ROMANIA’S PATH TO PROSPERITY

Systematic Country Diagnostic
Online Consultations

October 18 – November 30, 2017
OUTLINE OF PRESENTATION

1. Purpose and Process of the Systematic Country Diagnostic (SCD)
2. Romania Country Context
3. Recent Poverty and Shared Prosperity Patterns
4. What Should Romania Do to Boost Its Long-Term Growth Potential?
5. How Can the Benefits of Growth Be Spread More Equitably Across Society and Regions?
6. How Can Growth Be Made Environmentally Sustainable?
7. How Can Institutions be Strengthened to Achieve Sustainable and Equitable Growth?
The purpose of the SCD is to identify a set of priorities through which a country may most effectively and sustainably reduce poverty and increase shared prosperity; 

SCD will help the World Bank Group define its strategy for Romania for the period 2018-23 as part of a new Country Partnership Framework; 

SCD takes stock of key development challenges in Romania and progress attained; 

SCD identifies and, where possible, fills in the existing knowledge gaps; 

SCD process includes intensive consultations with key stakeholders across private sector, civil society, academia, local and national public authorities and other sectors.
LOGICAL FRAMEWORK

HOW CAN ROMANIA REACH THE TWIN GOALS OF REDUCING POVERTY AND ENHANCING SHARED PROSPERITY?

- Boosting the Economy’s Growth Potential
- Making Growth More Inclusive
- Greening Growth

Strengthening Institutions

HIGH LEVEL OF POVERTY
SOCIAL AND REGIONAL DISPARITIES
LOW QUALITY OF GROWTH
INCOMPLETE INSTITUTIONAL CONVERGENCE
LARGE INFRASTRUCTURE GAP
DEMOGRAPHIC CHALLENGES

Boosting the Economy's Growth Potential
Making Growth More Inclusive
Greening Growth

Strengthening Institutions
A CONDITIONAL SUCCESS IN REDUCING MACROECONOMIC VULNERABILITY
ROMANIA’S CONVERGENCE WITH THE EU-28 IS STILL SOME WAY OFF

GDP per capita, EU-28 =100 (PPS)

Number of years to achieve convergence with EU-28

<table>
<thead>
<tr>
<th>Romania’s growth rate</th>
<th>Number of years</th>
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<tbody>
<tr>
<td>4%</td>
<td>29</td>
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<tr>
<td>5%</td>
<td>19</td>
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<tr>
<td>6%</td>
<td>14</td>
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<tr>
<td>7%</td>
<td>11</td>
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<td>8%</td>
<td>9</td>
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Source: WB staff calculations based on Eurostat data on GDP per capita in PPS
Note: Annual growth rate of EU-28 is equal with EU-28 last five-year growth

Source: Eurostat, projections 2017-2020 based on the last five-year growth average
POOR QUALITY OF GROWTH

Contributions to Annual GDP Growth (expenditure approach)

- Consumption is the main driver of growth while the weak performance of investment negatively affects the potential of the economy.
- Romania’s external position has improved, but recent consumption boom has reversed the trend.
- Pro-cyclical fiscal behavior widened the fiscal deficit and threatens the stability of public debt.

Source: Eurostat, WB staff calculations
SECTORAL DRIVERS OF GROWTH REFLECT THE STRONG PERFORMANCE OF PRIVATE CONSUMPTION

Contributions to Annual GDP Growth (production approach)

- Wholesale and retail trade are driving growth in recent years reflecting robust domestic demand
- Romanian ICT is one of the main contributors to growth and the 5th largest (as % of GDP) in the EU as of 2016.
- Romanian agriculture still has a higher impact on GDP growth compared to regional peers.

Source: Eurostat, WB staff calculations
A PRECARIOUS SUCCESS IN REDUCING POVERTY AND SHARING PROSPERITY
PROGRESS IN POVERTY REDUCTION

• Success in poverty reduction in the last decade

• Poverty reduction was partially reversed by the crisis

• Poverty remains the highest in the EU, significantly higher than in Bulgaria, Poland

Source: WB Staff estimation using EU-SILC 2013

Source: WB ECAPOV, WDI and EUROSTAT
LARGE DISPARITIES PERSIST ACROSS SOCIAL GROUPS AND ACROSS REGIONS

Poverty rates by occupational status: self-employed, unemployed, inactive vs employees

- Poverty for people with primary education is ten times higher than for people with tertiary education;
- 70 percent of Roma vs 25 percent general pop are poor.

At-risk-of-poverty rate by NUTS3 region, 2011

SYSTEMATIC COUNTRY DIAGNOSTIC

PILLAR I

BOOSTING THE ECONOMY’S GROWTH
POTENTIAL
GROWTH HAS BEEN DRIVEN BY PHYSICAL CAPITAL ACCUMULATION AND EFFICIENCY GAINS (TFP)

Efficiency gains (TFP) have been an important driver of Romania’s growth (transition to a market economy)

A higher growth trajectory can be attained with more and better investment in physical and human capital and productivity improvements within firms (competition, skilled labor and technological upgrading)

Source: World Bank calculations, based on a human capital adjusted Solow model
CORRECTING MISALLOCATION OF RESOURCES WOULD INCREASE AGGREGATE PRODUCTIVITY

In Romania misallocation is likely due to weak competition in regulated sectors with spillovers for the rest of the economy.

Source: OECD indicators of product market regulation (PMR) 2013.
REMOVING BARRIERS TO AGGLOMERATION OF ECONOMIC ACTIVITY IN REGIONAL GROWTH POLES WOULD INCREASE AGGREGATE PRODUCTIVITY

Romania’s secondary cities are lagging

Cities and functional urban zones are performing below their economic potential

Source: Eurostat.
Note: GDP per Employed person (PPS) in 2014, employed persons include both employees and the self-employed.
Romania is a modest innovator

In Romania within-firm productivity improvements and the ability to move up global value chains are constrained by:

- underdeveloped infrastructure,
- inadequate skills and
- a scarce propensity to innovate

Source: European Commission, EIS2016.
Note: Summary Innovation Index calculated as the unweighted average of the re-scaled scores for all indicators.
INCREASING THE QUANTITY AND QUALITY OF CAPITAL AND LABOR KEY FOR EXPANDING THE PRODUCTION

Infrastructure quality vs. investment expenditure

Romania has one of the lowest activity rates in Europe


Source: Eurostat
Note: Activity rates for population aged 15-64 in EU countries (2016)
CHALLENGES TO BOOSTING THE ECONOMY’S GROWTH POTENTIAL
KEY QUESTIONS WHERE WE SEEK YOUR VIEWS

- How can Romania allocate resources better across sectors and firms?
- What are the barriers to the economic activity in regional growth poles?
- What are the incentives for Romanian firms to become more innovative and productive?
- What would increase the quality and quantity of capital and labor force in the Romanian economy?
SYSTEMATIC COUNTRY DIAGNOSTIC

PILLAR II

MAKING GROWTH MORE INCLUSIVE
POVERTY REDUCTION WAS DRIVEN BY PENSIONS AND LABOR INCOME

Pensions and labor income contributed to poverty reduction before the financial crisis

Jobs (labor income) are generally the most important and sustainable driver of poverty reduction

Market income can be boosted by investing in the productive capacity of households, providing more and better employment opportunities, and by addressing constraints to the efficient use of human capital, land and other assets.
Romania has one of the highest early school-leaving rates in the EU, which impacts the Roma in particular.

But disparities start early in kindergarten: 88% Romania vs 95% EU-average.

On health, infant mortality is three times the EU average, mortality from non-communicable diseases is among the highest, life expectancy is among the lowest.

Source: Eurostat
Lack of employment opportunities and low labor earnings have a strong association with poverty.

Labor force participation is particularly low among women, the youth and the Roma.

The Roma face systematic challenges in access to services and employment.
While many Romanians migrate externally, internal mobility is the lowest in the EU;

Severe lack of service provision in rural areas:
- 87% lack public water supply, 96% lack public sewerage
- One of the lowest road network density in the EU
- Physical infrastructure for education, health on downward trend

Formalization of land ownership could increase returns to capital (only 15% of rural and 51% of urban real estate is registered in Romania).
In Romania, social transfers are not effective in reducing poverty.

Low targeting
- High prevalence of categorical programs: many funds go to non-poor households.

Sustainability and adequacy of pensions.

Source: Eurostat
What are the main constraints for reducing early school leaving?

What are the main constraints for increasing labor force participation in Romania?

What are the constraints to increasing returns to labor and capital?

What are the challenges for Roma inclusion?

What are the challenges to improving the effectiveness of social transfers for poverty reduction?
SYSTEMATIC COUNTRY DIAGNOSTIC
PILLAR III
GREENING GROWTH
Environmentally sustainable growth is a priority for Romania

Romania does well in climate and energy (carbon intensity), agriculture (nitrogen use), and forests (tree cover) but scores worse in environmental health: health impacts (environmental risk exposure), air quality (household air quality and air pollution), and water and sanitation (drinking water quality and unsafe sanitation)
Romania’s greenhouse gas emission

- Romania made progress in reducing greenhouse gas emissions thanks to structural transformation of economy.
- Romania lags in measures of air and water pollution management, waste management, biodiversity conservation and natural resources protection.
- Insufficient climate change adaptation actions
  - Prevention of flooding, reduce impact of droughts.

Source: Eurostat
Romania has the second-lowest resource productivity in the EU

- Romania has the second-lowest resource productivity, the worst waste intensity and the second-lowest recycling rate in the EU

- Institutional failures related to the revision of national waste prevention program and adaptation of national measures on waste management and prevention led to repeated actions by EU institutions

Source: Eurostat
Resource productivity=GDP/domestic material consumption (EUR/kg).
CHALLENGES TO MAKING GROWTH ENVIRONMENTALLY SUSTAINABLE
KEY QUESTIONS WHERE WE SEEK YOUR VIEWS

- How can Romania make better use of its natural capital?
- What are the constraints to improving climate change adaptation?
- What are the main challenges to transitioning to a circular economy?
- How can environmental health outcomes be improved?
- What are the challenges to the planning and administrative capacity of the public sector?
SYSTEMATIC COUNTRY DIAGNOSTIC
PILLAR IV
STRENGTHENING INSTITUTIONS
QUALITY OF ROMANIAN INSTITUTIONS LAG EUROPEAN STANDARDS

Romania and the EU in several dimensions of governance

- Romania lags in all dimensions of governance, although more in some than others.
- Significant lags observed in government effectiveness, control of corruption, voice and accountability, and rule of law.

Source: World Governance Indicators
Reducing corruption is essential to build trust between citizens and the government, and enhance cooperation.

Trust in institutions is low and corruption high by European standards, although the fight against corruption is stepping up.
Romania had the highest economic risk rating in the EU in 2000-15

- Improving macroeconomic management is essential for economic stability and sustainability.
- However, Romania’s economic management remains subject to risks
  - Fiscal policy is heavily pro-cyclical.
Health and Education top the list of public services expected by citizens

- Inefficiencies in public administration hamper capacity for delivery of public services in education, health and infrastructure:
  - High bureaucracy;
  - Inadequate digital framework;
  - Restricted access for poor.
- Limited resources and low efficiency of public spending.
- Public investment management suffers from capacity constraints, leading to delays in project preparation and implementation.
CHALLENGES TO STRENGTHENING INSTITUTIONS
KEY QUESTIONS WHERE WE SEEK YOUR VIEWS

- What are the main challenges to policy commitment?
- What are the main challenges to commitment to formal rules for better macroeconomic management?
- How can trust in the State and institutions be enhanced?
- How can capacity be strengthened for better management of public investment?
- How can public spending be made more efficient for better service delivery in health and education?