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PROJECT PERFORMANCE ASSESSMENT REPORT

WHAT WORKS

ROMANIA

# Development Policy Loan with a Deferred Drawdown Option

Report No. 112699
JUNE 20, 2017

Report No.: 112699

# PROJECT PERFORMANCE ASSESSMENT REPORT

**Romania**

**DEVELOPMENT POLICY LOAN WITH A DEFERRED DRAWDOWN OPTION (IBRD-81760)**

**June 20, 2017**

**Human Development and Economic Management**
*Independent Evaluation Group*

## Currency Equivalents (annual averages)

*Currency Unit = Romanian New Leu (lei)*

| | | |
|---|---|---|
| 2012 | US$1.00 | lei 3.32 |
| 2013 | US$1.00 | lei 3.28 |
| 2014 | US$1.00 | lei 3.27 |
| 2015 | US$1.00 | lei 3.93 |

## Abbreviations and Acronyms

| | |
|---|---|
| ANAF | Agenția Națională de Administrare Fiscală |
| CPS | country partnership strategy |
| EU | European Union |
| FEG | Fiscal Effectiveness and Growth |
| GDP | gross domestic product |
| HTA | health technology assessment |
| ICR | Implementation Completion and Results Report |
| IEG | Independent Evaluation Group |
| IMF | International Monetary Fund |
| MTFF | medium-term fiscal framework |
| MTO | medium-term budgetary objective |
| NHIH | National Health Insurance House |
| PPAR | Project Performance Assessment Report |
| SOE | state-owned enterprises |
| VAT | value-added tax |

## Fiscal Year

Government: January 1–December 31

| | |
|---|---|
| Director-General, Independent Evaluation: | Ms. Caroline Heider |
| Director, Human Development and Economic Management: | Mr. Auguste Tano Kouame |
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| Task Manager: | Ms. Xiaolun Sun |

# Contents



This report was prepared by Xiaolun Sun and Aristomene Varoudakis, who assessed the program in June, 2016. The report was peer reviewed by Jorge Garcia-Garcia and panel reviewed by Chad Leechor. Carla Fabiola Chacaltana and Yasmin Angeles provided administrative support.

# Tables



# Appendixes

# Principal Ratings

| | ICR* | ICR Review* | PPAR |
|---|---|---|---|
| Outcome | Moderately satisfactory | Moderately satisfactory | Moderately satisfactory |
| Risk to Development Outcome | Modest | Modest | Moderate |
| World Bank Performance | Moderately satisfactory | Moderately satisfactory | Moderately satisfactory |
| Borrower Performance | Satisfactory | Moderately satisfactory | Moderately satisfactory |

* The Implementation Completion and Results Report (ICR) is a self-evaluation by the responsible World Bank global practice. The ICR Review is an intermediate Independent Evaluation Group product that seeks to independently validate the findings of the ICR.

# Key Staff Responsible

| Project | Task Manager | Sector Manager | Country Director |
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**IEG Mission: Improving World Bank Group development results through excellence in independent evaluation.**

**About this Report**

The Independent Evaluation Group (IEG) assesses the programs and activities of the World Bank for two purposes: first, to ensure the integrity of the World Bank's self-evaluation process and to verify that the World Bank's work is producing the expected results, and second, to help develop improved directions, policies, and procedures through the dissemination of lessons drawn from experience. As part of this work, IEG annually assesses 20–25 percent of the World Bank's lending operations through fieldwork. In selecting operations for assessment, preference is given to those that are innovative, large, or complex; those that are relevant to upcoming studies or country evaluations; those for which Executive Directors or World Bank management have requested assessments; and those that are likely to generate important lessons.

To prepare a Project Performance Assessment Report (PPAR), IEG staff examine project files and other documents, visit the borrowing country to discuss the operation with the government, and other in-country stakeholders, interview World Bank staff and other donor agency staff both at headquarters and in local offices as appropriate, and apply other evaluative methods as needed.

Each PPAR is subject to technical peer review, internal IEG panel review, and management approval. Once cleared internally, the PPAR is commented on by the responsible World Bank country management unit. The PPAR is also sent to the borrower for review. IEG incorporates both World Bank and borrower comments as appropriate, and the borrowers' comments are attached to the document that is sent to the World Bank's Board of Executive Directors. After an assessment report has been sent to the Board, it is disclosed to the public.

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***Outcome:*** The extent to which the operation's major relevant objectives were achieved, or are expected to be achieved, efficiently. The rating has three dimensions: relevance, efficacy, and efficiency. *Relevance* includes relevance of objectives and relevance of design. Relevance of objectives is the extent to which the project's objectives are consistent with the country's current development priorities and with current World Bank country and sectoral assistance strategies and corporate goals (expressed in poverty reduction strategy Papers, Country Assistance Strategies, Sector Strategy Papers, and Operational Policies). Relevance of design is the extent to which the project's design is consistent with the stated objectives. *Efficacy* is the extent to which the project's objectives were achieved, or are expected to be achieved, taking into account their relative importance. *Efficiency* is the extent to which the project achieved, or is expected to achieve, a return higher than the opportunity cost of capital and benefits at least cost compared with alternatives. The efficiency dimension is not applied to development policy operations, which provide general budget support. *Possible ratings for outcome:* highly satisfactory, satisfactory, moderately satisfactory, moderately unsatisfactory, unsatisfactory, highly unsatisfactory.

***Risk to Development Outcome:*** The risk, at the time of evaluation, that development outcomes (or expected outcomes) will not be maintained (or realized). *Possible ratings for risk to development outcome:* high, significant, moderate, negligible to low, not evaluable.

***World Bank Performance:*** The extent to which services provided by the World Bank ensured quality at entry of the operation and supported effective implementation through appropriate supervision (including ensuring adequate transition arrangements for regular operation of supported activities after loan/credit closing, toward the achievement of development outcomes). The rating has two dimensions: quality at entry and quality of supervision. *Possible ratings for World Bank performance:* highly satisfactory, satisfactory, moderately satisfactory, moderately unsatisfactory, unsatisfactory, highly unsatisfactory.

***Borrower Performance:*** The extent to which the borrower (including the government and implementing agency or agencies) ensured quality of preparation and implementation, and complied with covenants and agreements, toward the achievement of development outcomes. The rating has two dimensions: government performance and implementing agency(ies) performance. *Possible ratings for borrower performance:* highly satisfactory, satisfactory, moderately satisfactory, moderately unsatisfactory, unsatisfactory, highly unsatisfactory.

# Preface

This is the Project Performance Assessment Report (PPAR) of the Romania Development Policy Loan with a Deferred Drawdown Option (DPL-DDO). The €1 billion loan was approved on June 12, 2012, fully disbursed in two tranches between 2013 and 2014, and closed on October 27, 2014.

This report presents findings from an in-depth review of the project documents, discussions with World Bank country teams in Washington, DC, and Bucharest, and interviews with government officials and other stakeholders during an evaluation mission to Romania in June 2016. The cooperation and assistance of all parties consulted are gratefully acknowledged, as is support of the World Bank office in Bucharest.

The assessment aims first to serve an accountability purpose by verifying the program's success in achieving the intended outcomes. As part of a cluster of PPARs on DPL-DDO, the report draws lessons to inform the design and implementation of this type of instrument in Romania and other World Bank Group client countries.

Following standard procedures of the Independent Evaluation Group, the report was sent to the government officials and agencies in Romania for review and feedback. No comments were received.

# Summary

This PPAR evaluates the Romania development policy loan with a deferred drawdown option (DPL-DDO). In the fragile postcrisis global economic context, the government requested the €1 billion loan to consolidate fiscal gains, build fiscal buffers, and accelerate structural reforms to boost a sustainable economic recovery. The loan was approved by the World Bank Board of Executive Directors in June 2012 and closed in October 2014 after full disbursement in two tranches: €700 million in mid-October 2013 and of €300 million at the end of June 2014.

The objective of the DPL-DDO was to assist the government in meeting the fiscal sustainability goals defined by the European Union (EU) Fiscal Compact. The reform program aimed to (i) improve tax compliance, revenue collection and fiscal discipline, and reduce administrative costs; (ii) improve governance of energy state-owned enterprises (SOEs) and strengthen their fiscal sustainability; and (iii) improve fiscal sustainability of the health sector. An additional objective of the DPL-DDO, which was not explicitly stated as such in the program document or the loan agreement, was to help augment the government's fiscal buffer as the undisbursed funds of the loan could count toward it.

The DPL-DDO objectives were highly relevant. They were fully aligned with the policy priorities in the government's 2011–13 National Reform Program. The statement of objectives was clear, and the objectives were realistic because they were part of a reform program that was initiated several years before and was well under way when the DPL-DDO was negotiated. The additional objective of helping Romania increase its fiscal buffer was fully aligned with the Government Public Debt Strategy 2011–13, the Fiscal Budgetary Strategy for 2012–14, and the Fiscal Compact Convergence Program for 2013–15.

Design of the DPL-DDO program was substantially relevant, with the DDO providing finance to augment the government's fiscal buffer and the prior actions supporting critical reforms in areas prioritized by the government's National Reform Program. There was considerable continuity in the reform agenda supported by the World Bank through the regular DPL program, and some of the prior actions catalyzed long-overdue reforms.

The overall outcome of the DPL-DDO is rated **moderately satisfactory,** reflecting high relevance of the objectives, substantial relevance of program design, and partial achievement of the three program objectives. Progress in the power sector is by far the most significant, as in just a few years Romania achieved outcomes that may otherwise have taken more than a decade to achieve. The DPL-DDO made significant contributions to discontinuing nonmarket bilateral contracts and using a single-market platform for sales by electricity SOEs. The liberalization of the electricity market was part of the government's commitments with the EU for the deregulation of electricity prices. However, the program's efficacy for improving tax compliance, revenue collection, fiscal discipline, and fiscal sustainability of the health sector, is modest on both counts.

Risk to development outcome is rated **moderate.** The sustainability of the program's medium-term development outcomes faces varying degrees of risk across the operation's

different policy areas. There is a moderate risk to the sustainability of the fiscal consolidation effort, but Romania's commitment to the EU's Fiscal Compact provides greater assurance that, over the medium term, fiscal balances will remain on track. The liberalization in the electricity sector and the trend toward SOE transparency are unlikely to be reversed. The health technology assessment methodology was supposed to guide the revisions of the reimbursable drugs list, but because it is being used below its potential, there is a moderate risk to the realization of additional savings in the revisions of the reimbursable drugs list.

**Key Lessons**

- **The success of difficult institutional reforms in the energy sector underscored strong government commitment, which was strengthened by the liberalization roadmap agreed with the European Commission.** Commitments taken in parallel with reforms linked to the obligations of EU membership are hence likely to lead to more tangible results. In contrast, disruption created by major institutional reforms, such as tax administration reform, which required massive reallocation of staff and the establishment of new organizational structures, was underestimated and ultimately slowed down the reform process in restructuring the tax administration agency, and in revising the reimbursable drugs list.
- **More specifically, tax reforms are key to improving tax collection and reducing the compliance burden for taxpayers and businesses, but are potentially threatening to the status quo, which provides wide discretionary powers and rent-seeking opportunities.** Tax reforms require high-level political support from the Ministry of Finance and possibly the prime minister's office, as well as technical capacity from the tax administration agency. In Romania, political support has been weak. This has negatively affected the outcomes of the DPL-DDO, and of the subsequent tax administration project. Continuous World Bank pressure at the highest political level, as well as a strong commitment to provide the necessary technical and financial resources, may be required to implement tax administration reforms.
- **DPL-DDOs can be used as an effective mechanism for crisis support, and for supporting a borrower's medium-term debt management strategy.** In Romania, the operation was initiated to provide insurance against exogenous shocks by augmenting the size of the government's fiscal buffer. At a later stage, the government saw the DPL-DDO as an appropriate instrument of debt management and withdrew the loan proceeds in tranches to optimize its debt profile. This demonstrates the versatility of the DPL-DDO instrument, and its ability to meet client demand for flexible, innovative financial instruments for managing a spectrum of risks.

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# 1. Background and Context

1.1 Following a period of solid growth during 2006–08, Romania entered the 2008–09 global financial crisis with large fiscal and current account deficits (table 1.1). The global financial crisis caused a sudden stop of capital inflows to Romania and a shrinking of export markets, resulting in a 6.6 percent contraction of gross domestic product (GDP) in 2009. The contraction worsened the fiscal position, with the deficit reaching 8.9 percent of GDP in 2009. The economy remained in recession in 2010, with growth resuming moderately in 2011 and 2012, before accelerating in subsequent years (see section 4). Because of the crisis, the current account deficit fell to 4.5 percent of GDP in 2012 because imports contracted more than exports

**Table 1.1. Macroeconomic Developments in Romania** (percent of GDP unless otherwise indicated)

| | Year | | | | | | |
|---|---|---|---|---|---|---|---|
| **Macroeconomic Indicators** | **2006** | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** |
| Real GDP growth (percent) | 7.9 | 6.2 | 7.1 | −6.6 | −0.8 | 1.1 | 0.6 |
| CPI inflation (percent) | 6.6 | 4.8 | 7.8 | 5.9 | 6.1 | 5.8 | 3.3 |
| Current account balance | −10.4 | −13.8 | −12.4 | −7.5 | −4.1 | −4.5 | −4.5 |
| General government fiscal balance | −2.2 | −2.9 | −5.6 | −8.9 | −6.6 | −5.5 | -3.0 |
| Total revenue | 33.1 | 35.4 | 33.4 | 31.8 | 33 | 33.7 | 33.4 |
| Total expenditure | 35.3 | 38.3 | 38.9 | 40.6 | 39.6 | 39.2 | 36.4 |
| Primary balance | −1.4 | −2.2 | −5.2 | −7.4 | −5.1 | −3.9 | −1.3 |
| Public debt | 12.3 | 12.7 | 13.2 | 23.2 | 29.9 | 34.2 | 37.3 |
| Percentage of public debt with short-term residual maturity (up to one year) | 11.6 | 13.2 | 19.4 | 31.3 | 29.6 | 29.9 | 27.9 |

*Sources:* International Monetary Fund Article IV reports and World Bank data.
*Note:* CPI = consumer price index; GDP = gross domestic product.

1.2 Public debt increased due to a worsening fiscal position. Until 2008, Romania's public debt remained at around 13 percent of GDP. Because of the economic contraction and the larger fiscal deficit, public debt rose above 20 percent of GDP in 2009 and reached 37.3 percent of GDP in 2012. At the same time, the average maturity of public debt declined, with debt of up to one year representing 28 percent of the total in 2012, up from 12 percent in 2006.

## Fiscal Consolidation Program

1.3 Owing to the large fiscal imbalances and the sudden stop of capital inflows, the Romanian government took measures to put fiscal balances back on a sustainable path. The fiscal adjustment took place mostly between 2009 and 2012 and aimed to reduce the deficit to sustainable levels to create fiscal space for growth-promoting public investment. It was mainly expenditure driven, with two-thirds of fiscal consolidation originating in public expenditure downsizing. The adjustment was spread over a broad array of expenditures, but had three main areas of focus: (i) compensation of employees was reduced by 2.7 percentage points of GDP; (ii) social transfers were cut by 1.9

percentage points of GDP; and (iii) gross fixed capital formation was downsized by 1.4 percentage points of GDP. Adjustment on the revenue side relied mostly on increasing indirect taxes. Between 2009 and 2013, taxes on production and imports rose by 1.9 percentage points of GDP, mainly reflecting higher value-added tax (VAT) rates. By contrast, revenue from income, wealth taxes, and social security contributions declined. Romania's fiscal adjustment amounted to 6 percent of GDP, which was among the largest in the European Union (EU). It reduced the fiscal deficit from 8.9 percent of GDP in 2009 to 3 percent of GDP in 2012.

1.4 As the repercussions of the global financial crisis began to subside, it became clear that the external environment would remain weak because Europe was facing a period of slow growth and heightened uncertainty due to the Eurozone debt crisis. In the fragile global economic context, the Government of Romania focused on consolidating fiscal gains, building fiscal buffers, and accelerating structural reforms to boost a sustainable economic recovery. Further strengthening Romania's fiscal framework and enhancing its capacity to raise revenue emerged as a priority.

1.5 Romania's fiscal framework is mostly rules based, with specific national rules enforced along with the fiscal rules of the EU. Before the adoption of the Fiscal Responsibility Law (Law 69/2010) in 2010, fiscal policy was managed on a short-term basis without medium-term budgetary projections. The Fiscal Responsibility Law strengthened fiscal discipline by introducing (i) a medium-term expenditure framework; (ii) a ceiling of 3 percent of GDP for the fiscal deficit; and (iii) an independent fiscal council. In 2012, Romania, along with 25 other EU members, signed the Treaty on Stability, Coordination, and Governance in the Economic and Monetary Union (Fiscal Compact), which set new fiscal rules in response to the sovereign debt crisis in the Eurozone. Romania thus accepted the obligation of a maximum structural deficit of 0.5 percent of GDP, which could go up to 1 percent of GDP for countries with low public debt such as Romania. The 2011–13 National Reform Program reoriented the development agenda from crisis management to growth-promoting structural reforms to accelerate convergence toward EU standards of living.

## Development Support

1.6 Romania's development partners supported the government's fiscal consolidation program during the crisis. In 2009, a €20 billion financial package was provided by the International Monetary Fund (IMF; €13 billion stand-by arrangement), the EU (€5 billion cofinancing), the European Bank for Reconstruction and Development and the European Investment Bank (EIB) (€1 billion lending each). This program was fully disbursed, and followed by additional programs of the same nature—a stand-by arrangement of €3.5 billion from the IMF and a precautionary loan of €1.4 billion from the EU in 2011, and a stand-by arrangement of €1.98 billion from the IMF and a precautionary loan of €2 billion from the EU in 2013. None of these additional programs were drawn upon.

1.7 The World Bank approved six loans during this time (table 1.2): (i) a programmatic DPL series of three loans for a total amount of €1 billion; (ii) a DPL with deferred drawdown option (DPL-DDO) of €1 billion to support the reform agenda in the

2011–13 National Reform Program; and (iii) two Fiscal Effectiveness and Growth (FEG) DPLs of €750 million each, approved in 2014 and 2016.

**Table 1.2. World Bank Postcrisis DPL Programmatic Series in Romania (2009–16)**

| Project | Code | Original Amount (€) | Disbursed Amount (US$) | Board Approval | Closing Date |
|---|---|---|---|---|---|
| DPL 1 | P102018 | 300 million | 449.03 million | July 16, 2009 | December 31, 2009 |
| DPL 2 | P117667 | 300 million | 434.27 million | January 20, 2011 | June 30, 2011 |
| DPL 3 | P122222 | 400 million | 522.68 million | December 19, 2011 | December 31, 2012 |
| DPL-DDO | P130051 | 1 billion | 1.37 billion | June 12, 2012 | October 27, 2014 |
| FEG-DPL 1 | P148957 | 750 million | 843.9 million | May 22, 2014 | December 31, 2015 |
| FEG-DPL 2 | P149776 | 750 million | | September 8, 2016 | |

*Sources*: World Bank 2009b, 2010, 2011, 2012b, 2014b, and 2016a.
*Note:* DDO = drawdown option; DPL = development policy loan; FEG = Fiscal Effectiveness and Growth.

1.8 During the consultations for the midterm assessment of the fiscal year (FY)09–13 country partnership strategy (CPS), the government requested the DPL-DDO to build up its fiscal buffer, which would be equivalent to four months of financing requirements and consisted of (i) funds held at the National Bank of Romania; and (ii) the DPL-DDO funds, which could be drawn upon at the government's discretion in case of unexpected shocks. In 2012, the fiscal buffer was about US$3.8 billion on average and consisted only of cash before the approval of the DPL-DDO. It was equivalent to 3.5 months of annual gross financing requirements, which grew from about 2.7 months of gross financing requirements in 2011, but was still deemed insufficient in view of the heightened uncertainty caused by the Eurozone debt crisis. The government's objective, following a recommendation by the IMF, was to build a fiscal buffer for 2012 and beyond amounting to about €5–6 billion, which turned out to be larger than initially planned (€4 billion per program document).

# 2. Objectives, Design, and Their Relevance

2.1 According to the program document, the objective of the DPL-DDO was to assist the Government of Romania in meeting the fiscal sustainability goals defined by the EU Fiscal Compact. The DPL-DDO supported reforms to (i) improve tax compliance, revenue collection and fiscal discipline, and reduce administrative costs; (ii) improve governance of energy SOEs and strengthen their fiscal sustainability; and (iii) improve fiscal sustainability of the health sector.

2.2 To achieve these objectives, the prior actions focused on (i) reforms of the tax administration, especially for small tax payers and use of e-filing, and enactment of 2012 budget law and submission to the European Commission of the Convergence Program for 2012–15;[1] (ii) legal and regulatory reforms to liberalize electricity sales; and (iii) measures to rationalize the use of drugs, treatments, technology, and hospital facilities.

2.3 An additional objective of the DPL-DDO, which was not explicitly stated as such in the program document or the loan agreement, was to help augment the government's fiscal buffer in case of crisis-induced stress. Undisbursed funds could count toward it. This would be achieved through the DDO instrument, which gave the government access the DPL resources as part of a legally established buffer to be used in the event of a major external shock, especially in connection with the Eurozone debt crisis. The program document states that "the government does not intend to draw the DPL-DDO unless economic conditions worsen and this curtails Romania's access to financial markets" (World Bank 2012b).

## Relevance of Objective

2.4 The relevance of objective is rated **high.**

2.5 The objectives were highly relevant. They were congruent to the country context. Public finance reforms were particularly relevant as better revenue mobilization is a prerequisite for a sound fiscal framework in Romania, a country with the second lowest tax-to-GDP ratio in the EU. The objectives were reasonable and achievable because they were part of a reform program in these three policy areas that had started several years earlier and was well underway when the loan was negotiated. They were fully aligned with the policy priorities in the 2011–13 National Reform Program, which prioritized (i) public finance reforms to comply with the EU's Fiscal Compact; (ii) energy sector reforms and in particular governance of energy SOEs and energy market liberalization; and (iii) public health care financial sustainability. Helping Romania increase its fiscal buffer was also fully aligned with the Government Public Debt Strategy for 2011–13, the Fiscal Budgetary Strategy for 2012–14, and the Fiscal Compact Convergence Program for 2013–15.

2.6 The objectives were consistent with the three pillars of the World Bank Group's 2009–13 CPS for Romania (World Bank 2009a). Under the first pillar on public sector reform, the World Bank committed to supporting public financial management through the DPL program to improve the quality of annual budget planning and support tax administration reform in the later years of the CPS. Under the second pillar on growth and competitiveness, the World Bank would assist Romania in meeting its commitments in respect to energy market liberalization. Under the third pillar on social and spatial inclusion, the World Bank committed to supporting the design and implementation of a health sector reform program to improve health outcomes, with special focus on improving the design of the benefits package. As part of the 2014–17 CPS, the World Bank continues to provide support to tax administration reform under the Country Development Goal on Improving Public Administration and to health sector reform under the Country Development Goal on Improved Health Sector Delivery (World Bank 2014a).

## Relevance of Design

2.7 Relevance of design is rated **substantial.**

2.8 The DPL-DDO was designed to provide sufficient financing to augment the government's fiscal buffer while, at the same time, supporting critical reforms in areas prioritized by the government's National Reform Program. There was substantial continuity in the reform agenda supported by the World Bank. The three DPLs approved in 2009–11 supported reforms in public financial management, which were deepened by the restructuring of ANAF initiated by the DPL-DDO. Prior actions among DPLs 1, 2, and 3 and the DPL-DDO did not overlap; instead, complementarity and continuity existed to the extent that the DPL-DDO supported the submission of the 2012–15 medium-term fiscal framework (MTFF) to the European Commission, and DPL-2 and DPL-3 supported the submission of the MTFFs for the preceding time periods. The DPL-DDO also complemented the reforms in the health care sector supported by the three preceding DPLs, and initiated World Bank support for reforms in the energy sector. The two subsequent FEG DPLs continued to pursue reforms in all three areas. Furthermore, two investment operations—the Revenue Administration Modernization Project approved in 2013 and the Improving Health Care Quality and Efficiency Project approved in 2014—also supported reforms in public finance (tax administration) and health care (table 2.1). There was no overlap of prior actions related to health care reform.

**Table 2.1. Relationship of DPL-DDO to the Regular DPL Program and Investment Operations**

| DPL-DDO Policy Area | DPL Programmatic Series | Year | Investment Operation | Year |
|---|---|---|---|---|
| Public financial management | DPL-1 | 2009 | RAMP | 2013 |
| | DPL-2 | 2010 | | |
| | DPL-3 | 2011 | | |
| | FEG-1 | 2014 | | |
| | FEG-2 | 2016 | | |
| Energy sector reform | FEG-1 | 2014 | | |
| | FEG-2 | 2016 | | |
| Health sector reform | DPL-1 | 2009 | Health Care Project | 2014 |
| | DPL-2 | 2010 | | |
| | DPL-3 | 2011 | | |
| | FEG-2 | 2016 | | |

*Sources*: World Bank 2009b, 2010, 2011, 2012b, 2013, 2014b, 2014c, and 2016b.
*Note:* DPL = development policy loan; FEG = Fiscal Effectiveness and Growth; RAMP = Revenue Administration Modernization Project.

2.9 The DPL-DDO program explicitly focused on public sector management priorities, complementing the EU and IMF program arrangements, and triggered further reforms in the focus areas of the operation. As such, the prior actions of the DPL-DDO were relevant, and some of them catalyzed long-overdue reforms. Such prior action included the restructuring of ANAF, the discontinuation of opaque bilateral contracts at below-market prices in the electricity market, the adoption of a roadmap for the deregulation of the electricity market, and the revision of the list of reimbursable drugs. Reforms aimed to improve the governance of state-owned enterprises (SOEs) and liberalize regulated electricity prices were particularly relevant because energy SOEs, which dominate the sector, used to pose substantial risks to Romania's fiscal stability due to losses of potential revenue and arrears.[2]

2.10 The use of the DDO was relevant for helping protect the economy against unforeseen shocks that might have jeopardized the implementation of the government's financing strategy. The optional drawdown of the DPL-DDO resources allowed the government to increase the size of the loan amount compared with a regular DPL, while the undisbursed loan proceeds formed part of the government's fiscal buffer.

2.11 However, the DPL-DDO had a few design shortcomings. To promote fiscal consolidation, the program included relevant measures, but the quality of Romania's fiscal adjustment since the approval of the DPL-DDO raises questions.[3] The design could have included measures to improve the quality of fiscal adjustment. In tax administration reform, the government and the World Bank underestimated the difficulties associated with ambitious institutional reforms, setting targets that proved to be somewhat unrealistic.

2.12 It is worth noting that the standard requirement of adequate macroeconomic policy framework and satisfactory implementation of the reform program for maintaining access to the DPL-DDO funds was a cause of concern for some stakeholders. The goal of increasing the fiscal buffer was to afford the government a readily accessible source of financing if market conditions deteriorated to the point of temporarily cutting Romania off the financial markets. The prospect of losing access to the contingent line of credit due to derailment in its macroeconomic stability and reform progress, which could be temporarily compromised by the worsening global economic environment, made some counterparts feel that this feature of the DPL-DDO was not fully adapted to the crisis support nature of the operation.

# 3. Implementation

3.1 The DPL-DDO was appraised and negotiated in April 2012 and approved in June 2012. A new government took office in May 2012 and reiterated the commitment to fiscal discipline and the targets of the EU Fiscal Compact. The new government also pledged to expand and deepen the implementation of structural reforms, particularly in energy, health, and the management of SOEs, and championed the establishment of an independent energy regulator, which was crucial to advancing the agenda in the energy sector.

3.2 The government implemented significant prior actions in the three policy areas supported by the DPL-DDO (see appendix B). In tax and budgeting, it initiated the downsizing of local tax offices of the ANAF, enacted the 2012 budget law, which signaled a commitment to fiscal consolidation by projecting a fiscal deficit below 3 percent of GDP during 2012–14, and submitted Romania's first Convergence Program for 2012–15, which incorporated an MTFF consistent with the Fiscal Compact and a financing plan consistent with the MTFF, to the EU. It should be noted, however, that these prior actions were not very demanding, as they reflected the fiscal deficit ceiling imposed by the Fiscal Responsibility Law and Romania's obligations under the Fiscal Compact.

3.3 Prior actions in the energy sector included critical legislative and regulatory measures. The government prepared a new Electricity Law, which transposes the EU Third Package of Energy Reforms (adopted in July 2009) and aims to keep prices as low as possible, secure electricity supply, and increase service standards. The law also established the operational and financial autonomy of the energy regulator, and parliament approved it in 2012. Pursuant to the Memorandum of Understanding signed with the European Commission in March 2012, the government adopted a road map toward the deregulation of electricity prices. One of the boldest prior actions was a government decision to carry out all sales by Hidroelectrica through a competitive market process and to publish information on all bilateral contracts that were still in force.[4]

3.4 In the health sector, prior actions included a revision of the list of subsidized drugs to exclude drugs for which there is no medical evidence supporting their prescription. The government implemented the 2012 National Hospital Master Bed Plan to rationalize hospital infrastructure and established the institutional framework for the implementation of the health technology assessment (HTA).

3.5 The funds of this DPL-DDO were fully disbursed in two tranches: €700 million in October 2013 and €300 million in June 2014, one year before program expiration in June 2015. Debt management considerations and the unexpected sharp increase in the geopolitical tensions in neighboring Ukraine, leading to considerably heightened risks and volatility of the markets, prompted the government to request the withdrawal of the funds as a precautionary measure. The operation closed at the end of October 2014.

# 4. Achievement of the Objectives

4.1 In assessing the achievement of the objectives, this evaluation considers the outcome indicators proposed in the policy matrix (Table 4.1), as well as other relevant information.

**Table 4.1. Summary of Outcome Achievements**

| Outcome Indicator | Baseline 2011 | Target | 2016 or Latest | Status 2016 |
|---|---|---|---|---|
| Public financial management | | | | |
| Tax revenue (€) | 37 billion | 37.5 billion | 43.9 billion | Achieved and sustained |
| Tax administration cost as percentage of tax revenue (%) | 1.11 | 1.05 | 1.05 | Achieved with a one-year delay |
| General government cash budget deficit in % of GDP | 4.2 | <3 | 2.9 | Achieved but at risk of not being sustained |
| Governance of SOEs in the energy sector | | | | |
| Hidroelectrica's annual gross pretax revenue (€) | 755 million | 898 million | 899 million in 2015 | Achieved with one-year delay |
| Electricity sales at regulated prices to nonresidential consumers in electricity supply (%) | 25 | 0 | 0 | Achieved and sustained |
| Electricity sales at regulates prices in electricity supply (%) | 50 | <25 | 8 | Achieved and sustained |
| Health sector | | | | |
| Savings from revision of the basic health services package (€) | 0 | 100 million | 26 million in 2014 | Not achieved and no up-to-date estimates |
| Hospital beds contracted by NHIH (no.) | 129,524 | 123,127 | 119,579 | Achieved and sustained |
| Health prevention and promotion programs in Ministry of Health budget for national health programs | 16 | 15 | >30 | Achieved and sustained |

*Source:* World Bank, 2015, and IEG mission findings.
*Note:* ICR = Implementation Completion and Results Report; NHIH = National Health Insurance House.

## Objective 1: Improve Tax Compliance, Revenue Collection, and Fiscal Discipline, and Reduce Administrative Costs

4.2 The series of the three DPLs implemented prior to the DPL-DDO assisted Romania in improving fiscal discipline and strengthening public financial management mainly by supporting savings in the government wage bill and the implementation of an MTFF consistent with the EU guidelines. The reforms in public financial management supported by the DPL-DDO sought to help Romania strengthen its fiscal framework through modernization and restructuring of the ANAF, fiscal consolidation, and medium-term fiscal planning. Progress in these areas would be measured by an increase in tax revenue collection, a reduction in tax administration costs, and maintaining fiscal deficits below 3 percent of GDP.

4.3 **Restructuring and modernization of ANAF.** Through the restructuring supported by the prior actions, ANAF consolidated the number of tax administration units from 404 to 263 and reduced the number of staff positions by 4,927. The number of local tax offices was reduced from 263 to 221. The implementation of ANAF's 2012–14 restructuring plan continued in subsequent years, with the number of staff cut by 2,500 and the number of local tax offices further reduced to 160. Although the number of local tax offices remained above the target of 47 local offices for small taxpayers set in the restructuring plan, ANAF officials consider dismantlement of additional offices not warranted at this time, as education and age factors make it necessary to maintain field presence. In particular, local offices provide several services (such as tax certificates and e-filing advice) that are not available online. Because of the insufficient reduction of tax offices and staff, the savings in tax collection targeted by the DPL-DDO at approval were not realized by the closing of the operation. Tax administration cost as a percentage of tax revenue was estimated at 1.11 percent in 2014, unchanged from 2011, compared with a target of 1.05 percent. According to ANAF, this target was reached, with a one-year delay, in 2015.

4.4 ANAF has made progress in implementing e-filing of tax returns, which was made compulsory for legal entities but not for individual taxpayers. The rate of e-filing over 2013–15 was 84 percent on average. E-filing limited physical contacts between taxpayers and officials, thus reducing opportunities for corruption and improving tax compliance. The World Bank's *Doing Business* report provides evidence that these reforms have reduced the cost of tax compliance for businesses. According to the 2012 report, on average, firms made 113 tax payments a year and spent 222 hours filing, preparing, and paying taxes; by the 2016 report, firms made only 14 tax payments a year and spent 159 hours doing that (World Bank 2012a, 2016a). Consequently, Romania's ease of paying taxes ranking improved from 154 out of 183 economies to 55.

4.5 Despite the implementation of ANAF's tax compliance strategy for 2013–17, tangible progress in voluntary tax compliance and in reducing undeclared work earnings is limited. Although an antifraud department was created, not all staff have been recruited and trained. A risk analysis to identify regions and business sectors with a higher risk of noncompliance is yet to be undertaken. Low tax compliance and high tax evasion remain major challenges, especially in VAT and labor taxation. According to the Fiscal Council, the VAT efficiency index for Romania decreased from 0.55 in 2012 to 0.52 in 2014.[5] It is significantly lower than in Bulgaria (0.74), the Czech Republic (0.74), Estonia (0.84), and Slovenia (0.73) (Romania Fiscal Council 2014). On the other hand, taxation efficiency increased over the same period for the personal income tax, the corporate income tax, and social security contributions. There has also been an improvement in yields per audit, contributing to an increase in tax collection efficiency. Tax collected per audit more than doubled between 2012 and 2014.

4.6 Romania's 2016 Convergence Program includes measures to further improve the operation of ANAF to reduce tax evasion, improve voluntary compliance, and increase revenue collection. Among the measures are (i) application of a risk-based analysis for fiscal inspections; (ii) increased control of the antifraud unit; (iii) simplification of the VAT registration procedures; (iv) rollout of the undeclared work pilot; (v) continuation of the High Net Worth Individuals initiative; and (vi) assignment of the large and medium taxpayers to the regional structures. The World Bank is providing additional, more targeted support to ANAF through the Revenue Administration Modernization Project approved in March 2013.

4.7 **Fiscal consolidation.** Fiscal consolidation continued from 2012 to 2015, resulting in a decline of the fiscal deficit from 2.5 percent of GDP in 2012 to 1.5 percent in 2015, well below the DPL-DDO's fiscal deficit target of 3 percent (table 4.2). The fiscal deficit reduction was achieved through expenditure cuts—especially capital expenditure, which was reduced from 6 percent of GDP in 2012 to 4.9 percent of GDP in 2014. Following a 5 percentage points cut in social security contributions in October 2014 to reduce the high labor tax wedge, the government amended the Tax Code in 2015, which had an impact on a wide range of taxes, including reductions in VAT rates.[6] The foregone tax revenue from these tax cuts was only partly offset by increases in tax revenue from personal and corporate income taxes, excise taxes, and grants from the EU for capital investment.

**Table 4.2. Fiscal Developments** (selected indicators, 2011–16, in percent of GDP)

| | Year | | | | | |
|---|---|---|---|---|---|---|
| **Fiscal Indicator** | **2011** | **2012** | **2013** | **2014** | **2015** | **2016[a]** |
| Revenue | 33.1 | 33.0 | 32.0 | 31.7 | 33.1 | 31.3 |
| VAT | 8.7 | 8.6 | 8.3 | 7.5 | 8.1 | 6.9 |
| Social security contributions | 9.2 | 8.8 | 8.7 | 8.5 | 8.2 | 8.3 |
| Expenditure | 37.5 | 35.5 | 34.5 | 33.6 | 34.6 | 34.1 |
| wage bill | 7.0 | 7.0 | 7.4 | 7.5 | 7.4 | 7.7 |
| Pensions | 8.1 | 7.6 | 7.3 | 7.1 | 7.7 | 7.7 |
| Fiscal balance (cash basis) | −4.4 | −2.5 | −2.5 | −1.9 | −1.5 | −2.9 |
| Primary balance | −2.7 | −0.7 | −0.8 | −0.3 | −0.1 | −1.3 |
| Memo: total capital spending | 7.0 | 6.0 | 5.1 | 4.9 | 4.8 | 5.1 |

*Source*: Ministry of Public Finance and World Bank staff estimates.
a. Projection.

4.8 Because of these changes, the cash fiscal deficit in 2016 is projected to reach 2.9 percent of GDP, compared with a target deficit of 1.2 percent in Romania's 2015 Convergence Program. The relaxation of fiscal policy has been procyclical as it was implemented at a time when growth was gathering steam and was projected to remain solid. It may risk contributing to the economy overheating in the years ahead.

4.9 Government debt increased from 37.5 percent of GDP in 2012 to 39.8 percent in 2015 and is expected to gradually increase to 42.4 percent of GDP by 2019 because of fiscal loosening. Nevertheless, Romania's public debt remains one of the lowest in the EU. Per the World Bank's debt sustainability analysis, it would take a combined macroshock, slower growth, real exchange rate depreciation, and an interest rate hike to push public debt close to 60 percent of GDP, the limit of the EU's Stability Pact, by 2021.

4.10 Romania has been submitting an MTFF to the European Commission as part of its annual Convergence Program, and the quality of the MTFF has been assessed as high by the institution in comparison to those of the other EU member countries.[7] The MTFF of the 2012 Convergence Program, submitted in April 2012, projected a solid pick up of growth over 2013–15, which proved to be relatively accurate in retrospect—more accurate than the 2013 and 2014 Convergence Programs (table 4.3). However, it seriously underestimated the slowdown of growth in 2012.

**Table 4.3. Convergence Programs: Real GDP Growth and Fiscal Balance**

| | Year | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** |
| Convergence Program 2012 (projection 2013–15) | | | | | | | | |
| Real GDP growth[a] | 1.7 | 3.1 | 3.6 | 3.9 | | | | |
| Fiscal balance[b] | −2.8 | −2.2 | −1.2 | −0.9 | | | | |
| Convergence Program 2013 (projection 2014–16) | | | | | | | | |
| Real GDP growth[a] | | 1.6 | 2.2 | 2.4 | 3.0 | | | |
| Fiscal balance[b] | | −2.4 | −2.0 | −1.8 | −1.8 | | | |
| Convergence Program 2014 (projection 2015–17) | | | | | | | | |
| Real GDP growth[a] | | | 2.5 | 2.6 | 3.0 | 3.3 | | |
| Fiscal balance[b] | | | −2.2 | −1.4 | −1.3 | −1.1 | | |
| Convergence Program 2015 (projection 2016–18) | | | | | | | | |
| Real GDP growth[a] | | | | 3.2 | 3.4 | 3.7 | 4.0 | |
| Fiscal balance[b] | | | | −1.5 | −1.2 | −1.0 | −0.8 | |
| Convergence Program 2016 (projection 2017–19) | | | | | | | | |
| Real GDP growth[a] | | | | | 4.2 | 4.3 | 4.5 | 4.7 |
| Fiscal balance[b] | | | | | −2.9 | −2.9 | −2.3 | −1.6 |
| Realizations[c] | | | | | | | | |
| Real GDP growth[a] | 0.6 | 3.5 | 3.0 | 3.7 | 4.0 | | | |
| Fiscal balance[b] | −2.5 | −2.5 | −1.9 | −1.5 | −2.8 | | | |

*Sources*: Government of Romania, Convergence Programs 2012–16.
a. In percent.
b. In percent of GDP.
c. Projection for 2016.

4.11 The MTFF of the 2012 Convergence Program predicted a gradual decrease in fiscal deficits from 2.8 percent of GDP in 2012 to 0.9 percent in 2015. The 2015 fiscal deficit turned out to be higher, at 1.5 percent of GDP, but well below the DPL-DDO target of 3.0 for 2014. Slower cumulative growth and the cut in social security contributions enacted in October 2014 were the main reasons behind the worse than projected fiscal position in 2015.

4.12 The fiscal deficit targets in the 2016 Convergence Program are significantly higher than those in the 2015 program. This is mainly because of the considerable fiscal loosening adopted in the 2016 budget. For 2017, the MTFF envisages an unchanged fiscal deficit at 2.9 percent of GDP. Expenditure moderation is expected to offset a decrease in revenue resulting from already enacted additional tax cuts in 2017. On account of slower GDP growth and higher spending for compensation of civil servants, the European Commission expects the fiscal deficit may reach 3.4 percent of GDP in 2017. The MTFF projects a decrease in the fiscal deficit to 2.3 percent of GDP in 2018 and 1.6 percent of GDP in 2019. This reflects a steady fall of expenditures as a share of GDP, while revenue is projected to remain broadly stable. The envisaged consolidation relies on unspecified measures, as the MTFF does not provide details of the measures that would support the consolidation effort.

4.13 Romania reached the medium-term budgetary objective (MTO) of the Stability Pact in 2014 and 2015. The 2016 MTFF plans to significantly depart from the MTO in 2016 and 2017, with the structural deficit reaching 2.7 and 2.9 percent of GDP while closing the output gap. It projects structural deficits to return to an adjustment path toward the MTO from 2018 onwards. The MTFF envisages a structural deficit of 1.9 percent of GDP in 2019, twice as high as the MTO. Without specific consolidation measures, this adjustment path for the structural deficit may prove unrealistic.

4.14 The efficacy of objective 1 is rated **modest.** The outcome indicators associated with objective 1 of the DPL-DDO were achieved, although with delay. However, tax revenue in proportion to GDP did not increase over the review period because the untaxed shadow economy remains sizeable while low tax compliance and high tax evasion still remain untackled, especially in VAT, excises, and labor taxation. The quality of the fiscal adjustment achieved until 2015 is open to question, as it relied excessively on horizontal downsizing of the public investment program. The absence of clear prioritization criteria for public investment led to inefficiencies in project selection and implementation. These deficiencies pose considerable risks to the sustainability of these outcomes. Moreover, although Romania has implemented an MTFF in accordance with the commitments of the EU's Fiscal Compact, fiscal consolidation was recently reversed and measures to reduce future fiscal deficits are unclear.

## Objective 2: Improve Governance of SOEs in the Energy Sector and Strengthen Their Fiscal Sustainability

4.15 In the energy sector, the DPL-DDO supported reforms to improve the governance of SOEs and liberalize electricity prices. The deregulated energy pricing was expected to generate extra revenue and reduce power losses. The new Electricity Law does not allow SOEs in the energy sector to negotiate new sale contracts bilaterally. Consequently, practically all contracts are now negotiated on the power exchange market (OPCOM) and the share of nonresidential electricity sales through bilateral contracts declined from 25 percent in 2011 to 9.2 percent in 2014, well below the DPL-DDO target of 20 percent of electricity generation sales of electricity SOEs.

4.16 Hidroelectrica proposed linking the preexisting bilateral contract prices to market prices and shortening the duration of the contracts. Some customers accepted the offer, but the company has been in litigation with the customers who rejected it. The Court of Appeal is still to rule on cases that had been lost at first instance. Hidroelectrica's gross pretax revenue increased from €755 million in 2011 to €765.8 million in 2014, falling short of the DPL-DDO target of €898 million. Nevertheless, thanks to the discontinuation of below-market tariffs and an internal restructuring which reduced the number of employees by a third between 2012 and 2015, Hidroelectrica returned to profitability in 2013, posting net income of Romanian new leu (lei) 899 million (€200 million) in 2015. Foregone income due to electricity sold at below-market prices was estimated at lei 174 million in 2015, reflecting sales to residential customers at still-regulated prices. In June 2016, the company exited the insolvency procedure and will be run by an interim seven-member supervisory board.

4.17 To enable private investment in Hidroelectrica, preparation is ongoing for an initial public offering of shares on the stock exchange. Deregulation of electricity prices has progressed considerably. The timetable for eliminating regulated prices to final customers was met. In 2014, 83 percent of all electricity generation was sold through OPCOM (target 50 percent), compared with 25 percent in 2011. The share of electricity sales at regulated prices fell from 50 percent in 2011 to 17.9 percent in 2014, below the DPL-DDO target of 25 percent. It has declined further to an estimated 8 percent in mid-2016, as by then electricity sales to100 percent of nonresidential consumers and 70 percent of residential consumers were on the competitive market through the power exchange run by the OPCOM. The residential market is scheduled to be fully liberalized in January 2018.

4.18 The reforms pursued since 2012 have led to increased profits and internally financed investments by energy sector SOEs. They have also attracted private capital through privatization. At the same time, the liberalization of the electricity market entailed a rise in competition and lower prices for industrial consumers. In 2015, compared with 2014, the average annual electricity prices decreased for all the components of the wholesale market, with the most significant decrease registered on the intraday market. The volume of transactions on the competitive market increased by 34.5 percent compared with 2014.

4.19 The government has put in place measures to mitigate the impact of electricity (and gas) market liberalization for households. In particular, the three means-tested programs— the heating benefits, family benefits, and guaranteed minimum income program—have been consolidated into a single flagship antipoverty program called the Minimum Social Insertion Income Program. The government is planning to continue to increase the coverage, targeting, and generosity of this program in view of the full liberalization of energy prices for households in 2018.

4.20 The efficacy of objective 2 is rated **substantial.** All the expected outcomes have been achieved, although with delay in some cases, and the results have been sustained.

## Objective 3: Improve Fiscal Sustainability of Health Sector

4.21 Building on the reform agenda of 2009–11, which focused on containing costs and improving health care service quality, the DPL-DDO program aimed to promote cost-effective outpatient and primary care services, introduce copayments, rationalize hospital infrastructure, and review the basic benefit package reimbursed by the public health insurance system. The results would be measured by fiscal savings and higher budget allocation to health prevention and promotion programs.

4.22 The basic health care package was revised in 2012 to exclude two groups of drugs with no proven therapeutic value from the list of reimbursable drugs. Protocols for prescription were tightened for others. The National Health Insurance House (NHIH) reduced the reimbursement of reimbursable drugs in 2012–14 by an estimated €26 million through the delisting. The savings fell short of the DPL-DDO target of €100 million. Moreover, although the government was expected to continue revising the basic package, no significant action was undertaken. Pressure from the pharmaceutical lobby is generally considered a factor in the insufficient drive for this project. Since 2014, 20 drugs have been eliminated from the list of reimbursable medicines, but 57 new drugs have been added. The fiscal impact of these changes could not be assessed, as the Ministry of Health does not compute savings from the basic package on a regular basis.

4.23 Further, in the implementation of the 2012 National Hospital Master Bed Plan, the number of hospital beds for acute care contracted by the NHIH declined faster than anticipated, from 129,524 in 2011 to 121,579 in 2014, below the DPL-DDO target of 123,127. The number of beds has continued to decline since then, to 120,579 in 2015 and 119,579 in 2016. This represents important progress and follows an earlier reduction of 16 percent over the period 2002–07. Nevertheless, both the number of acute care beds and the number of hospital admissions per 1,000 inhabitants still exceed the EU average by about 30 percent. The government also increased the budget of health prevention and promotion programs to more than 30 percent of the Ministry of Health's budget for national health programs since 2014, thus exceeding the results expected in the relevant outcome indicator of the DPL-DDO.

4.24 An interim HTA tool to implement evidence-based assessment of drugs and essential health care technologies was introduced in 2012.[8] The Ministry of Health established the legal framework for implementing the HTA to make further adjustments to the basic package of services, and an HTA department was created. A draft interim HTA procedure to be applied to the already preapproved drugs for compensation was launched. HTA implementation was, however, based on a very simplified methodology and none of the drugs recently added to or eliminated from the basic health package have been ex- ante evaluated through the HTA framework, as committed under the DPL-DDO. Through the Health Sector Reform Project (March 2014), the World Bank is providing further assistance to enhance the methods and processes used in HTA by improving their timeliness and the quality of the assessments.[9]

4.25 The government implemented additional measures to control expenditures and improve the efficiency and effectiveness of health care. A comprehensive reform of the health care system was initiated in 2013, and the National Health Strategy for 2014–20 was introduced in July 2014. The World Bank continued to provide support to health care reform through the Health Sector Reform–Improving Health System Quality and Efficiency Project approved in March 2014. This project provides financing for short- and medium-term interventions in support of the National Health Strategy 2014–20.

4.26 The efficacy of objective 3 is rated **modest.** The DPL-DDO appears to have contributed to fiscal savings through some reform measures supported under the program, but there is lack of information on the effect of other measures, while the use of an assessment tool fell short of expectation. The World Bank's Health Sector Reform Project, approved in 2014, is expected to help fill these gaps.

## Additional Objective: Augment the Government's Fiscal Buffer

4.27 To further the effectiveness of the DPL-DDO, the government's fiscal buffer increased to €5.3 billion in 2013 and €6.6 billion in 2014 (table 4.4). After the closing of the operation, the fiscal buffer declined to € 5.7 billion in the first quarter of 2016, representing 5.8 months of annual gross financing needs. This lower level of buffer still provided a comfortable level of security owing to the favorable change in the maturity structure of public debt: during 2012–16, short-term debt declined from 19 percent of total debt to 13 percent, while long-term debt increased from 47 percent of total to 63 percent.

4.28 The government's cost of borrowing declined during this period from 6 percent in 2012 for domestic currency denominated debt to 5 percent in 2015. The weighted average of foreign currency denominated bonds declined slightly, from 3.9 percent in 2012 to 3.6 percent in 2015. In view of the general decline in interest rates during that period, and given the small decline in interest rates on Romania's bonds, it is not likely that this operation affected in any significant way Romania's borrowing cost.

**Table 4. 4 Romania's Financing Requirements and Fiscal Buffer (2011–16)** (€, billions)

| | Year | | | | | |
|---|---|---|---|---|---|---|
| | **2011** | **2012** | **2013** | **2014** | **2015** | **2016[a]** |
| Consolidated budget deficit | 5.6 | 3.3 | 3.6 | 2.8 | 2.3 | 4.7 |
| Primary deficit | 3.5 | 0.9 | 1.1 | 0.5 | 0.2 | 2.2 |
| Interest payments | 2.1 | 2.4 | 2.4 | 2.3 | 2.2 | 2.5 |
| Amortization | 12.0 | 11.9 | 12.6 | 11.0 | 11.2 | 10.9 |
| Domestic debt | 10.8 | 9.9 | 10.8 | 9.2 | 7.3 | 8.6 |
| External debt | 1.2 | 2.0 | 1.8 | 1.9 | 3.9 | 2.3 |
| Gross financing requirements | 17.7 | 15.3 | 16.2 | 13.8 | 13.5 | 15.6 |
| Fiscal buffer (annual average) | 3.437 | 3.818 | 5.334 | 6.649 | 5.501 | 5.763 |
| Fiscal buffer (months of gross financing requirements) | 2.7 | 3.5 | 5.5 | 6.9 | 5.9 | 5.8 |

*Sources*: Ministry of Public Finance, National Bank of Romania, and World Bank staff estimates.
a. Projection.

4.29 The efficacy of the additional objective is not rated. Augmenting the fiscal buffer was automatically fulfilled with the approval of the DPL-DDO, but the program did not specify expected outcomes from this action. There is no visible improvement in the government's capacity to raise funds. It is therefore difficult to judge the effectiveness of the operation in this regard.

# 5. Ratings

## Overall Outcome

5.1 The DPL-DDO objectives were highly relevant. The relevance of program design was substantial overall, with a few issues that potentially and eventually affected the achievement of program objectives. Progress in the power sector is by far the most significant and merits attention: in just a few years, Romania became a regional leader in electricity sector reforms and achieved outcomes that often take more than a decade to achieve. Of the other two program objectives—improving tax compliance, revenue collection and fiscal discipline, and reducing administrative costs; and improving fiscal sustainability of health sector—the efficacy of the operation is modest.

5.2 In some cases, the achievement of program objectives can be directly attributed to the actions supported by the DPL-DDO. Attribution is most clear in electricity sector outcomes concerning the discontinuation of nonmarket bilateral contracts and use of OPCOM as a single platform for sales by electricity SOEs. The liberalization of the electricity market is less directly attributable to the DPL-DDO as it is part of the Memorandum of Understanding signed between the government and the European Commission with a road map toward the deregulation of electricity prices. The achievement of health sector objectives can also mostly be traced to the DPL-DDO. The focus of the previous DPL series in the health care sector was on the introduction of copayments and the pricing of drugs. In public financial management, reforms to restructure the tax administration agency had also been initiated with support from the IMF and the European Commission. The DPL-DDO helped the government keep the momentum on these reforms while the 2013 investment operation continued the World Bank's support in ANAF's modernization. Reforms concerning the MTFF had been supported by the previous DPL series and were also part of Romania's commitments to the EU as part of its adherence to the Fiscal Compact. Finally, the increase in Romania's fiscal buffer can be clearly attributed to the DPL-DDO.

5.3 The overall outcome is rated **moderately satisfactory.**

## Risk to Development Outcome

5.4 The DPL-DDO supported reforms with medium-term outcomes. The sustainability of these outcomes faces varying degrees of risk across the operation's different policy areas. The overall risk to development outcome is rated **moderate.**

5.5 Despite ANAF's restructuring and the steps taken toward its modernization, further downsizing of its territorial network did not proceed as expected, and the sustainability of savings in the costs of tax collection seems questionable. Tax revenue in proportion to GDP did not increase over the review period because the untaxed shadow economy remains sizeable while low tax compliance and high tax evasion remain untackled, especially in VAT, excises, and labor taxation. These deficiencies pose a risk to the sustainability of the fiscal framework. Although Romania has implemented an MTFF in accordance with the commitments of the EU's Fiscal Compact, fiscal consolidation was recently reversed by procyclical tax cuts and measures to reduce future fiscal deficits are unclear. Thus, some risk to the sustainability of the fiscal consolidation effort exists, but Romania's membership to the EU and its commitment to the EU's Fiscal Compact provides assurance that, over the medium term, fiscal balances will remain on track.

5.6 Energy SOEs used to pose substantial risks to Romania's fiscal stability due to losses of potential revenue and arrears. With the discontinuation of bilateral contracts at below-market prices and the generalization of transactions on the power exchange operated by OPCOM, the reforms supported by the DPL-DDO contributed to improving the transparency of SOEs in the electricity sector. Together with the full liberalization of the nonresidential segment of the electricity market and the progress achieved in the liberalization of the residential electricity segment, these reforms have made Romania a regional leader in electricity market reform. This trend is unlikely to be reversed, reducing the risk to the sustainability of the outcomes achieved so far.

5.7 Although the revisions of the reimbursable drugs list have been insufficient to generate the fiscal savings targeted by the DPL-DDO, the fiscal savings realized through the restructuring of hospitals and the reduction of hospital beds are permanent in nature and thus sustainable. These fiscal savings have been reinforced and will continue in the future thanks to broader reforms to control expenditures and improve the efficiency and effectiveness of health care, including the introduction of copayments for nonemergency procedures. However, the HTA methodology is being used below its potential, thus putting at risk the realization of additional savings in the revisions of the reimbursable drugs list.

## World Bank Performance

5.8 World Bank performance is rated **moderately satisfactory.**

### QUALITY AT ENTRY

5.9 The World Bank prepared in a timely manner an operation that had strong strategic relevance, contributed to the government's fiscal buffer, and provided support for Romania's National Reform Program for 2011–13. The DPL-DDO was underpinned by sound analytical work and previous World Bank operations. It was solidly anchored in the ongoing DPL programmatic series. However, although many risks were correctly identified and appropriately mitigated, some difficulties were underestimated. These included the impact of the electoral cycle on continued fiscal consolidation, the complexity of and time required for the restructuring of the ANAF, and capacity constraints in the Ministry of Health which weakened the reform of the basic health package.

5.10 Quality at entry is rated **moderately satisfactory.**

### QUALITY OF SUPERVISION

5.11 Supervision was timely and ensured adequate monitoring of the implementation of the reform program. Aide-mémoire provided adequate analysis of macroeconomic developments, the implementation of the reform agenda, and recommendations on specific reforms, which were discussed with the government.

5.12 Quality of supervision is rated **satisfactory.**

## Borrower Performance

5.13 Borrower performance is rated **moderately satisfactory.**

5.14 The government remained committed to the reform program supported by the DPL-DDO. Implementation was generally efficient and took advantage of reform programs previously supported by the World Bank. Adequate implementation arrangements were put in place because the government needed the DPL-DDO, which counted as part of the fiscal buffer. A delivery unit was established in the office of the prime minister to coordinate the implementation of reforms supported by this operation. The Ministry of Public Finance coordinated the implementation of the DPL-DDO efficiently and transparently, and cooperated well with the Ministries of Economy (Energy Department) and Health.

5.15 The government deserves much credit for pursuing bold reforms in the electricity sector against political resistance, transforming the governance model of energy SOEs and liberalizing electricity pricing and trading, thereby putting Romania at the forefront of reforms among EU 7countries. On the other hand, the downsizing of the tax administration agency did not reach the levels planned by the authorities, mostly due to unrealistic expectations when the program was designed. Due to the fiscal easing in 2015–16, there is a risk of reversal for some of the hard-won fiscal gains, and clarity is still lacking on the measures required to reduce fiscal deficits in the future. At the same time, capacity limitations became apparent, especially in the health sector. The implementation of the basic health package by the Ministry of Health did not achieve the anticipated savings and was more limited in scope than initially planned.

## Monitoring and Evaluation

5.16 The monitoring and evaluation of the DPL-DDO is rated **substantial.**

### Monitoring and Evaluation Design

5.17 The indicators for energy and health care were relevant to the objectives of the DPL-DDO. By contrast, there were shortcomings in the design of the indicators in public financial management. In particular, no indicators directly reflected the enhanced enforcement of tax laws or the cost of compliance with tax regulations. Moreover, absolute amounts of revenue collected is not an adequate indicator and could have been replaced by tax revenue as a percentage of GDP.

### Monitoring and Evaluation Implementation

5.18 Monitoring and evaluation relied on the government's own system. Participating line ministries were responsible for collecting data in their area of responsibility, and the Ministry of Public Finance assumed a coordination role of the various involved ministries and agencies. The deficiencies in the outcome indicators related to public financial management were not corrected during implementation.

**MONITORING AND EVALUATION UTILIZATION**

5.19 The data generated by the DPL-DDO monitoring and evaluation framework were used to assist in the identification of reforms in debt management, investment prioritization, and performance of SOEs. The programmatic FEG-DPL series has followed up on the DPL-DDO reform agenda in the areas of public finance, energy, and SOEs. The monitoring and evaluation arrangements for the FEG-DPL are like those of the DPL-DDO.

# 6. Lessons

6.1 The design and implementation of this DPL-DDO offers valuable lessons on World Bank support for critical institutional reforms and for strengthening client capacities to respond to exogenous shocks. Three lessons emerge as the most important.

6.2 **The design of the reform program benefited from a solid foundation of country knowledge acquired through thorough analytical work.** It also built on the reform program supported by the programmatic DPL series and took into account the lessons learned through these operations. The success of difficult institutional reforms in the energy sector underscored strong government commitment to the reform process, which was strengthened by the liberalization road map agreed with the European Commission. Commitments taken in parallel with reforms linked to the obligations of EU membership are hence likely to lead to more tangible results. In contrast, insufficient drive to carry out difficult reforms led to slow progress in revising the reimbursable drugs list, while disruption created by major institutional reforms, such as tax administration reform, which required massive reallocation of staff and the establishment of new organizational structures, was underestimated and ultimately slowed down the restructuring of the tax administration agency.

6.3 **Difficult institutions reforms require sustained political commitment and support from development partners.** More specifically, tax reforms are key to improving tax collection and reducing the compliance burden for taxpayers and businesses, but they are also potentially threatening to the status quo, which provides wide discretionary powers and rent-seeking opportunities. Tax reforms require high-level political support from the Ministry of Finance and possibly the prime minister’s office, as well as technical capacity from the tax administration agency. In Romania, political support has been weak. This has negatively affected the outcomes of the DPL-DDO and of the subsequent tax administration project. The reduction of the number of regional offices has not materialized due to considerable political opposition. Budget support operations have the power to focus the minds of political decision makers, but once the money is disbursed the commitment fades. Continuous World Bank pressure at the highest political level, as well as a strong commitment to provide the necessary technical and financial resources, may be required to implement tax administration reforms.

6.4 **DPL-DDOs can be used as an effective mechanism for crisis support and for supporting a borrower's medium-term debt management strategy.** In the case of Romania, the operation was initiated to provide insurance against exogenous shocks by augmenting the size of the government's fiscal buffer. At a later stage, the government saw the DPL-DDO as an appropriate instrument of debt management and withdrew the loan proceeds in tranches to optimize its debt profile. This demonstrates the versatility of the DPL-DDO instrument and its ability to meet client demand for flexible, innovative financial instruments for managing a spectrum of risks.

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[1] EU member countries annually submit their fiscal plans for the next fiscal year to the European Commission, together with an MTFF for the subsequent three fiscal years.

[2] These were the result of entering into bilateral contracts with important commercial customers and setting tariffs at below-market prices. In particular, the terms pf the contract with Hidroelectrica, which accounts for 30 percent of Romania's total electricity supply, were highly unfavorable to the supplier.

[3] Current expenditure decreased by 1 percentage point of GDP, but this was achieved through a decrease in capital spending and in interest payments, while employee compensation increased (see table 4.2 in section 4). On the revenue side, Romania's tax collection in relation to GDP—one of the lowest in the EU, remained unchanged.

[4] Hidroelectrica had several ongoing long-term bilateral contracts with large customers and traders, which had been extended for a five-year period in 2009 with no possibility to renegotiate the tariff by more than 3.5 percent. The gain realized by these customers over 2003–12 is estimated at €1.5 billion. As a result of low revenue and rising cost, Hidroelectrica faced a liquidity crunch in April 2012 and filed for insolvency in June 2012. In 2012, the company had a loss of lei 508 million and an estimated lei 784 million of foregone revenue due to below-market price bilateral contracts.

[5] VAT efficiency is measured by the ratio of actual VAT collection to the estimated VAT liabilities based on the statutory VAT rates and the tax base.

[6] The VAT on food products was cut from 24 percent to 9 percent in June 2015; the standard VAT was cut from 24 percent to 20 percent in January 2016 (and to 19 percent in January 2017); the tax on dividends was cut from 16 percent to 5 percent; personal income tax allowances for dependents were increased; and excise taxes were cut on petroleum products and increased on cigarettes and some other products.

[7] See http://ec.europa.eu/economy_finance/db_indicators/fiscal_governance/documents/f7_mtbf_ms_en.pdf.

[8] Within the last 30 years, many European countries have established HTA programs to inform a variety of decisions, from determining pricing and reimbursement to setting health service standards. A key policy objective behind HTA is to reduce variations in the adoption of new technologies, thereby reducing variation in provider practices by informing technology use in clinical protocols.

[9] The project supports additional technical assistance, equipment, and training to further develop standards and protocols and performing HTA, as well as to strengthen the health sector capacity to develop and implement the HTA.

# Appendix A. Basic Data Sheet

**DEVELOPMENT POLICY LOAN WITH A DEFERRED DRAWDOWN OPTION (P130051)**

**Key Project Data** (US$, millions)

| | Appraisal estimate | Actual or current estimate | Actual as % of appraisal estimate |
|---|---|---|---|
| Total project costs | 1,330 | 1,370 | 100 % |
| Loan amount | 1,330 | 1,370 | 100 % |

**Actual Disbursements**

| | Fiscal Year 2013 |
|---|---|
| Appraisal estimate (US$, millions) | 1,330 |
| Actual (US$, millions) | 1,370 |
| Actual as % of appraisal | 100 % |
| Date of final disbursement: October 17, 2013 | |

**Project Dates**

| | Original | Actual |
|---|---|---|
| Initiating memorandum | 02/27/2012 | 06/12/2012 |
| Negotiations | 04/27/2012 | 04/27/2012 |
| Board approval | 06/12/2012 | 06/12/2012 |
| Signing | 09/11/2012 | 09/11/2012 |
| Effectiveness | 09/11/2012 | 01/11/2013 |
| Closing date | 12/31/2015 | 10/27/2014 |

## Staff Time and Cost

| Stage of Project Cycle | Staff Time and Cost (World Bank Budget Only) | |
|---|---|---|
| | **Staff weeks (number)** | **US$, 000s (including travel and consultant costs)** |
| **Lending** | | |
| **Total** | **50.96** | **364.80** |
| **Supervision/ICR** | | |
| **Total** | **88.26** | **651.31** |

## Task Team Members

| Names | Title | Unit | Responsibility/ Specialty |
|---|---|---|---|
| **Lending** | | | |
| Raluca Marina Banioti | Program Assistant | ECCRO | Team support in Bucharest |
| Carlos Marcelo Bortman | Sr Public Health Specialist | GHNDR | Sector Expert |
| Steen Byskov | Sr Financial Economist | GFMDR | |
| Roy S. Canagarajah | Operations Adviser (formerly Lead Economist) | AFRDE | Co-TTL |
| Bogdan Constantin Constantinescu | Sr Financial Management Specialist | GGODR | Financial management |
| Nancy Sabina Davies-Cole | Program Assistant | GMFDR | Team support in DC |
| Richard Florescu | Senior Operations Officer | GSPDR | Health and Social Protection |
| Joseph Paul Formoso | Senior Finance Officer | CTRLA | |
| Daria Goldstein | Senior Counsel | LEGCF | |
| Antonia T. Koleva | Operations Officer | GSPDR | |
| Jean-Francois Marteau | Sector Leader | ECCU5 | |
| C. Bernard Myers | Senior Public Sector Specialist | GGODR | Public Sector Expert |
| Kari J. Nyman | Lead Specialist | GEEDR | Energy Expert |
| Catalin Pauna | Senior Economist | GMFDR | Co-TTL |

# Appendix B. Policy Areas and Prior Actions

| Objective | Prior Actions |
| --- | --- |
| **I. Improve tax compliance, revenue collection, and fiscal discipline** | The borrower's government has launched the modernization of tax administration by (a) reducing the number of local tax offices for small tax payers to no more than 221 (that is, by at least 39 percent) on the basis of Government Decision No. 564/2011 and ANAF President Order No 2180/ 2011 as amended; (b) expanding electronic tax filing by all legal entities to at least 80 percent on the basis of the Minister of Economy and Finance Order No. 858/2008 as amended, the ANAF President's Order No. 2520/2010 and the government's Emergency Ordinance No. 117/2010 for the tax declarations available for e-filing; (c) approving the ANAF restructuring plan for 2012–14 to further reduce the number of local tax offices for small tax payers to 47 and expand electronic tax filing for legal entities to 96 percent for tax declarations available for e-filing, pursuant to the Government's Memorandum dated April 18, 2012. |
| | The Borrower has enacted the 2012 Budget Law to strengthen fiscal discipline and demonstrate commitment to fiscal consolidation in line with the 2012–14 Fiscal Strategy. |
| | The Borrower's Government has approved and submitted to the European Commission the Convergence Program for 2012–15 which incorporates: (a) a medium-term fiscal framework consistent with the provisions of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the Fiscal Compact), and (b) a financing plan consistent with the above referenced fiscal framework. |
| **II. Improve governance of energy SOEs to strengthen their fiscal sustainability** | The borrower's government has approved a memorandum No. DPES 172 dated March 8, 2012 to carry out Hidroelectrica's electricity sales through competitive market processes and to publish information on all bilateral contracts for electricity sales. |
| | The borrower's government has approved and submitted to the borrower's parliament a new Electricity Law that transposes the EU Third Package of Energy Reforms and sets forth the operational and financial autonomy of the energy regulator ANRE. |
| | The Borrower's Government has approved a roadmap for phasing out regulated prices for electricity, pursuant to the Government's Memorandum dated March 16, 2012. |
| **III. Improve fiscal sustainability of health sector** | The borrower has approved under the government's Decision No 359 dated April 18, 2012 the exclusion of selected drugs compensated for indications outside the terms of their marketing approval or for which there is no scientific medical evidence supporting their indication, from the lists of compensated drugs and has issued an MoH Order No423 dated April 26, 2012 and NHIH Order No. 118 dated April 27, 2012 setting forth the conditions under which drugs in the basic health package services can be reimbursed. |
| | NHIH has implemented the 2012 National Hospital Master Bed Plan approved by the Borrower's Government Decision No. 151/2011. |
| | The Borrower's Government has established the institutional framework for the implementation of the health technology assessment pursuant to the Borrower's Government Decision No 351/2012. |

# Appendix C. List of Persons Met

| Name | Title | Organization |
|---|---|---|
| Catalin Pauna | Sr. Economist | The World Bank, Bucharest |
| Cristina Petcu | Health Economist | The World Bank, Bucharest |
| Elisabetta Capannelli | Country Manager | The World Bank, Bucharest |
| Boni Cucu | General Director | Ministry of Public Finance |
| Victor Ionescu | General Director | OPCOM |
| Liliana Pecheanu | Ioana Burla's department | Ministry of Public Finance |
| Gabriel Neagu | Ioana Burla's department | Ministry of Public Finance |
| Octavian Deaconu | Secretary General, National Agency for Fiscal Administration | Ministry of Public Finance |
| Ionut Dumitru | Head of Fiscal Council and Chief Economist | Raiffeisen Bank |
| Niculae Havrilet | President | ANRE |
| Stefan Nanu | General Director | Ministry of Public Finance |
| Richard Florescu | Health economist | World Bank retiree |
| Oana Truta | Vice President | Franklin Templeton Investment |
| Dan Matei | Director of Debt Department | Ministry of Public Finance |