



The World Bank

Romania First Green, Resilient and Inclusive DPO (P178912)

Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 25-May-2022 | Report No: PIDA34185



BASIC INFORMATION

A. Basic Project Data

Country Romania	Project ID P178912	Project Name Romania Inclusive and Green Growth DPL (P178912)	Parent Project ID (if any)
Region EUROPE AND CENTRAL ASIA	Estimated Board Date 30-Jun-2022	Practice Area (Lead) Macroeconomics, Trade and Investment	Financing Instrument Development Policy Financing
Borrower(s) Romania	Implementing Agency Ministry of Finance		

Proposed Development Objective(s)

The Program Development Objective of the proposed operation series is to support the Government of Romania's efforts to: 1) strengthen inclusion and fiscal management; and 2) foster decarbonization and climate resilience.

Financing (in US\$, Millions)

SUMMARY

Total Financing	524.20
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DETAILS

Total World Bank Group Financing	500.00
World Bank Lending	500.00
Total Non-World Bank Group Financing	24.20
Trust Funds	24.20

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context



The proposed operation in the amount of US\$524.2 million is the first in a programmatic series of two loans to support the Government of Romania to enhance inclusion, including of the forcibly displaced persons from Ukraine; strengthen fiscal management; and foster decarbonization and climate resilience. Romania is an upper-middle-income country, but its level of income varies widely across regions. In addition, it has the highest poverty rate and is one of the most unequal countries in the European Union (EU). Hence the inclusion agenda is paramount in the country and will likely gain added significance with the war in Ukraine and the influx of forcibly displaced persons (FDPs) into Romania. The country has also been running a large structural fiscal deficit, even prior to the pandemic, because of tax cuts and permanent spending increases. With the economic and humanitarian spillovers of the war, spending pressures will increase. The war has also brought to the fore the issues of energy security and independence, adding to the existing debate on the sector's role in achieving reduced greenhouse gas (GHG) emissions. Social inclusion, fiscal reforms and decarbonization efforts will be important priorities for the Government over the next few years. Some of these efforts will be supported through the proposed operation by providing FDPs with public services and other humanitarian assistance, undertaking fiscal reforms, including pensions and supporting climate adaptation and mitigation efforts. **The proposed operation will also benefit from concessional financing of \$24.2 million from the IBRD Fund for Innovative Global Public Goods (GPG) Solutions (in addition to the UD\$500 million loan).**¹

Prior to the COVID-19 pandemic, Romania enjoyed strong economic growth; however, the COVID-19 crisis and the war in Ukraine have exposed important structural challenges and added to the fiscal pressures. Despite strong growth averaging 5.3 percent between 2017-2019, the budget deficit averaged 3.3 percent of GDP over the same period, reducing the available fiscal space and the capacity to address the impact of economic shocks. Structural constraints challenge the sustainability of the economic recovery and Romania's long-term growth. The influx of FDPs risks straining Romania's weak social contract but can also provide opportunities if adequate short- and medium-term action is taken to integrate the FDPs and mitigate the impact on host communities. Official Government information puts the total number of Ukrainian FDPs entering Romania at around 850,000, making Romania the second largest recipient of arrivals after Poland, with 100,000 remaining in Romania as of end-April 2022. The energy crisis resulting from the war in Ukraine could potentially delay or even reverse the energy transition process, although accelerating the transition will reduce dependence on energy imports. Achieving the decarbonization objectives and reducing dependence on Russian energy imports will require an increase in locally produced renewable energy, and a boost to energy efficiency. This is all the more important as Romania's vulnerability to climate change is relatively high, while its readiness to adapt is rated as relatively low. Addressing these challenges is compounded by limited institutional capacity.

Romania's macroeconomic policy framework is adequate for this operation. Despite the economic shock of the Russia-Ukraine war and its accompanying fiscal pressures, the Government continues to implement a macroeconomic policy mix aimed at reducing the fiscal deficit while supporting vulnerable populations (including the forcibly displaced persons and host communities), stabilizing the public debt and containing internal and external imbalances. Enhanced fiscal management remains a central priority in the context of additional spending needs to accommodate the influx of FDPs and mitigate the impact of rising prices.

¹ In line with its Capital Package commitment, IBRD launched the GPG Fund in June 2019 as a three-year pilot, and FY22 is the third year of operation of the fund. Projects are selected based on additionality, innovation, replicability, and sustainability criteria. Management intends to learn from the pilot implementation to improve the design of the GPG Fund and to contribute to global knowledge on effective GPG delivery.



Relationship to CPF

This DPL series underpins all the three objectives of the Country Partnership Framework (FY2019-23). The proposed series links to all three pillars of the Romania CPF FY19-23: the FDP actions map directly into the Focus Area I: ‘Ensure Equal Opportunities for All’, specifically, on improving access to modern health care and connecting the poor and vulnerable to jobs; the green agenda links to Focus Area III: ‘Build Resilience for Shocks’, specifically, on improving preparedness to natural disasters and climate change; the actions on renewables also link to the Focus Area II: ‘Catalyze Private Sector Growth and Competitiveness’. In addition, the proposed operation benefits from the World Bank Group Green Resilient and Inclusive Development (GRID) approach; the Fragile Conflict and Violence (FCV) Strategy 2020-2025; and is private capital enabling (PCE). This DPL series is also aligned with the strategic framework of the World Bank Group for ‘Global Impacts of the War in Ukraine, 2022’ to support short-, medium- and long-term considerations of the war.

This proposed operation supports progress towards the WBG’s twin goals in Romania. Increased support to and integration of FDPs from Ukraine into the Romanian society will help them become self-reliant and enable them to get employed. This will help them sustain themselves and provide for their families. Pension, tax and spending reforms will enable efficient use of fiscal resources and increased fiscal space. This will help the Government increase fiscal buffers and improve public spending which will be beneficial for the poor and those in the bottom 40. Efforts aimed at decarbonization and increased forest cover will support a reduction in extreme weather events which typically impact the poor and vulnerable to a larger extent. Finally, increased private sector participation in renewables and building renovations will provide jobs while also supporting the transition to net zero emissions.

C. Proposed Development Objective(s)

The Program Development Objective of the proposed operation series is to support the Government of Romania’s efforts to: 1) strengthen inclusion and fiscal management; and 2) foster decarbonization and climate resilience. The Government seeks to strengthen fiscal management; protect critical social spending amid rising spending pressures associated with the war in Ukraine; and advance its green transition objectives. The proposed Inclusive and Green Growth DPL will support the Government of Romania in addressing some of the key structural challenges faced by the country and its emergency response to the consequences of the war in Ukraine.

Key Results

The reforms supported by pillar I of the programmatic DPL series will help achieve the following results (i) increased share of FDPs with government recognized IDs; (ii) increased share of FDP women with access to reproductive healthcare; (iii) increased access to social assistance programs; (iv) access of FDPs to the Romanian labor market; (v) opportunities for training for FDP and host teachers; (vi) strengthening of fiscal management through improved budgeting, lower share of variable pay in public sector wages and increased sustainability and equity of the public pension system. The reforms supported by pillar II of the programmatic DPL series will help achieve the following results (i) increase in the share of buildings renovated with increase in energy efficiency; (ii) Increase in renewable energy contracted; and (iii) increased area under afforestation works.

D. Project Description

The proposed operation is the first in the series of two DPLs and is structured under two pillars. The first pillar aims to strengthen inclusion and fiscal management. In DPL1, the first pillar includes policy measures taken to enable the provision of education and health services, housing, social assistance and access to the labor market. It also includes measures to



support host communities by increasing the capacity of the Government by enabling hiring of staff at national and local levels. The first pillar also includes measures to address structural inefficiencies that have contributed to Romania's fiscal imbalances, including measures to improve the tax and spending efficiency of the Government and sustainability of the pension system. Relevant measures include program-based budgeting and increased use of electronic platforms. The second pillar supports decarbonization and climate resilience. Under the first operation, supported measures include renovation of buildings to increase energy efficiency, amendments to the energy law to support renewables, including through greater private sector participation, and increased afforestation and reforestation. **The first operation in the series is structured as an emergency support to the Government of Romania given the influx of FDPs from Ukraine.**

The proposed operation supports the Government's medium-term program for 2021-2024. The Government's program for 2021-2024 aims to build a cohesive and open society that benefits from an improved education and health system, and from reduced inequalities between men and women and between urban and rural areas. At an operational level, the Government's program aims to implement the reforms included in the National Program of Recovery and Resilience (NRRP). The proposed operation supports the Government in all of the six pillars of the NRRP, facilitating a larger absorption of EU Funds. The measures implemented to facilitate the access of the FDPs to social services and the labor market and their integration in the host communities are aligned with the NRRP pillars of smart, sustainable and inclusive growth; social and territorial cohesion; health, and economic, social and institutional resilience; and policies for the next generation, children and the youth. The pensions, social assistance, public pay and budget reforms promote smart, sustainable and inclusive growth. The tax reforms advance the digitalization of the public sector, while the measures aimed at improving energy efficiency in buildings, promoting renewable energy, decarbonization and reforestation are in line with the green economy pillar of the NRRP, and will facilitate the absorption of EU Funds channeled under the RRF to incentivize the post pandemic economic growth and green transformation. The World Bank has been providing support to the Government of Romania in many of these key reform areas over several years, prior to and during the formulation of the NRRP, the Government's key reform and investment program. The proposed operation is also aligned with the Government's program explicitly developed for Ukrainian FDPs, which is still evolving.

The proposed operation will support the Government in dealing with the spillovers of the war in Ukraine. In the face of two contiguous crises, the pandemic and then the war, the Government is facing increased spending pressures. It has begun its fiscal consolidation process after 2020 but it now needs to support vulnerable households and small businesses from the impact of higher energy prices while also providing social services and assistance to FDPs. Meanwhile, EU financing in these areas is yet to be articulated. In addition, Bank's support in the areas included in the DPL series will be complemented with sustained policy advice and implementation support while it has also contributed to appropriate design for longer-term impact. The Bank's assistance will complement EU support and will also help in unlocking EU funds through the achievement of NRRP milestones and improved absorption of funds.

Technical assistance by development partners, including the World Bank Group, will be crucial for reform implementation and sustainability. Implementation capacity of the Government of Romania is limited. In addition to the World Bank, which provides technical and analytical assistance in most of the areas supported by the DPL series, the Government also works closely with the European Commission and other IFIs. The World Bank has several Reimbursable Advisory Service (RAS) agreements in preparation or implementation with the Government on many of the areas supported by the DPL series like wages, pensions, social assistance and labor, tax and budget reforms and the energy sector. In addition, the IMF provides technical assistance on modernizing tax administration. The Government of Romania also works with the European Bank for Reconstruction and Development and the European Investment Bank especially on infrastructure and projects supporting the green transition.

E. Implementation

Institutional and Implementation Arrangements



The Ministry of Finance (MoF) leads the effort in coordinating the overall implementation of the DPL. The MoF has experience and is conversant with World Bank policies and procedures through lending, Reimbursable Advisory Services (RAS) and Technical Assistance (TA) operations. Given the history of budget lending operations in Romania, some institutional capacity has been built up on data requirements and overall monitoring arrangements. Romania is a subscriber to the Fund's Special Data Dissemination Standard Plus (SDDS Plus) since November 2019. In addition, data is generally available through the MoF and the central bank's website. The World Bank team will continue to provide support to the Government in monitoring the reform progress and results.

The World Bank team works closely with relevant ministries and agencies to monitor progress. This includes the MoF, the National Bank of Romania (NBR), the Chancellery of the Prime Minister, Ministry of Labor and Social Solidarity, Ministry of Education, Ministry of Energy, Ministry of Environment, Water and Forests and other relevant ministries.

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

Poverty and Social Impacts

Overall, the policy reforms supported by this operation are expected to have positive effects on Romanian households' welfare in the long run with some short-term costs associated with some of the actions under both pillar I and pillar II.

Under pillar I, the actions taken by the Government are expected to have positive effects on the wellbeing of FDPs while potentially mitigating the negative effects on host communities. Under pillar I, the provision of basic services and access to the labor market for FDPs from Ukraine can have positive impacts on their welfare. However, such measures might crowd out services and increase job competition for Romanians in host communities, especially those in rural and lagging regions where existing services and job opportunities are limited. The tale of two Romanias set out in the Systematic Country Diagnostic (2018) already highlights such stark inequality between urban and rural areas. The mitigation measures include Government's support to host communities through hiring of additional temporary government staff so that service delivery to host communities can be maintained. Prior action on improving the fiscal position of the Government under pillar I can potentially open up additional fiscal space for social spending.

The actions supported by pillar II are likely to improve the quality of life for all segments of the population, especially communities living in polluted areas, and in energy-inefficient buildings in the long run. As documented in the literature, climate change and environmental degradation disproportionately affect the poor and vulnerable. Hence, these measures are likely to improve households' welfare in the long run. Also, the transition to renewables and energy efficiency renovation will help create jobs, spur technological innovation, and increase climate resilience. While, some sections of the community (like renters in multi-family apartment buildings) could be negatively impacted, this impact is expected to be negligible as Romania has the highest rate of home ownership in the EU, and only 3.9 percent of the population are renters, and only a subset of them is subject to a potential increase in rental prices as these are often fixed or indexed to inflation. The short-term price effects of renewables on Romanian energy consumers are expected to be negligible while the energy efficiency and afforestation measures will have a positive effect. Several prior actions - particularly those focused on the FDPs, majority of which are women - provide strong support to women and marginalized groups.

Environmental, Forests, and Other Natural Resource Aspects

The prior actions supported by this DPL have positive or neutral environmental impacts. The pillar I prior actions of this operation are expected to have mostly neutral or positive effects on the environment, forests, and other natural resources. The first two prior actions under pillar I will ensure the right for FDPs to reside in Romania and access social services and the labor market. Such actions help mitigate the potential adverse environmental effects associated with FDP-affected areas like subsistence use of the environment to meet basic needs (firewood collection) and unregulated



waste disposal or water use. The access of FDPs to services and assistance reduces the risk of the establishment of unregulated FDP camps. The fiscal prior action encourages switching to e-invoicing, reducing the overall environmental implications of processing invoices, reducing paper and ink use (as most ink is toxic, when the paper biodegrades, if left behind it can be damaging to the environment). In addition, companies that send and receive electronic documents also help cut down on fossil fuel pollution from mailing and shipping. Nevertheless, electronic waste (IT equipment) would need to be properly managed and discarded to avoid any potential negative environmental effects.

The pillar II reforms have overall positive environmental effects. Amending the energy law will help increase low-carbon energy generation and also reduce certain types of air pollution, while proposed actions on energy renovation of buildings will result in energy efficient buildings, thereby, reducing energy use and associated GHG emissions. Despite these notable positive benefits, it is advisable that during implementation, investments in these areas ensure that land use and waste is adequately managed by the existing legislative framework, including Environmental Impact Assessments (EIA). Incentives to accelerate afforestation and reforestation will contribute to both climate change mitigation and adaptation by increasing long-term carbon storage within forests, helping balance the overall national GHG emissions, and restoring ecosystem integrity and enhance forest cover in Romania. Also, Romania's current regulations on forest regeneration and afforestation could effectively support the mitigation of negative effects, if any.

G. Risks and Mitigation

The overall risk rating for this operation is Moderate. Among the risk categories, political and governance risk is deemed to be substantial, technical design risks are low, while all other categories of risks are moderate, including 'other risks' related to the fallout from the war. The political and governance risk is substantial primarily because of political instability and frequent changes in the ruling coalition. Risk mitigation includes strong Government ownership and the backing of the European Commission for the reforms, supplemented with financing through the National Recovery and Resilience Plan; as well as the Bank's strong policy dialogue with the Government of Romania. There is considerable uncertainty related to the ongoing war in Ukraine which could potentially get prolonged. These events will have substantial implications on FDP arrivals, energy costs and supply and other broader repercussions, including impacts on growth, fiscal needs, and security concerns.

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APPROVAL

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