced disasters, epidemics/pandemics, and technological accidents. 101 catastrophic events were recorded in the country between 1900 and 2021 — including 53 floods, 11 earthquakes, 20 extreme temperature events, 11 storms, and two major droughts — affecting over 2 million people, and causing nearly 5,000 deaths and more than US$17.2 billion in losses and damages.[128] Notably, Romania is among the EU countries at highest risk of earthquakes and floods from fluvial and surface water.[129] More than 75 percent of the country's population lives in areas susceptible to earthquakes, with Bucharest widely regarded as the most seismically risky city in Europe.

Potential risks and damages from flooding and seismic events are on the rise, due to climate change and aging infrastructure. The government liability from losses in the event of a major disaster could exceed 0.4 percent of GDP, considering the vulnerability of the residential building stock (estimated to account for more than 50 percent of potential losses) and of public assets.[130] Romania needs to substantially reduce exposure to disaster and climate risk in both the private and public sectors, incentivize the uptake of household and public-asset insurance, and consider making use of sovereign-level financial instruments (e.g., contingent financing and catastrophe bonds). As of 2020, Romania's building stock comprised more than 5.5 million buildings — with residential buildings accounting for more than 90 percent of the total, followed by educational and commercial buildings.[131] Most public assets are owned or managed by local authorities, which thus have a major role to play in strengthening disaster and climate resilience. Disasters also affect people's livelihoods and well-being, risking to push families into poverty.[132] The Social Vulnerability Index[133] shows that high levels of vulnerability correlate with low disaster resilience in peripheral rural areas, which are especially exposed to risk from earthquakes and floods.[134] Urban areas also show signs of social vulnerability.

Disaster impacts are also increasing due to the concentration of people and economic assets and climate change. Forest fires, droughts, landslides, strong winds, and extreme heat also pose significant threats, with climate change likely to increase the frequency and severity of weather-related disasters. At the same time, adaptation readiness in Romania is relatively low, as highlighted in the SCD 2018 and the ECA CCAP. The MunichRe NatCat database[135] estimates €12 billion of losses (99 percent of which were not insured) and almost 1,322 fatalities in the country since 1980 due to climatological and hydrometeorological events. Notably, natural disasters and climate risk disproportionately affect Romania's poorer counties.[136]

Climate change is causing greater variability in precipitation, leading to increasingly severe flood and drought events and attendant water security challenges. This will significantly increase the challenges of Romania's water sector to safely provide water for consumption, agriculture, and energy production, and to protect society, the economy, and the environment from flooding. Water security is already at stake under current climate condition. Existing water infrastructure assets, including many reservoirs and flood defences, have significant shortcomings, and may collapse under the strain of a changing climate. Both infrastructure and institutions for managing water resources, and especially water-related risk, need urgent modernization and reinforcement.

Challenges in the water sector augment vulnerability in energy and agriculture. More severe and frequent droughts will impact hydro and nuclear power generation, which account for around 30 and 20 percent of electricity generation in Romania, respectively. Enhancing energy-sector resilience calls for improving the management of water resources and the efficiency of hydropower generation infrastructure, diversifying energy sources, reducing demand pressure through energy efficiency measures, and investing in additional capacity to offset potential hydropower reduction during dry periods. Moreover, the agriculture sector is particularly vulnerable to the effects of climate change because of fragmented land holdings, inadequate agricultural extensions services, lack of modern and efficient irrigation/drainage systems that could reduce dependency on rain-fed production, and poorly developed ICT systems to share information and provide advisory and support services to farmers, particularly smallholders who struggle to access such services through traditional market channels.

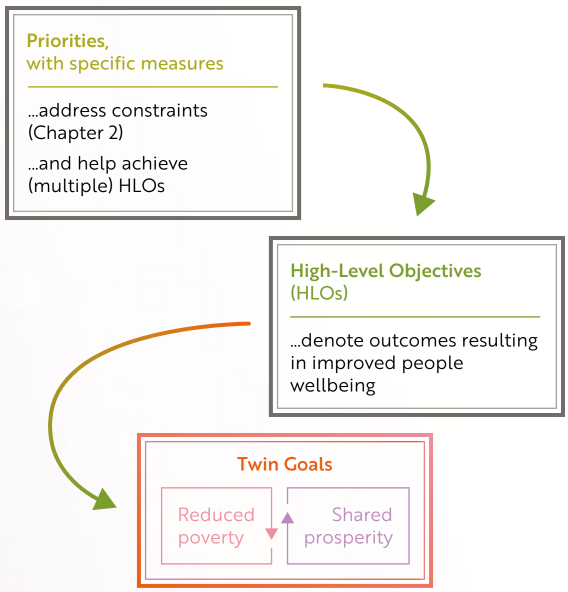
While Romania's vulnerability to climate change and natural disasters is relatively high, its readiness to adapt remains low. Romania has been strengthening its legislative and organizational framework for disaster mitigation, preparedness, and response. However, the investment required to support effective climate policies and disaster risk reduction remains limited, with missed opportunities to maximize adaptation and the inclusion co-benefits achievable when improving public and private assets. Preparing for catastrophic events requires better cross-institutional coordination, and increased horizontal and vertical capacity. In addition, the social protection system is not well placed to adapt to climate-induced shocks, lacking capacity to integrate data on poverty and natural disasters to identify vulnerabilities.[137] Coordination between the Disaster Risk Management (DRM) sector and the social protection system is limited, as shown by the lack of early-action trigger disbursement mechanisms to support communities in case of need.

3 PRIORITIES FOR INCLUSIVE, STRONG, AND SUSTAINABLE GROWTH

This SCD Update reassesses Romania's priorities for achieving inclusive, strong, and sustainable growth, building on: the analysis presented in the previous chapters; extensive consultations with central and local governments, NGOs/CSOs, academia, and other stakeholders; and guidance from the Country Management Unit (CMU). The reforms proposed in the SCD Update are aligned with those identified in the SCD 2018, but they are grouped differently. This revision aims to highlight the role of relevant reforms in improving the population's living standards, and to grant emerging priorities — particularly climate change adaptation and mitigation — a more visible role, given the prominence of the green transition (and the associated EU funds) in national and EU-wide policy goals.

The selection of priorities relied on extensive consultations with the Romania CMU and sectoral teams from the World Bank, IFC, and MIGA. From these discussions, the team collected a longlist of nearly 100 policy actions to address the constraints described in Chapter 2. The team then used four criteria to prioritize these actions: (i) expected impact towards the WBG's twin goals; (ii) complementarity with other policies and goals; (iii) feasibility of policies under current economic, governance, and capacity conditions; and (iv) time horizon for the policies to produce results. As a result of the prioritization process, the SCD Update sets forth 17 priorities, with specific measures underpinning them. Annex 2 provides a detailed table mapping each of the priorities into the four selection criteria.

FIGURE 3.1 Priorities, to HLOs, to Twin Goals



The resulting 17 *priorities* were mapped to six *High-Level Outcomes* (HLOs), formulated to capture desired improvements in the population's wellbeing (Table 3.1). The identified priorities aim to address key constraints discussed in Chapter 2. Each priority maps into and helps progress towards one or multiple HLOs, with mapping presented in Table 1. The HLOs, if achieved over the next five to ten years, would mark an improvement in the wellbeing of the population, and especially of the poorest and most vulnerable (Figure 3.1). The HLOs are complex, interrelated, and — as the name suggests — high-level; therefore, multiple priorities can be relevant to multiple HLOs.

This chapter outlines the relevant priorities for each HLO. The priorities are numbered, but the numbering is not a ranking. The chapter also recommends *specific measures* that would help meet priorities and HLOs, but the list of suggested measures is not exhaustive.

TABLE 3.1 High-Level Outcomes and Priorities

High-Level Outcomes	Priorities
I. **Predictable institutional and economic environment for people and businesses**	1. Mitigate the impact of political instability through establishment of medium-to-long-term strategic and spending priorities [HLO2, HLO3, HLO4, HLO5, HLO6] 2. Improve citizens' trust in the state [HLO2, HLO3, HLO4, HLO5, HLO6] 3. Ensure fiscal sustainability [HLO2, HLO3, HLO4, HLO5, HLO6]
II. **Equal access to high-quality public services at central and local levels**	4. Enhance public sector human-resource management to improve public-service delivery [HLO1, HLO3, HLO4, HLO5, HLO6] 5. Increase effectiveness and efficiency of public-service delivery at central and local levels [HLO3, HLO4, HLO5, HLO6] 6. Improve access to quality public infrastructure and services (e.g., transport, digital network, water and sanitation, district heating, solid waste management, social benefits and social services) for the poor, the vulnerable, and those in rural areas [HLO3, HLO4, HLO5, HLO6]
III. **Better health and education outcomes for all**	7. Improve health outcomes and provide equitable access to healthcare services [HLO4] 8. Provide access to quality education for all [HLO4] 9. Strengthen lifelong skills formation, especially for vulnerable groups [HLO4]
IV. **Favorable conditions for more and better private-sector jobs**	10. Close the gaps in transport and other infrastructure for international and domestic connectivity [HLO2] 11. Increase financial intermediation and inclusion [HLO 5, HLO6] 12. Enhance market competition and innovation [HLO5, HLO6]
V. **Climate change mitigation for environmental sustainability of economic activity**	13. Accelerate decarbonization, improve regional interconnections, and ensure energy security [HLO2] 14. Reduce environmental degradation (water, land, atmospheric) [HLO2]
VI. **Resilience to shocks and adaptation to climate change, especially for vulnerable households**	15. Scale-up risk prevention/reduction, and improve preparedness for, response to, and recovery from natural disasters [HLO2] 16. Enhance financial resilience of the public and private sectors to natural disasters [HLO2, HLO4] 17. Safeguard water security, and ensure better prevention of and protection from water-related disasters [HLO2]

Note: Secondary HLOs in brackets.

HLO-I Predictable political and economic environment for people and businesses

While many priorities and HLOs are connected, HLO-I — *Predictable political and economic environment for people and businesses* — is the most cross-cutting, with *each* of its priorities mapping into *all* HLOs. This reiterates the key lesson from the SCD 2018: despite impressive economic growth, achieving shared prosperity and sustainable welfare improvements will remain a distant reality if Romania does not address its governance challenges. Institutional strengthening is required across all tiers of the government (national and local) and policy areas, for both existing and emerging challenges and opportunities. The priorities identified under this HLO aim to strengthen the public planning and implementation framework, anchoring it with medium-term objectives; reduce disruption from political instability; gradually enhance fiscal sustainability; and foster accountability to increase citizens' trust.

PRIORITY #1:
Mitigate the impact of political instability through the establishment of medium-to-long-term strategic and spending priorities, *supported by the following specific measures:*

Link strategic planning to budget priorities at center-of-government (CoG) level. This can be achieved by strengthening the link between planning and public spending (efficiency/efficacy); aligning strategic policy priorities to public investment, in order to reduce duplication, inefficiency, and the infrastructure gap; and by increasing transparency and improving monitoring of the implementation of strategic plans.

Strengthen the strategic management and planning framework at central level. This entails a focus on implementing recent legislative changes under the NRRP, aiming to strengthen strategic management and planning and gradually introduce results-based budgeting. Such effort will require political leadership, as well as bolstering the planning and budgeting capacity of ministries and agencies through skills upgrades and systems enhancement. Institutional strategic plans prepared by ministries will benefit from being integrated into the budget preparation process.

PRIORITY #2:
Improve citizens' trust in the state

Strengthen the accountability of institutions by reinforcing the Court of Accounts. Enhancing the auditing capacity of Romania's Court of Accounts (RCOA) would have a positive impact on public services and the efficient use of government resources. To this end, it is critical to develop the RCOA's annual and multi-year audit programs linked to the goals and objectives of its strategic plan, and to implement a staff recruitment and training model that matches staff competencies to institutional strategic priorities, and while improving the quality of audits.

Develop and implement a new strategy for the justice sector. Such a strategy would be best focused on improving intra- and inter-institutional capacity, strengthening HRM practices, and building out more responsive and resilient infrastructure to deliver high-quality, efficient, and effective services to citizens.

PRIORITY #3:
Ensure fiscal sustainability

Reduce the fiscal deficit and stabilize public debt through policy and institutional reforms. To close the fiscal deficit stemming from structural issues (public wages and pensions), the pandemic-induced crisis, and Russia's invasion of Ukraine in a sustainable fashion, the government has committed in the NRRP to promoting reform on both sides of the budget: revenues and expenditures. To improve revenue collection, a modernization of the Tax Administration Agency (ANAF) has been launched, although results will only become apparent in the medium term. Removing or reducing tax exemptions (e.g., for the self-employed, or for certain categories of employees) would significantly boost budget revenues. On the expenditure side, the recently launched reforms of public wages and public pensions, if brought to conclusion, have the potential to lead towards a more fiscally sustainable and equitable path.

Adopt medium-term fiscal consolidation measures, such as improving the tax administration as well as payments processes and systems. Relevant measures include streamlining budget processes; developing a digitized Integrated Financial Management Information System (IFMIS); enhancing the efficiency and effectiveness of revenue collection and the tax administration through business process reengineering, integrated risk management, and systems modernization; and mandating the use of electronic invoices to increase VAT collection and combat tax evasion.

HLO-II Equal access to high-quality public services at central and local levels

HLO-II focuses on achieving public services that are both high-quality, and equally accessible across geographical, income, ethnic, and any other formal or informal divides. As is the case for HLO-I, the priorities under HLO-II are highly cross-cutting. For instance, priority #4 recognizes the urgency to equip the government with skills and incentive structures that can both boost service delivery for people across Romania and strengthen core government functions at central and local levels. In addition to capacity improvements, stronger coordination across government departments and tiers of government can bring efficiency gains, while selective decentralization can bring more accountable, locally informed decision-making tailored to citizens' needs. At the same time, enhancing the quality of social services and coverage of outcome-oriented social protection systems, while targeting vulnerable groups and those with less access to opportunities, would contribute to a more equitable society.

PRIORITY #4:
Enhance public sector human-resource management to improve public-service delivery

Speed up the implementation of human-resource management (HRM) reforms in the civil service and digitize the HRM system. Operationalizing HRM reforms developed for the civil service would help ensure a competency-based approach to recruitment, performance management, and career progression. This includes rolling out the competency framework model, along with an improved classification of public administration jobs and the development of clear job descriptions. The new merit-based recruitment system (the National Contest) should be piloted and updated based on the pilot's results. Digitizing the HRM system and developing more-effective competency-based training would be also valuable. Finally, the government can introduce employee engagement tools to monitor progress on key reforms, including the future implementation of performance-based pay mechanisms. Implementing HRM reforms will also require a stronger institutional set-up and greater capacity within the National Agency for Civil Servants.

PRIORITY #5:
Increase effectiveness and efficiency of public-service delivery at central and local levels

Support the digital transformation of the public sector, including digital skills development. The government can accelerate the digital transformation of the public administration through a holistic approach, starting from bolstering foundational elements such as ICT architecture, the policy and regulatory frameworks, and digital skills. The mandate of the Ministry of Research, Innovation and Digitalization can encompass the role of digital transformation office in the center of government, with a clear remit for cross-government coordination. The government can also consider developing Government Cloud Infrastructure, establishing a citizen-centric e-government portal, and preparing and implementing an HR strategy for ICT staff in the public administration. These measures will require upgrades to the data infrastructure, new digital platforms and services, and new or updated laws and regulations. At the same, guaranteeing sufficient physical access to services will be necessary for inclusiveness. A successful transformation will also depend on upskilling public servants and boosting basic digital skills among the wider population, with a focus on low-education, low-income, elderly and fragile groups.

Implement results-based and programmatic budgeting. The efficiency and effectiveness of public investment programs would benefit from a shift from a retail approach that addresses individual investments, to a more systematic and results-oriented framework. Thus, investment allocations should be tied to a set of minimum-access and/or performance-based conditions. Collecting and analyzing information from the execution of the budget, and feeding it back into the decision-making process, would contribute to incrementally stronger links between performance and budget allocations.

Strengthen CoG to promote cross-government coordination and the alignment of Public Investment Management (PIM) with strategic priorities. Relevant steps include: strengthening national and subnational government capacity to increase efficiency and value for money in public capital spending; developing integrated IT planning and monitoring systems, to support informed decision-making on public investments; establishing a consolidated government investment strategy; rolling out a consolidated data platform and a project bank to better prioritize projects and more effectively monitor individual investments and broader portfolios. Moreover, public procurement can be a strategic tool to secure social, environmental, and innovation benefits. Reducing administrative costs through centralized procurement, enhancing transparency, strengthening procurement monitoring, supervision, and control functions, and further developing the capacity, capability, and integrity of procurement professionals at both national and subnational levels would also improve the quality of public investment management.

Decentralize, transfer certain public assets, and create own-source revenue opportunities for local governments. Transferring some of the assets owned by the central government to local authorities, or enabling partnerships between central and local administrations — while ensuring the latter are adequately resourced — could enable local regeneration projects with transformative potential. Reviewing the subnational fiscal transfer framework, developing a market-based property valuation system, and equipping local governments to enhance their property tax collection system are other critical areas.

PRIORITY #6:

Improve access to quality public services for the poor, the vulnerable, and those in rural areas

Improve accessibility and quality of municipal infrastructure and services — transport, digital networks, clean water and sanitation, district heating, and solid-waste management, including through public-private partnerships, where appropriate. Bridging the urban-rural divide and closing the infrastructure gap in peri-urban localities requires major investments in public infrastructure (potentially in the form of public-private partnership), integrated approaches (e.g., at the metropolitan or functional urban area level), well-coordinated spatial planning, better targeting, and a stronger focus on results, impact, and sustainability. Public investments in digital connectivity will be necessary in regions that are not economically viable for private telecoms operators. Moreover, the government's preparation, implementation, and monitoring of programs in water and sanitation infrastructure — such as the national program First Connection to Water and Sanitation under the NRRP — can make a meaningful impact, while developing a national Water Supply and Sanitation Strategy can help address infrastructure implementation bottlenecks and incentivize performance improvement. Further capacity building and institutional strengthening of important sectoral players, such as the National Authority for the Regulation of Public Utility Community Services (ANRSC), is also important. Legislation on waste-management responsibilities and ownership would be beneficial to the ailing and largely inefficient solid-waste management system, especially if it encourages private-sector participation. In transport infrastructure, addressing the maintenance and rehabilitation backlog on the road and railways network, on and beyond TEN-T corridors, is paramount. The maintenance of the rail network would need additional funding, with 75 percent of all lines needing urgent repairs. Moreover, almost 60 percent of national roads and highways have exceeded their service life and require capital repairs, an issue that CNAIR (the state-owned road administrator) has little capacity to address. The solution may reside in the new entity CNAIR managing new motorway investments, and CNAIR partnering with local authorities to ensure maintenance services. Overall, the most effective way of bringing benefits to transport users is to ensure competition in the supply of transport services, thus incentivizing efficiency and quality among operators.

Enhance the effectiveness and administrative efficiency of the social benefits system. Relevant steps include: (i) ensuring that means-tested benefits are more effective in reaching the poorest, and of sufficient value to help beneficiaries rise out of poverty and social exclusion; (ii) consolidating means-tested benefits, to enhance administrative efficiency and facilitate access for eligible families; and (iii) linking social benefits to human development outcomes, e.g., by using early childhood development interventions and other social services to raise school attendance among vulnerable population groups; as well as incentivizing employment by linking vulnerable groups to employment services and skills development.

Strengthen community-level social services for vulnerable groups, including people with disabilities and the elderly population. Progress in social services hinges on an adequate regulatory framework, a clear strategy for developing services at the county level tailored to the needs of vulnerable groups, and budgetary arrangements ensuring sufficient financing. Given the country's demographic trends, demand for social services for vulnerable groups — including children, people with disabilities, and the elderly, among others — is expected to grow. Meeting this demand will require enhanced case management; accurate needs assessments; integrated service provision at the community level; greater room for co-decision and participation of beneficiaries in the provision of social services; faster deinstitutionalization; and better information management and monitoring.

HLO-III Better health and education outcomes for all

With lack of skills an increasingly binding constraint to growth and inclusion, HLO-III defines human capital improvement as a standalone objective, while acknowledging its close connections with HLOs II and IV. Although human capital outcomes depend on a multitude of factors, health and education have a substantive impact on a person's economic and physical wellbeing. Human capital — and particularly skills — was also flagged as an ever more urgent bottleneck during extensive consultations with stakeholders in the private sector, government, academia, and civil society. Similarly to HLO-II, HLO-III is underpinned by priorities focused on improving health and education outcomes for all — while paying special attention to those currently with poorer access or lower quality services, and those whose learning outcomes deteriorated during the pandemic. In addition, priority #9 advocates for a lifelong approach to skills formation, with a view to not only improving economic outcomes for workers — especially those falling behind or employed in declining sectors — but also to building a stronger, more adaptable labor force that can help boost growth in the coming decades.

PRIORITY #7:
Improve health outcomes and provide equitable access to healthcare services

Boost efficiency in health spending and improve the quality of healthcare and patient safety. Introducing discipline in public expenditure and supporting preventive care and primary healthcare (PHC) is recommended to ensure that Romania gets the best value for money. Relevant steps include: rebalancing the currently hospital-centric system towards effective PHC; implementing centralized procurement and other pharmaceutical policies; and improving data governance and health IT systems.

Expand the scope of PHC and the supply of outpatient healthcare in vulnerable communities, and harmonize benefits packages for the insured and the uninsured. Enhancing access to PHC for underserved populations — the poor, the uninsured, and vulnerable communities — requires expanding legal entitlements and public financing. Harmonizing the benefits packages for the insured and the uninsured would yield direct economic benefit through greater efficiency in health spending. Moreover, the role of family physicians should be strengthened by (i) expanding their mandate toward preventive care and initiation of care for several ambulatory care-sensitive conditions, and (ii) adjusting capitation rates by disease risk, so that providers are incentivized to treat high-risk groups.

Strengthen community healthcare services, such as community nurses and Roma health mediators. Community-based models of care can facilitate health education, and help address cultural norms hindering the use of care that is legally, physically, and financially accessible. Relevant steps include: (i) expanding community healthcare, including through increased budget allocations, and strengthening its collaboration with PHC; (ii) standardizing the daily work of community health workers, including community health nurses and Roma health mediators, and (iii) providing health education and support in navigating the health system, particularly PHC.

Modernize public healthcare infrastructure and service delivery. Targeted investments — building on synergies between World Bank support, NRRP financing, and structural funds — could focus on: (i) improving access to and quality of selected life-saving services and screenings, (ii) strengthening government capacity for improving the quality of medical care; (iii) reinforcing public health emergency response, especially in relation to COVID-19; (iv) increasing resources for hospitals, PHC, and inpatient care; and (v) reforming lagging areas of healthcare, such as mental health, palliative care, and geriatrics.

PRIORITY #8:
Provide access to quality education for all

Increase access to integrated, affordable, and quality Early Childhood Education and Care (ECEC), especially in rural, poor, and marginalized areas, and in areas where employment and learning opportunities for women are greater. The supply of quality ECEC services can be coupled with vocational education and training or dual education programs, prioritizing low-literate mothers — including those in Roma communities, where the risk of child marriage is greater — and NEETs.

Improve the quality of education in primary and secondary schools where more students are at risk of dropping out and exhibit poor academic performance. An integrated framework of education and psychosocial support in such schools hinges on greater and more effective investment in developing the cognitive and socio-emotional skillsets of children, teacher training, and a modern and inclusive learning environment. In addition, a School Early Warning Mechanism would help schools identify, support, and track the progress of students at risk of dropping out, with a focus on creating a positive climate in schools, bringing out-of-school children back to school, implementing learning recovery plans, and monitoring progress toward better learning outcomes and school completion.

Accelerate learning recovery, particularly for children from households with low socioeconomic status. An appropriate learning recovery framework encompasses an initial assessment, a consolidated curriculum, improved classroom practices, expanded instructional time, digital equipment, small group tutoring, and self-guided learning, especially for disadvantaged students.

PRIORITY #9: Strengthen lifelong skills formation, especially for vulnerable groups

Develop activation and employment support measures for vulnerable job seekers and the inactive population. The government can enhance the capacity and efficiency of the public employment agency (ANOFM) to help the young, the vulnerable, and other difficult-to-employ groups enter the labor market. Reform can enable ANOFM to provide programs and training courses addressing specific labor market demand for skills, support the transition from education to the labor market (particularly for at-risk youth), and improve labor market mediation. In addition, the government can incentivize the implementation and effective integration of existing programs on outreach, counseling, training, and mediation, and enhance case management to improve services for disadvantaged or at-risk job seekers and the economically inactive population. It is equally important to align migration policy to labor market needs, to help fill emerging labor shortages. Stronger monitoring and evaluation capacity would help ensure that public resources are directed to programs with a strong track record of positive results.

Design a flexible vocational training system focused on skills relevant to the labor market. It is important to harmonize the quality of Initial Vocational Education and Training (IVET) and Continuous Vocational Education and Training (CVET), clarify the links between occupational standards, qualifications, and curricula, and ensure that curricula and skills have relevance on the job market. Technical and Vocational Education and Training (TVET), including short courses, needs to be more flexible, permeable, and accessible, to offer lifelong learning opportunities to the Romanian workforce. Investments in digital infrastructure and training programs for teachers and students can enhance online learning and teaching, especially in IVET. Moreover, the government can consider more inclusive approaches to program delivery and collect more data on vulnerable students.

Improve on-the-job training, including traineeships and apprenticeships. The government can use the existing social partnership structure to increase the role and responsibility of employers in providing on-the-job training to workers, as well as incentivize private investment in more effective on-the-job training.

HLO-IV Favorable conditions for more and better private-sector jobs

HLO-IV recognizes that the private sector will remain the engine of growth, but needs a better enabling environment to operate effectively and be competitive within the EU and beyond. With Romania's public resource envelope among the smallest in the EU, it is paramount to focus on key priorities: better infrastructure; a more predictable regulatory environment to boost market competition, innovative capacity, and financial sector development; and functioning labor markets where employers can find, and build on, relevant skills. While the forthcoming Romania CPSD will delve into these issues, this section outlines some of the necessary measures.

PRIORITY #10: Close gaps in transport and other infrastructure for international and domestic connectivity

Invest more and more efficiently in national and subnational transport infrastructure, mobilizing private financing where appropriate. The on-going partnerships with the local administrations and the challenge to fund numerous transport projects in the next decade stretches well beyond the available EU funding. This raises two challenges: (a) building the capacity to evaluate, deliver, and monitor dozens of transport infrastructure projects; and (b) mobilizing the necessary funds. Legally insulated project delivery units, clear mechanisms for project-related political debate, and stability of the technical process can help mitigate political economy challenges at different stages of the project cycle. Such arrangements could apply to nationally important projects, such as the modernization of motorways and national railways.

PRIORITY #11: Increase financial intermediation and inclusion

Develop a strategic and coordinated approach to foster financial inclusion, financial literacy, capital market development, and greening of the financial sector. Coordinated efforts among policymakers are essential to tackle significant financial inclusion gaps. Critical measures include: designating a lead institution on financial inclusion, with a clear mandate; developing a comprehensive approach to financial literacy for individuals and MSMEs, targeting key segments; and rolling out a coordinated strategy in support of capital market development, integrated with the sustainable finance agenda. Development finance institutions, including the soon to be established national development bank, can play a catalyzing role in green finance markets. The data infrastructure supporting financial inclusion, especially in relation to data about the rural gap, needs to become more robust.

Enhance access to finance for individuals, by increasing account ownership and usage and leveraging digital financial services. Key initiatives should focus on: (i) digitizing person-to-government and government-to-person payments, to incentivize a shift away from cash among consumers; (ii) enhancing the rural payments infrastructure, particularly to boost acceptance of electronic payments among merchants; (iii) leveraging existing rural networks, such as Posta Romana and third-party retail agents, as low-cost delivery channels; and (iv) further fostering fintechs and broader innovation. Other valuable steps include performing a broad analysis of constraints to digital payments, and developing a retail/digital payment strategy.

Enhance access to finance for MSMEs by diversifying available financial instruments and market players, and strengthening financial infrastructure. Relevant measures include: supporting cooperative banks and microfinance institutions to modernize systems and expand operations; enabling financial institutions to access relevant government data on SMEs; encouraging the use of instruments that are especially valuable to SMEs, such as factoring; conducting a comprehensive assessment of legal, regulatory, tax, and market-infrastructure issues affecting the development of the capital markets; and fostering capacity building across capital markets stakeholders. Public support instruments, such as credit guarantee programs for SMEs, can be reassessed to identify areas for improvement and maximize the efficiency of public resources, including through the upcoming development bank. Steps to improve credit infrastructure include enabling the Credit Bureau to capture alternative data sources and company information, lowering the coverage threshold for the Central Credit Registry to capture small borrowers, and addressing challenges in the insolvency and secured transaction frameworks. Setting up the Romanian national development bank will aim to address gaps in access to finance and help catalyze private investments.

PRIORITY #12:
Enhance market competition and innovation

Remove regulatory constraints to growth of productive firms and streamline administrative procedures. The deterioration in allocative efficiency in selected sectors points to the importance of removing barriers to the undisturbed flow of production factors, as well as of greater competition. The services sector requires particular attention from policy makers, as it faces specific challenges from anticompetitive barriers and onerous administrative procedures that significantly hold back the growth of more-productive firms.

Reduce/streamline the role of SOEs to ensure competitive neutrality. SOE activity should have a clear economic rationale and avoid crowding out the private sector. Therefore, state-controlled firms should only operate in sectors where the presence of the state is needed as a last resort, to correct for a market failure. When SOEs compete with the private sector they should follow commercial rules, showing a positive net present value and achieving a commercial rate of return.

Improve the design and implementation of policies that promote technology adoption, technology transfer, digitization, and the upgrade of firm capabilities. It is important to design policies that incentivize firms to digitize, build innovation capacity, and enhance managerial skills to successfully transition towards Industry 4.0. Linkages between foreign firms and local suppliers would also promote corporate expansion, innovation, and skills upgrades, especially in the ICT and automotive sectors, which feature a significant concentration of highly productive companies.

Increase the scale and effectiveness of R&I spending and enhance the innovation ecosystem. Greater financing for research and innovation (R&I) can help improve the quality of innovation outputs. Moreover, increasing the predictability and competitiveness of the resources made available to the R&I sector is a pressing priority, along with reinforcing governance, coordination, and capacity across institutions that design and implement R&I policy.

HLO-V Climate change mitigation for environmental sustainability of economic activity

HLO-V and attendant priorities set out the first key steps for delivering on Romania's climate ambition, anchored in the EU-wide legally binding commitments and deadlines. As climate action presents an additional challenge to Romania's development priorities, it is intrinsically linked to, and relies on progress toward, other HLOs — especially the institutional strengthening and long-term planning articulated under HLO-I. While the forthcoming Romania CCDR will outline mitigation and adaptation opportunities in more detail, the priorities below emphasize decarbonization in key polluting sectors (particularly energy and transport), the expansion of carbon sinks through forest management, and measures to avert broader environmental degradation. Careful policy consideration will be needed to not only ensure the equitability of the transition — not just in the coal regions, but in the shrinking sectors of the economy as mitigation policy action induces structural transformation; but also to limit the trade-offs between development and climate objectives, instead aligning them for inclusive and sustainable growth.

PRIORITY #13:
Accelerate decarbonization, improve regional interconnections, and ensure energy security

Accelerate the deployment of low-carbon electricity and heat generation technologies and the electrification of the economy, ensuring an equitable energy transition. Boosting adoption of new technologies and achieving efficiency and financial sustainability in the energy sector hinge on mobilizing private-sector investment at scale and increasing the absorption of EU funds. This requires more efficient institutions, well-governed SOEs, and stable, predictable, and transparent legal and regulatory frameworks. An upgraded electricity transmission network is necessary for the growth of green energy generation. The progressive phasing out of obsolete, polluting technologies will require adding new renewable energy capacity at the appropriate pace, as well as policies to ensure an equitable transition for negatively impacted population groups.

Reduce the energy intensity of the economy through more-efficient energy consumption. The building stock, including public buildings, will need progressive renovation to reduce energy losses, and the installation of energy-efficient equipment and appliances. Renovating distribution networks can also reduce energy consumption by utilities (e.g., district heating and water networks). Industrial and agricultural processes should incorporate low-carbon technologies and integrate energy-efficient systems. The general public can contribute by embracing energy efficiency and conservation.

Support transport decarbonization by shifting to cleaner transport modes. The transport sector, in particular road transport, is the third-largest source of CO_2 emissions in Romania, after electricity and heat generation. To meet binding EU emissions targets, Romania will need to implement effective road pricing, end fossil fuel subsidies, and improve railway management.

Facilitate the transition of cities to climate neutrality. Coordinated and integrated efforts at the local level are critical to the transition to climate neutrality, especially as urban and peri-urban areas generate nearly half of domestic GHG emissions. If supported with sustained and coordinated efforts, more cities in Romania can follow the lead of Bucharest, Cluj-Napoca, and Suceava, which have pledged to complete the transition by 2030 under the EU's flagship "100 Climate Neutral Cities by 2030" Mission.

PRIORITY #14:
Reduce environmental degradation

Bolster the management of protected natural areas and forests. Under the NRRP, Romania has committed to reforming the protection of natural areas and implementing the EU Biodiversity Strategy. The NRRP also envisions a reform of forest management and governance systems, through the development of a new national forest strategy and a robust strategic and regulatory framework for the implementation of sustainable forest policies in support of climate change mitigation and adaptation. Implementing such reforms would help reduce biodiversity loss and forest degradation.

Implement the National Circular Economy Strategy. As part of the NRRP, Romania adopted a National Circular Economy Strategy in September 2022. Further measures under the NRRP include the adoption of a circular economy action plan covering the whole life cycle of products, as well as legislation on unitary waste management, waste treatment, municipal sanitation services, and the responsibilities of packaging producers. A swift implementation of the National Circular Economy Strategy and the related action plan will be critical.

Adopt a National Air Pollution Control Program. Romania needs to reach full compliance with EU air quality standards, and maintain a downward trend in the emission of air pollutants to reduce adverse impacts on health and the economy. To this end, priority measures include upgrading the air quality monitoring network, and ensuring timely reporting of air quality data.

HLO-VI Resilience to shocks and adaptation to climate change, especially for vulnerable households

Considering Romania's high vulnerability to natural disasters and climate change impacts, HLO-VI reiterates the importance of continued upgrades to the country's response, recovery, and adaptation capabilities. Resilience to natural disasters and ability to adapt to climate systems rests on development of response systems with adequate capacity and funding. Enhancing financial and social protection systems would not only directly support the population, but also help build the foundation for the mitigation efforts outlined under HLO-V. With lagging water service access and its role in key economic sectors' ability to adapt to climate change, water action is paramount.

PRIORITY #15:

Scale up risk prevention/reduction, and improve preparedness for, response to, and recovery from natural disasters

Integrate disaster and climate resilience into development policies and investments. Action areas for the government include: streamlining approval processes, conducting regular revisions based on legislative or technical priorities, and evaluating their effectiveness after regular consultations. Investments can be targeted to maximize cost-effectiveness, address multiple hazards, and ensure co-benefits in sustainability inclusivity, and population's well-being.

Invest in disaster- and climate-resilient public and private buildings. Increasing the share of disaster- and climate-resilient buildings in the total stock, and investing in critical emergency-response infrastructure, are urgent priorities. Land use and urbanization planning also need to integrate disaster and climate resilience.

Bolster the civil protection system (vertical and horizontal). There are opportunities to upgrade infrastructure, equipment, and tools, mobilize additional human and financial resources, and improve evacuation, sheltering, and volunteer-engagement frameworks, in line with a whole-of-society approach. A coherent recovery framework will need to take into account 'Building Back Better' principles for post-disaster reconstruction.

Build surge capacity in the public and private sectors for catastrophic, complex, and cascading events. In a context of more frequent and intense disasters, adequate surge capacity is critical to saving lives and livelihoods and protecting assets. Achieving it entails supporting key institutions and the private sector to improve emergency contingency and business continuity planning, as well as readiness for multiple risks. Critically, this includes ensuring surge capacity in emergency response, healthcare, and social services.

PRIORITY #16:

Enhance financial resilience of the public and private sectors to natural disasters

Develop an adaptive social protection system. Romania's social protection programs need to become adaptive, so they can better respond to shocks and support the poorest and most vulnerable in recovering from disasters. This entails: (i) optimized data collection, (ii) integration of DRM and social protection strategic frameworks and strategies, (ii) coordination and collaboration across government and with CSOs; and (iv) interoperability of social protection and disaster event data.

Expand the availability of disaster insurance for private and public assets. Disaster response, recovery, and reconstruction place a major financial burden on the government, partly due to a low uptake of catastrophe insurance among homeowners (even though it is legally mandatory), and the limited application of public-asset insurance. A broad review of natural-disaster insurance would help assess existing instruments and/or develop new ones.

Enhance the financial sector's readiness to support climate change adaptation and mitigation and increase public awareness. A clear funding gap exists in many disaster scenarios. A disaster finance strategy aimed at devising predictable, rapid, and flexible financing instruments (e.g., contingent lines of credit, insurance) for disaster response, recovery, and reconstruction is a critical step.

PRIORITY #17:
Safeguard water security, and ensure better prevention of and protection from water-related disasters

Accelerate investments in water infrastructure and create a new financing model for the water sector. The operation, maintenance, and modernization of water resources and flood-risk management infrastructure hinges on updated, more robust financing mechanisms. This entails a revision of current legislation (the Water Act and related secondary legislation), as well as expanding ANAR's capacity and resource allocation through both training and a new approach to the three Ts: tariffs, taxes, and transfers.

Expand water storage, both natural and man-made. With increasing variability in precipitation due to climate change, the role of water storage at times of drought, as well as in retaining excess water and preventing flooding, is ever more important. Investment is needed to rehabilitate, retrofit, and better operate existing reservoirs. Natural storage is to be protected more effectively and, where possible, re-established, e.g., by reconnecting flood plains to rivers, or through reforestation.

Assess water security and develop drought-risk management strategies at river-basin scale. A better understanding of water security risks and the preparation of long-term water management strategies require an updated assessment of water availability and demand, as well as of flood, drought, and water quality risks at river-basin scale. Plans drawing from these assessments should set out water allocation policies, measures for more efficient use and re-use of water, and drought forecasting and contingency programs.

Enhance agriculture's adaptability to climate change. Many risks to agriculture are water-related (e.g., from intensifying flooding and droughts), spelling out a need to improve the sector's readiness for climate change adaptation. Efforts in this area could start with developing a national strategy and action plan for the adaptation of agriculture to climate change, underpinned by a diagnostic study at the level of agro-eco zones and exploitations.

KNOWLEDGE GAPS

The priorities for Romania will continue to evolve as the political and economic landscape changes domestically and internationally, and new evidence emerges. During the diagnostic, the team identified certain knowledge gaps that would merit further research. Filling these gaps would help policy makers design more effective interventions and better assess their impacts. Some gaps will be addressed in forthcoming diagnostics, such as the CCDR, CGA, and CPSD; others depend on shortcomings in the available data. Notable knowledge gaps include:

- Up-to-date analysis of the pattern of migration and its linkage with the spatial pattern of labor market demand and supply, detailed characteristics of Romanian migrants, and the role of remittances in the local economy. A fresh round of EU-wide census data from 2021–2022 can be an important source to fill this knowledge gap.

- In-depth analysis and interlinkage of spatial disparities in poverty, climate vulnerability, and related development outcomes at granular level (e.g., town/commune). Data from Romania's 2022 census, together with household and administrative data and climate risk maps, can potentially address this gap.

- The effects of demographic trends (e.g., aging and emigration) on fiscal space (both for tax revenue and social spending), growth, and development outcomes.

- The determinants of gender gaps in labor market opportunities. Addressing the root causes of the gender gaps in economic opportunities can help ease the pressure of skills shortage identified in this SCD Update. The forthcoming CGA can build a foundation for in-depth understanding of gender disparity and help design appropriate policies to tackle the constraints Romanian women in the labor market.

- In-depth analysis of the whole-of-economy impacts of reaching the EGD targets, and the trade-offs and policy options for Romania in relation to climate change mitigation and adaptation. The forthcoming CCDR will be a starting point for analytical work on the interplay of development and climate objectives.

ANNEX 1

BOXES

BOX A.1 An update on firm productivity

Despite three decades of dynamic economic growth, labor productivity in Romania remains below the EU average. To produce the same output as its average German peer, the average Romanian manufacturer needs almost four times as many employees, while the average firm in construction or services needs three times as many.

Aggregate productivity performance is mainly driven by two components: i) within-firm productivity growth, i.e., firm-level improvements in productivity due to, for example, innovation, technology adoption, or better managerial practices; and ii) between-firm productivity growth, i.e., greater allocative efficiency that helps more-productive firms increase their market share.

Starting in around 2013, rising firm-level efficiency improvements and markups (within-firm productivity growth) boosted total factor productivity (TFP) in Romania's manufacturing sector; in recent years, more-productive firms have increased their market share (between-firm productivity growth), sustaining productivity performance in the sector. Manufacturers in Romania experienced a positive within-firm productivity shock that peaked around 2015–2016, followed by improvements in allocative efficiency (Figure BA.1.1)—effectively, the increased capabilities of high-productivity firms translated into greater market share, underlining an efficient market dynamic. The slow-down in within-firm productivity after that peak indicates a need for policies that incentivize continued capability improvements among firms—e.g., through digitization, building innovation capacity, and enhancing managerial skills—in order to successfully transition towards Industry 4.0.

In services, an inefficient allocation of resources to less-productive firms (i.e., a negative between-firm component) has countered a positive performance in within-firm productivity. Services firms in Romania also experienced a positive within-firm productivity shock, which gradually faded after its peak in 2015–2016 (Figure BA.1.2). Unlike in manufacturing, productive services firms were not able to capitalize on improved efficiency, which points to an inefficient market dynamic. The lack of progress in allocative efficiency in services warrants urgent investigation from economic policymakers, and emphasizes the need for instruments that facilitate the mobility of production factors across firms in the sector.

FIGURE BA.1.1 Decomposition of Growth in Manufacturing Productivity (TFP)

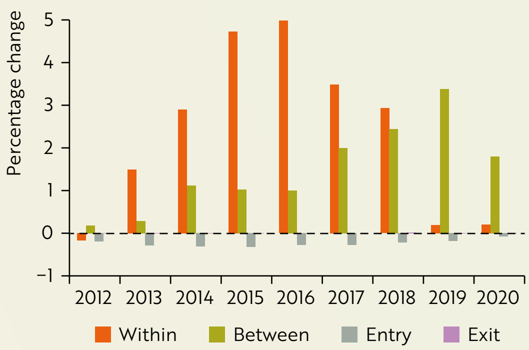
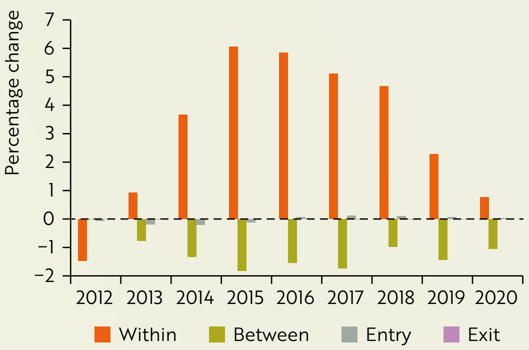


FIGURE BA.1.2 Decomposition of Growth in Services Productivity (TFP)



Source: World Bank analysis based on data from Romanian Ministry of Finance.

Note: Decomposition of three-year productivity growth rates per the Melitz-Polanec method (Melitz and Polanec, 2015), smoothed out to show annual change.

BOX A.2 SCD 2022 is an Update to SCD 2018

This study aims to update the first Romania Systematic Country Diagnostic (SCD), completed in 2018, which identified four priority areas to boost growth and inclusion in the country (see below). Romania has made some progress since the publication of the SCD 2018 in addressing constraints to growth, as well as in reducing poverty and inequality, but more needs to be done to substantially improve outcomes for citizens and businesses across income groups and regions.

A Summary of the 2018 Romania SCD

The country's transformation in the 30 years prior to 2018 was "a tale of two Romanias": one urban, dynamic, and integrated with the EU; the other rural, poor, and isolated. A consolidation of democratic institutions accompanied an unprecedented rise in income per capita. The most dynamic firms and individuals fully benefited from the country's EU membership since 2007, with Bucharest and a handful of other cities becoming vibrant centers with growing population and income. Yet, vast segments of the population were left behind, unable to take advantage of the same opportunities.

Against this backdrop, the SCD 2018 focused on four main areas…

1. Easing supply-side constraints to **growth**
2. Expanding opportunities for **shared prosperity**
3. Improving resilience to natural hazard and **climate change**
4. Strengthening **institutions** for inclusive growth

… and identified four priority areas of intervention:

- increasing the effectiveness and efficiency of the state in public-service delivery
- ensuring equal opportunities for all
- catalyzing private-sector growth and competitiveness
- building resilience for sustainable growth

Key lesson from SCD 2018: Despite impressive economic growth, shared prosperity and sustainable welfare improvements will remain a distant reality if Romania does not **address its governance challenges**.

BOX A.3 Development of secondary cities

Most well-performing regions in the EU have a dynamic urban area or agglomeration within their boundaries, or are close to such an area. A significant body of research shows that urban areas are a country's economic growth engines, and the areas most likely to generate the productivity surplus necessary to sustain regional and national growth.

Secondary cities are particularly important, as their performance can boost or tank a regional economy. Lagging regions tend to have poorly performing urban areas. Conversely, dynamic urban areas have a positive development impact well beyond their administrative boundaries.

Among Romania's less-developed regions, those near a dynamic city display much higher rates of socio-economic development than those further away, according to a range of indicators (e.g., firm revenues and the Local Human Development Index). While not all Romanian cities are vibrant economic hubs, most have witnessed a trend of development in functional urban areas (FUAs) that extend beyond their administrative boundaries. The population of these FUAs has grown significantly in recent years.

The FUAs of Bucharest and of Romania's 40 county capitals account for 90 percent of national firm revenues. They also concentrate 80 percent of the population that has completed higher education, attracted 67 percent of commuters in 2011 and 66 percent of migrants between 2001 and 2011, and account for 61 percent of national employment and 58 percent of the population.

More importantly, the rural areas within these FUAs have registered the fastest growth in recent years. This indicates that the most efficient path to development in lagging regions involves strengthening their main urban areas, and expanding the access of the rural hinterland to the opportunities that cities offer (e.g., jobs, education, specialized healthcare, art, culture, entertainment, shopping, and transportation).

BOX A.4 Green growth and opportunities ahead

The expression "green growth" describes economic growth which ensures that natural assets continue to provide resources and environmental services for people's wellbeing. The sustainable use of renewable resources such as forests, fisheries, water, and clean air, and the efficient exhaustion of non-renewable resources such as minerals, have been considered part of a sustainable growth agenda for decades. Romania is well-endowed with various natural resources, which, if used productively, can support strong and sustained economic growth.

The mitigation of GHG emissions is another critical, and especially challenging component of environmental sustainability. As a member of the EU, Romania has an obligation to reduce its GHG emissions, with current and prospective targets that will result in progressively tighter requirements for carbon reduction.

Adaptation to a changing climate is also part of a country's sustainable growth path. Regardless of future GHG emissions, the climate is already changing, with increasingly frequent and severe extreme weather events. As a country that faces significant risks from climate change, Romania needs to factor their potential impacts into planning for sustainable development paths.

The most recent element of the green growth agenda is a strong emphasis on innovation and green jobs. A shift towards greener growth is expected to spur technological innovation, especially in the energy sector, and promote the emergence of new industries. Innovation can help decouple growth from natural resource depletion and GHG emissions, by allowing for more output with fewer and more environmentally friendly inputs.

Climate action is at the heart of the European Green Deal (EGD) launched in December 2019, and access to EU funds will provide opportunities to implement targeted measures. The EGD is an ambitious package of measures aiming to turn the EU into the first climate-neutral continental bloc by 2050, resulting in a cleaner environment, more affordable energy, smarter transport, new jobs, and a better quality of life overall. In addition, at the end of 2020, the EU and its member states jointly committed to the binding target of a net domestic reduction of at least 55 percent in GHG emissions by 2030, compared with 1990 levels.

The green transition provides an opportunity to place Romania's growth on a more sustainable path. To support this transition, over 41 percent of funds from the Recovery and Resilience Plan for Romania are allocated to green measures. Additionally, the EU Cohesion Funds for 2021–2027 will provide ample opportunity to support EGD objectives.

FIGURE BA.4.1 Diagram of green growth

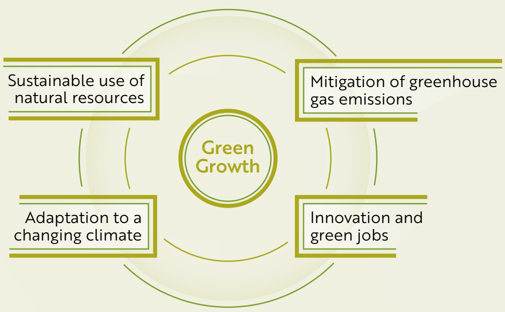
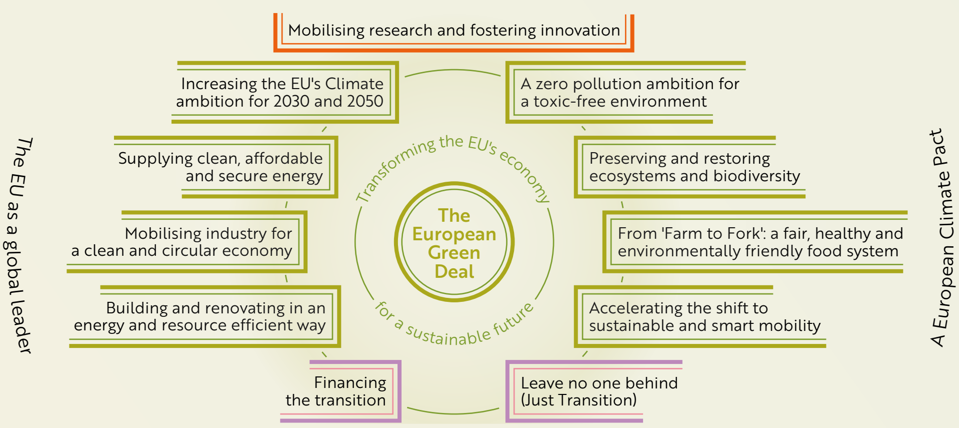


FIGURE BA.4.2 The European Green Deal



BOX A.5 The NRRP and its expected impact

The Romanian government's National Resilience and Recovery Program (NRRP) outlines the country's reform and investment priorities, with a view to supporting resilience and crisis preparedness, and promoting adaptability, sustainability, and inclusive growth. A thorough NRRP is a prerequisite for accessing funds from the EU's Recovery and Resilience Facility.

The Romanian NRRP focuses 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 proposed reforms in these six areas touch on the pension system; the judiciary; the public administration; the tax system; social inclusion programs and the minimum wage; education and healthcare; and decarbonization, particularly in energy and transport.

Substantial funding will support the green and digital transitions, aiming to heal social scarring from the pandemic and address infrastructure bottlenecks. Over 60 percent of Romania's NRRP funds have been allocated to the green (41 percent) and digital (20.5 percent) transitions. Romania has prioritized investment in sustainable transport and EV charging stations (€8.9 billion), education and training to support digital skills (€4.9 billion), and clean technologies and renewables (€4.5 billion). These efforts aim to address critical issues that affect growth and development, such as the poor state of infrastructure, skills mismatches, and shortcomings in labor quality.

The government estimates that NRRP funds and initiatives will add up to 5.4 percentage points to the real GDP over the 2021–2026 period, in a scenario of 100 percent absorption for both grants and loans. On the other hand, in a scenario of 100 percent absorption for grants and 33 percent for loans, the cumulative impact would reduce to 4.3 percentage points. Given Romania's low historical absorption of EU funds, a lesser impact than under even the more pessimistic government scenario is conceivable, and may slow down the country's economic recovery.

ANNEX 2

PRIORITIES AND SELECTION CRITERIA

High-Level Outcomes	Priorities	Expected impacts on the twin goals	Complementarity to other policies	Feasibility of policies under current economic, governance, and capacity conditions	Time horizon for policies to yield results (short term, medium term, long-term) *
I. **Predictable institutional and economic environment for people and businesses**	1. Mitigate the impact of political instability through establishment of medium-to-long-term strategic and spending priorities	High	High	Medium	Long term
	2. Improve citizens' trust in the state	High	High	Medium	Long term
	3. Ensure fiscal sustainability	High	High	Medium	Medium – long term
II. **Equal access to high-quality public services at central and local levels**	4. Enhance public sector human-resource management to improve public-service delivery	High	High	High	Medium – long term
	5. Increase effectiveness and efficiency of public-service delivery at central and local levels	High	High	High	Medium – long term
	6. Improve access to quality public infrastructure and services (e.g., transport, digital network, water and sanitation, district heating, solid waste management, social benefits and social services) for the poor, the vulnerable, and those in rural areas	High	High	High	Medium – long term
III. **Better health and education outcomes for all**	7. Improve health outcomes and provide equitable access to healthcare services	High	High	High	Medium – long term
	8. Provide access to quality education for all	High	High	High	Medium – long term
	9. Strengthen lifelong skills formation, especially for vulnerable groups	High	High	High	Medium – long term

High-Level Outcomes	Priorities	Expected impacts on the twin goals	Comple-mentarity to other policies	Feasibility of policies under current econom-ic, governance, and capacity conditions	Time horizon for policies to yield results (short term, medium term, long-term) *
IV. **Favorable con-ditions for more and bet-ter private-sec-tor jobs**	10. Close the gaps in transport and other infrastructure for international and domestic connectivity	High	High	Medium	Medium – long term
	11. Increase financial intermedi-ation and inclusion	High	High	High	Medium – long term
	12. Enhance market competition and innovation	High	High	High	Medium – long term
V. **Climate change mitigation for environmen-tal sustainabil-ity of economic activity**	13. Accelerate decarbonization, improve regional intercon-nections, and ensure energy security	High	High	Medium	Medium – long term
	14. Reduce environmental degradation (water, land, atmospheric)	High	High	Medium	Long term
VI. **Resilience to shocks and ad-aptation to cli-mate change, especially for vulnerable households**	15. Scale-up risk prevention/re-duction, and improve pre-paredness for, response to, and recovery from natural disasters	High	High	Medium	Medium – long term
	16. Enhance financial resilience of the public and private sec-tors to natural disasters	High	High	Medium	Long term
	17. Safeguard water security, and ensure better prevention of and protection from wa-ter-related disasters	High	High	Medium	Medium – long term

(*) Short term is defined as within 2 years, medium term is between 2 and 5 years, and long term is above 5 years.

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NOTES

1. Defined as real GDP per capita in PPP 2017 international US$.
2. European Investment Bank, 2021
3. Pal et al. 2019
4. The net change in the fixed assets of companies.
5. Eurostat. 2022. Labor productivity per person employed and hour worked. Online data code: TESEM160. https://ec.europa.eu/eurostat/databrowser/view/tesem160/default/table?lang=en
6. Cruz, Marcio et al, World Bank report — Starting Up: Entrepreneurship Ecosystems in Romania, World Bank, 2022: https://openknowledge.worldbank.org/handle/10986/37564
7. Inchauste and Militaru 2018.
8. World Bank 2018. ROU SCD 2018 — Agriculture background note
9. Romania has been under the EU's excessive deficit procedure since 2020, with a deadline to eliminate the excess deficit by 2024.
10. World Bank staff Debt Sustainability Analysis, February 2023
11. In 2021, public sector assets, mainly denominated in domestic currency, represented 24.2 percent of the banking sector's aggregate asset portfolio, making bank portfolios especially sensitive to changes in interest rate. Between January and late April 2020, 10-year sovereign bond yields increased from 4.38 percent to 4.74 percent, while the spread in 10-year credit-default swaps for Romania increased from 115.6 bps to 169.8 bps.
12. The share of stage 2 loans (those with increased credit risk) was the highest in the EU in 2021.
13. ILO, 2020; Kulic et al., 2020
14. WB working estimate
15. World Bank 2022d
16. Per WB classification, based on 2021 data. The pandemic-triggered crisis briefly brought Romania down to upper-middle-income status in 2020, but strong economic growth boosted GNI per capita and pushed Romania back into the high-income group in 2021.
17. Gross National Income
18. Inchauste and Militaru 2018.
19. This SCD refers to two types of poverty rates: (i) the national, official at-risk-of poverty rate, per Eurostat definition; and (ii) the international poverty rates used for comparison across countries and time. The national at-risk-of poverty line is defined as 60 percent of the median adult-equivalent income after social transfers. The international poverty line is US$6.85 per capita per day at 2017 Purchasing Power Parity.
20. European Commission, 2021
21. Eurostat, Romania SILC 2010–2020, referring to household income 2009–2019
22. National Institute of Statistics, 2022
23. GFDDR and World Bank, 2021
24. Eurostat 2022
25. World Bank, 2020
26. World Bank Global Findex Database, 2021
27. Constructed by Romania Aspen Institute, the Local Business Environment Index (LBEI) rates and ranks Romanian municipalities based on four factors: local entrepreneurship (30 percent weight); innovation (20 percent); investment financing (35 percent); and local public support (15 percent).
28. World Bank, 2021a
29. European Centre for Disease Prevention and Control, data as of October 2022.
30. Romania borders Ukraine to the north and to the east and is a potential route for FDPs. Romania has an ethnic Ukrainian minority of around 8,000 permanent residents—the sixth-largest in the country—concentrated in the north.
31. UNHCR data, accessed February 2023
32. Romania Prime Minister's Office, 2023.
33. World Bank, 2021a
34. World Bank, 2021c
35. Romania lost two positions on the Digital Economy and Society Index (DESI) between 2020 and 2021, most recently ranking last out of 27 countries.
36. DESI, 2021
37. Eurostat, 2022
38. Eurostat COVID-19 Impact on ICT usage among enterprises, 2021
39. In addition to the Recovery and Resilience Facility, the Next Generation EU plan includes funding for other programs, including Just Transition, React-EU, Invest EU, Horizon, and RescEU.
40. Per Ministry of Investments and European Projects reports as of December 2021
41. Eurostat 2022
42. Ministry of Public Works, Development and Administration and the World Bank 2022
43. European Commission 2022. "Summer Eurobarometer 2022 — Romania Country Factsheets"
44. Flash Eurobarometer 489, Q1 (available at: https://europa.eu/eurobarometer/surveys/detail/2272)
45. Only 17 percent of Romanian internet users engage actively with e-government services. The country performs significantly below the EU average in the availability of digital public services to citizens (with a score of 44, versus the EU average of 75) and businesses (with a score of 42, versus the EU average of 82). The use of pre-filled forms has been increasing year over year, but Romania's score of 19 in this area is significantly below the EU average of 63. Furthermore, at 76 percent, the country ranks below the EU average (81 percent) on open data.
46. European Commission, 2020
47. See first evaluation of 2014–2020 POCU interventions in education, 2020, accessed Nov 2021: Primul-raport-de-evaluare-a-intervențiilor-POCU-2014-2020-în-domeniul-educației-1.pdf.
48. Eurostat 2022
49. World Bank 2018. Water Analysis

50. Avoidable mortality encompasses preventable deaths (i.e., avoidable through better public health interventions, such as systematic screening for cancer), and treatable deaths (i.e., avoidable if the healthcare system provides timely and effective medical treatment).
51. Eurostat 2022
52. Eurostat 2022
53. EU Fundamental Rights Agency, 2022
54. Eurostat 2022
55. Tesliuc et al., 2015
56. European Commission (2020) Country Report Romania 2020, Brussels, SWD(2020)
57. We computed inequality of opportunity based on the methodology introduced by the European Bank for Reconstruction and Development (2017).
58. World Bank 2021a
59. World Bank calculation based on National Institute of Statistics data, 2021
60. World Bank, 2020b
61. Eurostat. The 2021 EU Aging Report
62. World Bank, 2018. Romania SCD
63. Eurostat, 2022
64. Eurostat, 2022
65. Eurostat, 2022
66. Rate of working-age individuals not in the labor force (neither working, nor actively looking for a job).
67. Eurostat indicator lfsa_ipga, accessed April 2021. The inactivity rates for those between the ages of 15 and 64 declined from 34.4 percent in 2016 to 31.4 percent in 2019
68. Eurostat, 2022
69. World Bank, 2020c
70. A 2020 survey by Romania's Department for Sustainable Development found that the majority of respondents believed in equality between women and men, but were more conservative in relation to gender roles within the family. 76 percent of respondents believed that a man's role is to earn money, while 83 percent believed that women's most important role is to care for the home and family .
71. ILO 2019
72. EU SILC 2020
73. World Bank, 2020c
74. Eurostat experimental statistics on skills mismatches: https://ec.europa.eu/eurostat/web/experimental-statistics/skills
75. E.g., software and applications developers and analysts, generalist and specialist medical practitioners, electrical engineers, physical and engineering science technicians, machinery mechanics and repairers, cooks, van and motorcycle drivers, garment and related trades workers (Romania Systematic Country Diagnosis, 2018).
76. Otto Kässi, Vili Lehdonvirta, Online labour index: Measuring the online gig economy for policy and research, Technological Forecasting and Social Change, Volume 137, 2018, Pages 241–248
77. World Bank 2020c
78. European Commission Education and Training Monitor, 2019 Romania Report
79. Per the "Survey regarding the participation to continuous education and training of employees at risk on the labor market," Magdalena Balica, Cezar Bîrzea, Ciprian Fartusnic, Irina Horga, Mihaela Jigau, Laura Tufă, Bogdan Voicu, Vlad Achimescu. 2010.
80. Soft skills in high demand include interpersonal and communication abilities, professionalism, collaboration and teamwork abilities, attention to detail, and planning and organizational abilities.
81. World Bank Enterprise Survey 2019.
82. World Bank 2020c
83. In the 2014–2020 EU programming period, Romania's National Employment Agency (ANOFM) was scheduled to utilize European Social Funds to support multiple modernization and capacity-building projects. However, due to ANOFM's limited capacity in project formulation as well as other institutional constraints, less than 10 percent of the allocated funds were deployed by the end of 2020.
84. Eurostat LMP data, 2022
85. The Draft National Strategy for Employment 2021–2027 reflects the importance of a new approach by ANOFM in implementing ALMPs to improve access to the labor market for job seekers and inactive persons. EU funds, namely the NRRP and the Education and Employment Operational Program 2021–2027, will be key to rolling out relevant measures.
86. Global Competitiveness Scores 2008–2018. World Economic Forum, The Global Competitiveness Report 2017/18
87. Romania InfraSAP, 2019
88. Please see InfraSAP (2019) and CPSD (forthcoming) for a more detailed discussion.
89. World Bank, 2019
90. European Investment Bank Investment, 2019
91. Elements for the Design of Romania's Strategy for Infrastructure Investments in Education Institutions, Transport Component, June 2017, World Bank.
92. The EAPI includes a set of indices considering three key energy sector objectives: i) economic growth and development; ii) environmental sustainability; and iii) energy access and security. Its ranking is based on the average of these three dimensions.
93. Romania's 2021–2030 Integrated National Energy and Climate Plan
94. Decarbonization of the energy sector is explored in the forthcoming Romania CCDR. The role of the private sector in renewable energy is at the core of the forthcoming Romania CPSD.
95. Measured based on standard deviation over the period considered. Volatility of public investment in Romania was around five times higher than the EU-27 average.
96. Eurostat, 2022
97. National Bank of Romania
98. OECD PMR, 2020
99. European Investment Bank, 2021
100. Other financial sector institutions include non-bank financial institutions (5.1 percent of financial sector assets), investment funds (5.7 percent), private pension funds (10.2 percent), and insurance companies (3.5 percent). Source: NBR
101. ECB Data Warehouse.
102. Similarly, the penetration of deposits (37.8 percent of GDP) is lower than both the expected 25th percentile (83.8 percent) and the ECA average (43.8 percent). Source: Finstats 2020.
103. Loans to households stood at 14.2 percent of GDP at end-2021. Source: NBR.

104. World Bank analysis of NBR data.
105. Bucharest Stock Exchange Monthly Report for September 2022. World Bank calculations based on domestic market capitalization of the BSE (per BSE monthly reports for December 2020 and December 2021). GDP estimates from the IMF WEO October 2022 database.
106. World Bank Global Findex Database, 2021.
107. The poorest 40 percent of the population was 20 percentage points less likely to have an account than the richest 60 percent, a gap that has narrowed since 2017 but remains substantial. The gap in account ownership between more educated and less educated adults amounted to 38.6 percentage points. Source: Findex 2021.
108. According to the IMF's Financial Access Survey (FAS), the number of debit and credit cards per 1,000 adults in Romania was 1,149 in 2020, the lowest among regional peers. Similarly, Global Findex 2021 places debit card ownership among Romanian adults at 52.6 percent, lower than regional peers such as Serbia (61.5 percent), Hungary (79.0 percent), Bulgaria (71.3 percent), Poland (83.9 percent), Czech Republic (89.0 percent), and Croatia (67.5 percent).
109. The share was 87.5 percent in Serbia, 87.1 percent in Croatia, 93.2 percent in Poland, 94.1 percent in Czech Republic, 86.4 percent in Hungary, and 75.2 percent in Bulgaria. In Romania, 61.9 percent of adults reported paying utility bills in cash only—a significantly higher share than in regional peers.
110. IMF Financial Access Survey 2020.
111. 40 percent of firms had a loan/line of credit. Enterprise Surveys 2019.
112. Financial Inclusion in Romania: Issues and Opportunities. World Bank, March 2020. Similar findings are reported in NBR 2021 "Survey on the access to finance of non-financial corporations in Romania". 85 percent of respondents used only internal sources for financing, while only 7 percent of enterprises used bank loans as a financing source.
113. OECD PMR, 2020
114. OECD 2020
115. Global Competitiveness Index, 2020
116. Romanian National Bank — Survey June 2021
117. In 2021, the percentage of Romanian MSMEs that introduced product or process innovations, marketing or organizational innovations, or provided ICT training to their staff were all below EU averages. Spending on R&D equaled 0.48 percent of GDP in 2019, well below a 2 percent target for 2020 and the EU average of 2.12 percent. In 2021, Romania was last in the EU for number of patent applications to the European Patent Office per million inhabitants (2.79 versus the EU average of 147).
118. World Bank, 2022b
119. Eurostat Structural Business Database
120. OECD, 2021
121. World Bank staff estimates, EU RER 7, 2021
122. Figures concerning sectoral GHG emissions vary by source due to differences in methodology, but this does not affect the conclusions of a qualitative assessment.
123. European Commission, Romania Country Report, 2020
124. World Bank Romania, 2021d
125. European Commission 2022.
126. Eurobarometer — Special issue on Climate Change, 2021
127. National Committee for Macroprudential Oversight (NCMO) Working Group on Supporting Green Finance, final report, June 2021.
128. EM-DAT. 1900–2019. "Global Occurrences from Natural Disasters." EM-DAT: The Emergency Events Database, Université Catholique de Louvain–CRED (EM-DAT, CRED / UCLouvain), D. Guha-Sapir. Brussels, Belgium. Link.
129. Romania has the third-highest annual seismic risk of all EU member states, with an annual average loss of €512 million mostly arising from damage to residential buildings. The estimated annual average risk to life is 275 fatalities. The annual average loss from flood damage to private and public buildings is estimated at €585 million (0.28 percent of GDP). The annual expected windstorm damage is estimated at €83 million, and over 660,000 people in Romania are exposed to windstorm hazard.
130. Cook, Samantha et. al, 2021
131. World Bank, 2021c
132. Kerblat, Yann et. al, 2021
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