COUNTRY PRIVATE SECTOR DIAGNOSTIC

CREATING MARKETS IN ROMANIA

Raising Romania's Private Sector Potential for Greener Growth

Executive Summary

December 2023

WORLD BANK GROUP

THE WORLD BANK IBRD • IDA

IFC International Finance Corporation

About IFC

IFC — a member of the World Bank Group — is the largest global development institution focused on the private sector in emerging markets. We work in more than 100 countries, using our capital, expertise, and influence to create markets and opportunities in developing countries. In fiscal year 2022, IFC committed a record $32.8 billion to private companies and financial institutions in developing countries, leveraging the power of the private sector to end extreme poverty and boost shared prosperity as economies grapple with the impacts of global compounding crises. For more information, visit www.ifc.org.

© International Finance Corporation 2023. All rights reserved.
2121 Pennsylvania Avenue, N.W.
Washington, D.C. 20433
www.ifc.org

The material in this work is copyrighted. Copying and/or transmitting portions or all of this work without permission may be a violation of applicable law. IFC does not guarantee the accuracy, reliability or completeness of the content included in this work, or for the conclusions or judgments described herein, and accepts no responsibility or liability for any omissions or errors (including, without limitation, typographical errors and technical errors) in the content whatsoever or for reliance thereon. The findings, interpretations, views, and conclusions expressed herein are those of the authors and do not necessarily reflect the views of the Executive Directors of the International Finance Corporation or of the International Bank for Reconstruction and Development (the World Bank) or the governments they represent.

EXECUTIVE SUMMARY

Country context

Romania has made impressive strides in economic performance over the past two decades, as EU integration helped accelerate income convergence towards the bloc's average. Between 2000 and 2022[i], Romania's income per capita in PPP (2017 international US$) rose from 26.4 percent to 76.7 percent of the EU average, real GDP per capita in PPP more than doubled (from US$12,177 to US$32,738), and GDP grew at an average annual rate of 3.5 percent (nearly triple the EU average). Moreover, Romania's economic growth has shown substantial resilience in the face of the pandemic, Russia's invasion of Ukraine, and the associated economic shocks.

The shift towards sustainable, well-governed, and inclusive economic growth remains in progress, with headwinds for the private sector. Although high on average, Romania's economic growth has been very volatile, mainly driven by consumption, and associated with major environmental externalities—such as high levels of air pollution in urban areas. The productivity dividends from the reforms spurred by EU accession in 2007 have dwindled, due to gaps in governance and quality of institutions, unfavorable demographics, and acute skills shortages that affect the quantity and quality of labor. Structural transformation remains ongoing: agriculture still accounts for a large share of employment, while the relative contribution of services to GDP and employment is the lowest in the EU. Despite the availability of sizable EU funds, infrastructure remains underdeveloped relative to the country's income level, constraining private investment and productivity in several key sectors. Unsustainable wage dynamics and an aging and shrinking labor force further compromise productivity. The country's vast shadow economy, estimated at 21 percent of GDP, generates additional challenges. Informal workers are a major component of the labor market, especially in low-skilled roles. Private investment has been relatively high, but a shallow financial sector limits the availability of long-term finance.

Substantial internal inequalities exacerbate the country's challenges and highlight the urgency of expanding access to economic opportunities and better jobs. Although robust economic growth has translated into poverty reduction, Romania still has the highest poverty rate in the EU. Approximately 45 percent of the population lives in rural areas, where the poverty rate is six times as high as in metropolitan areas. Disparities between leading and lagging regions, as well as between urban and rural zones, are large and often widening. The Systematic Country Diagnostics (SCD) 2018 summarized the overarching narrative of the country's socio-economic development as "A Tale of Two Romanias": one urban, dynamic, and integrated with the EU; the other rural, poor, and isolated.[1] The population in the bottom 40 percent of the income distribution has limited access to productive employment and struggles to reap the benefits of economic

i. Some information presented in this report may not reflect the latest data or developments available due to a combination of factors, including but not limited to: better representation of structural factors by pre-COVID data; consistency with recently published World Bank reports; general cut-off point for the preparation of the report (April 2023).

growth. Nearly half of those in the bottom 40 percent do not work, while 28 percent engage in subsistence agriculture. Social disparities are widening, with vulnerable groups such as the Roma facing deprivation on multiple fronts and often living in precarious conditions. Additionally, the gender gap in labor force participation is the largest in the EU, and the female entrepreneurship is undercapitalized in Romania, with disparities in self-employment rates across genders and with only 17.2 percent of companies having a female top manager - see Romania Gender Assessment (forthcoming) for more details.

Two recent shocks and two impending transitions highlight both existing gaps, and opportunities for a more inclusive, resilient, and sustainable private sector–led growth model. The COVID-19 pandemic and Russia's invasion of Ukraine have tested Romania's economic resilience and left considerable scars, particularly on the country's human capital. The green and digital transitions can bring major opportunities to Romania, but need a supportive institutional environment, and a workforce ready for the changes to come.

Focus of the report

The first part of this Country Private Sector Diagnostic (CPSD) provides an overview of Romania's economic performance, and of five key cross-cutting constraints to private sector development in the country. First, the inadequate education of the workforce has shot up the list of constraints in the business environment, as reported by firms. Second, the business environment tends to be unpredictable—a consequence of institutional shortcomings, including deficiencies in governance. Third, impediments to competition, associated with a relatively high degree of state control of the economy as well as barriers to entry (especially in services), distort market outcomes and hamper the efficient allocation of resources. Fourth, Romania's economy has little innovative capacity, mainly due to chronic underinvestment and shortages of skills. Fifth, essential infrastructure (e.g., in energy and transport) suffers from significant shortcomings. Other cross-cutting issues (for example, challenges in the education system) are analyzed in depth in the Romania 2023 SCD Update[2], while the Romania Country Climate and Development Report (CCDR) provides an in-depth overview of climate objectives and the potential implications for the economy and people.

The second—and core—part of the CPSD explores how Romania can harness private investment in three critical enabling sectors to reignite sustainable economic growth and social inclusion. To identify short- to medium-term opportunities for private sector growth and enhanced service provision across the country, the CPSD focuses on crucial sectors featuring gaps that affect the whole economy. These are: the energy sector, with a focus on renewables; the transport sector; the financial sector, with an analysis focusing on inclusion through digitalization on the one hand, and the sector's readiness for the green transition on the other. Notably, surveys of Romanian firms identify shortcomings in the transport and financial sectors among the top constraints in the business environment, and a wealth of analytical work shows that private sector-led solutions can address many such gaps. Renewable energy and energy efficiency are strategic areas in the European Green Deal, offering technological solutions that are increasingly cost-effective and need to be deployed at scale, while Russia's invasion of Ukraine has brought to the fore a renewed emphasis on energy security. The financial sector has a crucial role to play not only in enabling green growth by mobilizing and allocating private capital, but also in expanding access to finance for individuals and micro, small, and medium enterprises (MSMEs), thus helping bridge regional divides and foster social inclusion.

In addition, three "tradeable opportunity highlights"—focusing on industry, services, and agriculture, respectively—outline how improvements in the key enabling sectors could expand opportunities for trade across the economy. Specifically, Opportunity Highlight 1 explores how Romania's private sector may find a role in new, green value chains (e.g., supplying inputs or components for electric vehicles and wind or solar power generators), building on the green transition and recent global trends toward reshoring and nearshoring. Opportunity Highlight 2 examines how Romania can boost the performance of the services sector—which lags the EU average on many dimensions—to maximize benefits for the wider economy. Relevant steps include improving digital skills, boosting enrolment in tertiary education, and enhancing management practices at firm level. Finally, Opportunity Highlight 3 recognizes that while agriculture remains an important sector of the Romanian economy and a large employer, its productivity is significantly lower than the EU average, and the gap is not showing signs of closing. Addressing key constraints—such as underinvestment in mechanization due to limited access to finance, a shortage of specialized skills, impediments to technology adoption, lack of economies of scale, and infrastructural and geographical barriers that hinder access to markets—can boost agricultural productivity and value addition.

PART 1: The private sector already drives Romania's growth, but addressing cross-cutting constraints can enable more private capital mobilization and help boost the economy's dynamism and sustainability

Addressing the cross-cutting constraints can bring more dynamism to MSMEs and further boost the private sector's role in driving Romania's economic growth. MSMEs play an important role in the Romanian economy, but less so than in regional peers, and have the potential to become more productive and dynamic. They account for about 65 percent of employment and 56 percent of value added in Romania, in line with EU averages but less than in regional peers—for example, MSMEs generate almost 80 percent of employment in the Baltic countries, and 68 percent in Poland and Czechia. Labor productivity in Romania has been catching up with the EU average but remained around 33 percent lower in 2021. Aggregate productivity gains in recent years largely stem from improved allocative efficiency, whereby productive firms have increased their market share. Lack of digital skills, poor human capital, brain drain, and shortcomings in the business environment are major and intertwined challenges to productivity growth in the country. In addition, the productivity of MSMEs is held back by limited access to finance, due to both demand-side (e.g., undercapitalization of firms, informality, limited collateral, low financial literacy) and supply-side factors (e.g., deficiencies in the financial infrastructure).

Cross-cutting constraint #1: Skills shortages and mismatches

The combination of a fast-growing economy, one of the highest rates of emigration in the EU, and a lagging education system has turned the skills gap into the key impediment to private sector development. Romania's population has been decreasing due to ageing and emigration, and the working-age population (20-64 years old) will shrink by an estimated 7.5 percent by 2025 from 2019 levels, with another 3 percent drop between 2025 and 2030. At the same time, the labor force participation rates among women and the young are some of the lowest in the EU. The deficiencies of the education system, unfavorable attitudes to lifelong learning, and ineffective vocational training and active labor market policies combine with brain drain to cause skills shortages and mismatches, which reduce innovation capacity as well as growth and earnings potential (see Romania 2023 SCD Update). Romania has the lowest score

in the EU on the Human Capital Index (HCI): 0.58, meaning that children born in Romania today will be 58 percent as productive when they grow up as they could be if they received full education and healthcare. In addition, Romania has the lowest rate of participation in lifelong learning in the EU, due to both cultural and systemic barriers, while the country's workforce has lower levels of digital and soft skills relative to EU standards. At a sectoral level, 51 percent of industrial companies suffer from skills shortages, versus 40 percent of companies in agriculture and services.[3] Greener jobs coming alongside the green transition to achieve Romania's climate objectives demand more of the higher skills already in short supply in Romania—a factor that may deepen the skills deficit and hamper the green and digital transitions, unless education systems and social protection policies are fundamentally rethought (see Romania CCDR and other recent analytical work for more details).[4]

Cross-cutting constraint #2: Governance and institutional shortcomings affecting the business environment

The unpredictability of the business environment and deficiencies in governance pose a significant challenge to the private sector's development in Romania. Inefficiency of the tax administration, perceived corruption, and political instability are major constraints in the business environment. Although Romania has made progress in improving its business environment, many tasks (e.g., obtaining electricity supply and construction permits, resolving insolvency, protecting minority investors, and enforcing contracts) remain onerous for businesses. Romania also stands out for its restrictive regulation of professional and transport services (including airlines). Furthermore, as of 2018, Romanian firms reported that an estimated 18 percent of their senior management's time was spent on dealing with tax regulations (a higher figure than in 2009), versus 13.5 percent on average in peer countries.

Cross-cutting constraint #3: Barriers to competition

A high degree of state control of the economy, an unequal playing field between State-Owned Enterprises (SOEs) and private firms, and barriers to entry hamper competition in Romania. The OECD's 2018 Product Market Regulation (PMR) index—which captures state control, barriers to entry, and barriers to trade and investment—shows that state control over the economy in Romania is greater than in most OECD countries.[5] Barriers to entry that could be removed to boost competition and GDP growth include, among others: i) burdensome administrative procedures; ii) unnecessary entry requirements in road freight services and professional services; and iii) minimum and maximum fees for legal services, as well as recommended fee guidelines for engineering and architectural services. Moreover, SOEs enjoy significant regulatory privileges, including exemptions from legal requirements on corporate governance; a lack of rules mandating the separation of commercial and non-commercial functions; and a lack of requirements for SOE investments to show positive rates of return. The application of existing rules suffers from fragmented responsibilities for SOE oversight, inconsistent reporting, unclear terms of compensation for public service obligations, and poor transparency of state aid allocation.

Cross-cutting constraint #4: An underperforming innovation ecosystem

Romania's economy is limited in its innovative capacity, mainly due to chronic under-investment, shortages of skills, and governance deficiencies. Romania ranks last on the EU Innovation Scoreboard, signaling a poor ability of Romanian firms to move up the value chain. Romanian firms underperform their EU peers in product and process innovation, marketing and organizational innovation, R&D expenditures, patent applications, and ICT training. Romania has by far the smallest share of innovative

enterprises in the EU: as of 2019, only 10 percent of Romanian firms had introduced a new or significantly improved product or service over the previous 12 months, fewer than in regional peers such as Bulgaria, Hungary, or Poland. Moreover, no single agency is responsible for the overall management and coordination of innovation policy.

Cross-cutting constraint #5: Infrastructure and connectivity issues

Romania's infrastructure does not reflect the country's status as an EU member, or its overall high level of development—as outlined in detail in Part 2 of this report. Romania's infrastructure metrics lag the rest of the EU, with the country ranking last in the bloc on quality of overall infrastructure nearly every year since 2007. According to the 2019 Global Competitiveness report, Romania performed especially poorly on quality of roads, ranking 119th out of 141 countries—the worst placement in the EU and, despite being a high-income country, well below some upper-middle-income countries. The major role of SOEs in the country's infrastructure sector (especially transport and energy) leads to underinvestment and/or crowds out the private sector. Public investment averaged 4.2 percent of GDP between 2000 and 2020, above the EU-27 average of 3.2 percent of GDP, but it was highly volatile. The government's use of cuts to investment as an instrument to meet fiscal deficit targets has been a major contributor to volatility. The insufficient coverage of transport infrastructure networks hampers competitiveness and job creation. On the other hand, digital infrastructure is relatively well developed, albeit with sizeable regional variations.

While all sectors of the economy will need to decarbonize to deliver on the green transition's objectives, the shift in the energy sector and its implications for energy security are paramount. The energy sector is the main contributor to greenhouse gas (GHG) emissions in Romania (66 percent of total emissions), highlighting the importance of the energy transition in several related sectors. Among the emissions attributed to energy, 32 percent come directly from energy generation, 24 percent from transport, and 15 percent from manufacturing activities. Therefore, in the short-to-medium term, increasing the share of electricity generation from renewables, their storage capacity, and laying the foundations for transport decarbonization are key considerations, examined in Part 2 of this report.

Municipal infrastructure remains underdeveloped and requires significant investment. Many Romanian cities face challenges around urban transport, with Bucharest ranked among the most congested cities in the world, and the transport sector has been responsible for an increasing share of GHG emissions in recent years, primarily from daily commuting within metropolitan areas. Moreover, heating infrastructure is old and inefficient: 80 percent of the country's heat generation capacity is more than 30 years old, and the age of some installations exceeds 45 years.

Romania is missing out on the opportunity to fully embrace the public-private partnership (PPP) model, where suitable, to involve the private sector in financing, developing, upgrading, and operating key infrastructure assets. In certain infrastructural domains (e.g., aviation and railways) the private sector can help surmount funding gaps and improve efficiency, including through PPPs. This modality may also be well suited to delivering discrete assets with limited complexity and risks (e.g., waste treatment plants, cogeneration facilities), particularly at the municipal level—while carefully considering the implementation capacity of subnational governments, to avoid creating contingent liabilities. Romania's current legal framework for PPPs, however, requires optimization to boost private sector investment.

PART 2: Enabling private sector investment to unlock bottlenecks and reap dividends across the economy

Renewable energy: Unleashing the potential of renewables for a greener energy supply

The rapid decline of Romania's fossil energy sources, limited capacity for energy imports, and Russia's invasion of Ukraine have exacerbated concerns over the security of the country's energy supply. The Romanian domestic generation mix remains tilted towards fossil fuels (65 percent of total generation in 2020) but their contribution to electricity output has declined in recent years—largely due to the closure of units that no longer met environmental standards, technical failures affecting obsolete plants, and increasing marginal costs. Non-hydro renewable energy (RE) generation accounts for between 9 and 10 percent of Romania's electricity output. Most of the decline in energy output from fossil fuels has been covered through energy imports, which poses additional energy security risks and interconnectivity constraints. Currently, SOEs have a dominant role in energy production, accounting for more than 80 percent of electricity generation, 50 percent of gas production, and virtually all co-generation capacity for district heating. Despite the availability of significant EU funding, SOEs are slow in investing to replace obsolete capacity, and tend not to reinvest their profits. Limited liberalization and the lack of a competitive market constrains private sector investments, as well as benefits for consumers.

To realize its considerable RE potential and meet the EU's ambitious decarbonization goals, Romania needs to scale up significantly its RE investments. The EU and its member states have revised materially its climate targets, with the introduction of the European Green Deal in 2020 setting out net zero targets by 2050, the adoption of the Fit-for-55 package in July 2021, and the RePowerEU plan unveiled in May 2022. Member states including Romania are now expected to revise their National Energy and Climate Plans by 2023. Romania's current target of deriving 30.7 percent (currently under revision) of its final energy consumption from RE by 2030 will most likely be scaled up to 45 percent—the revised EU target. Romania's RE potential is estimated to be sizable, amounting to 54 GW from solar, 16 GW from onshore wind, and 11 GW from hydro. The World Bank has recently estimated the technical potential to develop offshore wind at a total of 76 GW. However, after 2015 and despite soaring energy prices in 2022-23, investments in utility-scale RE have come to a halt. The total installed capacity remains at 3 GW for onshore wind, and 1.5 GW for solar.

Romania struggles to attract private investment to the development of utility-scale RE projects. Despite significant potential interest from private investors since 2016, investments have largely failed to materialize due to frequent changes to the relevant support scheme, legal and regulatory bottlenecks, long waiting times for permits, and network access issues. Hobbled by a precarious financial situation, Romanian transmission and distribution (T&D) operators have only been allocating marginal investments to the grid, leading to frequent electricity losses. Thus, grid modernization is an unresolved challenge: most of the major projects planned by the transmission operator Transelectrica—e.g., for new lines and substations, as well as for grid digitalization—are delayed by up to 15 years, despite the government's ambition to integrate more than 7,000 MW of electricity from RE by 2030. Moreover, the regulatory framework for the development of energy storage solutions is still emerging.

Yet, Romania can unlock the utility-scale RE market by using site-specific auctions (e.g., sealed-bid auctions) in the short term, capacity auctions in the medium term, and PPP solutions for battery storage and pumped-storage hydro. Site-specific auctions can be suitable to the Romanian context—notably, for offshore wind projects, where

development risks are high and private sector players have historically struggled to secure sites and connection agreements. Moreover, Romania would benefit from developing a sophisticated PPP market to mobilize private sector involvement in energy infrastructure—especially for battery storage facilities of at least 400 MW, which would support RE development while maintaining grid and frequency stability. Moreover, district heating offers a range of opportunities for the development of PPPs at the municipal level. Private participation may benefit municipalities financially, enhance efficiency, and lower costs and improve service for users, in a context where municipal budgets have a debt ceiling which affects large-scale investments in services, though again with careful considerations for fiscal risks. Romania urgently needs to define a National Energy Plan to accelerate the deployment of RE—including by streamlining the process for regulatory approvals and reducing waiting times for permits—and boost private sector investment in the sector.

Transport sector: Significant gaps hamper decarbonization and competitiveness

The subpar quality of transport infrastructure is a key bottleneck to Romania's development and its convergence with the EU, with the country facing a range of transport-related challenges. These include regional disparities in connectivity, a growth in sectoral GHG emissions, and vulnerability to climate change (e.g., Bucharest is the third-fastest-warming capital in the EU, and one of the most congested cities in the world). Despite significant public investment, mainly funded by the EU and focused on roads, Romania still lags in Europe in terms of transport infrastructure and service quality. In large part, Romania's infrastructure development is held back by its governance environment, characterized by lack of stability, ineffectiveness, and outright impediments to infrastructure project delivery. Around 28 percent of Romanian firms identify transportation issues as a major obstacle to their operations, and many businesses report major delays on some of the main transport routes they use, owing to lack of maintenance and insufficient rehabilitation work.

Romania urgently needs effective instruments to address chronic underinvestment in transport infrastructure. Notwithstanding recent reforms, the development of key transport infrastructure largely remains a centralized responsibility of the national government, while state agencies face institutional and financial limitations. The major role of SOEs in transport services results in underinvestment and/or crowds out the private sector, while SOEs themselves face operational and financial challenges due to a heavy debt burden and/or limited public resources. Romania has also been missing out on the opportunity to utilize its conducive, albeit untested, PPP regulatory framework to involve the private sector in financing, developing, and operating key transport infrastructure assets.

Expanding access to finance for individuals and MSMEs

Greater access to finance for individuals and MSMEs and the development of green finance can help drive private sector growth, and foster innovation that is essential for a successful green transition. Romania's financial sector remains small relative to its regional peers, and low levels of financial intermediation and inclusion hinder the sector's ability to support productive, inclusive, and green growth. Significant efforts are needed from the public and private sectors to enhance financial inclusion for individuals and MSMEs, while unlocking the full potential of the financial sector to foster the green transition.

Romania has the lowest level of financial intermediation in the EU. The total assets of the banking sector as a share of GDP stood at 52.5 percent as of June 30, 2022, lower than in comparable countries such as Poland (95 percent), Bulgaria (95.3 percent), Croatia (140 percent), and the Czechia (147 percent), and significantly lower than the Euro area average of 289.1 percent.[6] The financial sector is dominated by banks, which tend to offer basic products and have ample lending capacity; as of Q3 2022, credit institutions (mostly banks) held 76.5 percent of Romania's total financial sector assets. Romanian banks are pursuing a large-scale shift to digital financial services (DFS), and financial technology companies (fintechs) have started to enter the market, particularly for innovative digital payment services. Non-bank financial institutions (NBFIs) are small, but they play an important role in financing micro-entrepreneurs and rural consumers. Capital markets are shallow, both for equities and corporate bonds, and venture capital to support innovative firms is limited. Disparities in access to finance are wide, both by region and by income bracket.

Financial inclusion for individual consumers in Romania is low, due to both supply- and demand-side factors. According to the World Bank's Global Findex database, 69.1 percent of adults in Romania owned a transaction account in 2021—a figure more than 10 percentage points higher than in 2017, but still lower than the averages of both regional and income peer countries. Account usage rates and savings are also lower than in regional peers. Card ownership and usage have historically been limited, but digital payments have increased significantly in recent years. Poor financial literacy, mistrust of the financial sector, comfort with using cash, and a limited rural payments infrastructure (with fewer and fewer physical access points, such as ATMs and bank branches, in rural areas), have all contributed to stifling financial inclusion among individual consumers.

Access to finance is key for MSMEs to deliver growth and employment. Significant gaps in access to finance affect not only individual consumers, but also MSMEs, which are important economic agents in Romania. The MSME financing gap is estimated[7] at 26 percent of GDP, with about 36 percent of micro enterprises and 14 percent of small and medium-sized enterprises either fully or partly credit constrained. Access to finance is necessary to develop the private sector, enhance productivity and growth, and ultimately create jobs and reduce poverty. Yet, up to 26 percent of Romanian firms identify access to finance as a major constraint, with the share of firms that had a loan application rejected reaching 22.5 percent—almost three times higher than the Europe and Central Asia (ECA) average.

As is the case for individual consumers, both demand- and supply-side factors explain the low levels of MSME finance in Romania. On the demand side, many firms are undercapitalized (34 percent of all firms in 2020, according to NBR data),[8] have poor quality financial statements (when available), a high degree of informality, limited hard collateral, and low levels of financial literacy. As a result, MSMEs may not display much demand for finance, while it is challenging for financial service providers (FSPs) to serve them. On the supply side, deficiencies in financial infrastructure increase the cost and risk to lenders of serving MSMEs. As a result, banks are very risk averse, and rely heavily on hard collateral and guarantees (both from national schemes and EU-funded programs). MSME loans are generally over-collateralized—with average collateral requirements amounting to nearly 240 percent of loan value, the highest rate among regional peers—and very few loans are secured by movable collateral.

Addressing financial inclusion challenges for both individuals and MSMEs in Romania requires multi-pronged strategies. Such strategies should especially focus on four key goals: (1) developing a holistic approach to financial inclusion; (2) increasing account ownership and usage; (3) leveraging digital financial services; and (4) expanding MSME finance.

Enabling the financial sector to support growth and the green transition

Mobilizing and efficiently allocating private capital is essential to Romania's decarbonization, as green finance gains momentum and continues to expand. The green and low-carbon transition will require substantial investments, based on multiple sources and types of financing.[9] The effective mobilization of public, blended, and private finance hinges on putting in place appropriate institutional frameworks. While a significant portion of investments is expected to be funded by the public sector (including through EU funds), the financial sector will have a crucial role in reorienting commercial capital towards net-zero purposes and setting the ground for market-based, low-carbon economic transformation and green growth. The banking sector's exposure to green assets amounted to RON 5.1 billion (just over €1 billion) in June 2021, equal to 4 percent of its total non-financial corporate exposure and three times greater than at the beginning of 2021.[10] At the same time, the Romanian financial sector faces climate-related risks, which require new approaches and action from financial practitioners and policymakers.

Banks are still developing the core systems and capacity to engage more in green finance, with demand-side constraints exacerbating supply-side issues. Banks require more detailed information on sectoral pathways for the transition to the green economy, to identify business opportunities and assess whether companies are transition-ready. Firms, including small and medium enterprises (SMEs), must demonstrate their commitment to low-carbon business models; however, their understanding of the risks and opportunities associated with climate change, and their ability to develop transition plans, remain limited. Beyond the banking sector, capital markets can play an important role in greening the economy, but they remain underdeveloped in Romania.

The financial industry needs to build capacity in green finance, possibly through a combination of private and public sector initiatives. The National Bank of Romania, industry bodies, and experienced commercial banks can play a leading role. Green finance coalitions (e.g., in the form of an implementation committee) or sustainable finance knowledge centers could also be set up to provide thought leadership, raise awareness of excellence and best practice, build capacity in the sector, host peer networks, and facilitate innovation with supportive frameworks and tools. The new national development bank in Romania can also play a key role in expanding capacity for green finance.

A strategic framework and sequencing can accelerate the achievement of Romania's climate and sustainable development goals. In particular, the green finance agenda can best be pursued as part of a comprehensive long-term strategy for broader financial sector development.

Summary of policy recommendations

Figure ES.1 summarizes priority recommendations for unlocking more dynamic private sector growth and private investment opportunities in Romania. The recommendations (presented in the table) address the main structural challenges to private sector-led growth in the short to medium term. The prioritization criteria applied are: economic impact, decarbonization of the economy, opportunities to unlock private investment, and political economy feasibility. Recommendations related to the key cross-cutting constraints holding back private sector growth in Romania have been well documented in recent World Bank publications and thus beyond the scope of this CPSD. Therefore, the top part of the figure highlights selected recommendations from these analytics – particularly the Romania SCD Update[11] and the Romania Country Economic Memorandum[12] - to address the cross-cutting constraints discussed in the CPSD.

FIGURE ES.1 PRIORITY RECOMMENDATIONS FOR UNLOCKING PRIVATE SECTOR GROWTH AND INVESTMENT OPPORTUNITIES

CROSS-CUTTING

1. Skills shortages and mismatches	2. Governance and institutional shortcomings affecting the business environment	3. Barriers to competition 4. An under-performing innovation ecosystem	5. Infrastructure and connectivity issues
Provide access to quality education for all. Strengthen lifelong skills formation, especially for vulnerable groups. Improve on-the-job training, including traineeships and apprenticeships.	Mitigate the impact of political instability through establishment of medium-to-long-term strategic and spending priorities . Ensure fiscal sustainability.	Enhance market competition and innovation, including by: streamlining/reducing administrative procedures for market entry, and moving towards competitive neutrality for SOEs.	Close the gaps in transport and other infrastructure for international and domestic connectivity. Improve access to quality public infrastructure and services (e.g., transport, digital network, water and sanitation, district heating, solid waste management, social benefits and social services) for the poor, the vulnerable, and those in rural areas. Accelerate decarbonization, improve regional interconnections, and ensure energy security.

SECTORAL

Joint Transport and Renewable Energy

POLICY AREA	SPECIFIC ACTIONS	TIMELINE
Strengthen technical capacity and legislative base for project preparation and PPP management	Develop centralized units at both the national and local level with the expertise to develop projects and PPPs.	ST
	Promote success stories and ensure transferability of good practices in PPP development.	ST

Renewable Energy

POLICY AREA	SPECIFIC ACTIONS	TIMELINE
Encourage private investment in RE	Review regulatory and permitting constraints for investments in RES according to EC's Guidelines.	ST
	Enable investments in high-voltage transport networks to avoid grid congestion in areas with new renewables developments.	MT-LT
	Enable investments in distribution grids to integrate distributed generation from renewables at local level.	MT-LT
	Draft policy for long-term contracting of ESCOs through PPP structures and adequate financial instruments.	ST
	Pilot utility-scale wind and solar projects through sealed-bid auctions and CfD-set benchmark for a bankable project structure.	ST

EXPECTED OUTCOMES

Higher Private Capital Mobilization

More and Better Jobs

More Dynamic Private Sector

More Sustainable & Inclusive Growth

Note: CCR= Central Credit Registry; CfD= Contract for difference; ESCO=Energy Service Companies; MSMEs=Micro-, Small and Medium Enterprises; NDB= National Development Bank; PPA=Power Purchase Agreement; PPPs = Public-private partnership; RE = Renewable energy; SOE = State-owned enterprise; MT= medium term; ST = short term; LT= long term.

CROSS-CUTTING

1. Skills shortages and mismatches	2. Governance and institutional shortcomings affecting the business environment	3. Barriers to competition 4. An under-performing innovation ecosystem	5. Infrastructure and connectivity issues
Provide access to quality education for all. Strengthen lifelong skills formation, especially for vulnerable groups. Improve on-the-job training, including traineeships and apprenticeships.	Mitigate the impact of political instability through establishment of medium-to-long-term strategic and spending priorities . Ensure fiscal sustainability.	Enhance market competition and innovation, including by: streamlining/reducing administrative procedures for market entry, and moving towards competitive neutrality for SOEs.	Close the gaps in transport and other infrastructure for international and domestic connectivity. Improve access to quality public infrastructure and services (e.g., transport, digital network, water and sanitation, district heating, solid waste management, social benefits and social services) for the poor, the vulnerable, and those in rural areas. Accelerate decarbonization, improve regional interconnections, and ensure energy security.

Transport

POLICY AREA	SPECIFIC ACTIONS	TIMELINE
Improve transport infrastructure	Update the national master transport plan to provide a framework for integrated transport corridors and synergies between national, regional, and urban transport systems.	ST
	Pilot test PPPs as a modality to attract private sector to municipal/regional projects in integrated urban transport, regional/metropolitan railways, electrified mass transport, e-mobility, cycling, and urban regeneration.	MT
	Identify one to three motorways to be developed via PPPs, linked to urban transport and logistic nodes.	MT
	Pilot PPP concessions on segments of the railway network.	LT
	Update and develop technical specifications and design guidelines at national level for sustainable urban mobility projects.	MT

EXPECTED OUTCOMES

Higher Private Capital Mobilization
More and Better Jobs
More Dynamic Private Sector
More Sustainable & Inclusive Growth

Note: CCR= Central Credit Registry; CfD= Contract for difference; ESCO=Energy Service Companies; MSMEs=Micro-, Small and Medium Enterprises; NDB= National Development Bank; PPA=Power Purchase Agreement; PPPs = Public-private partnership; RE = Renewable energy; SOE = State-owned enterprise; MT= medium term; ST = short term; LT= long term.

CROSS-CUTTING

1. Skills shortages and mismatches	2. Governance and institutional shortcomings affecting the business environment	3. Barriers to competition 4. An under-performing innovation ecosystem	5. Infrastructure and connectivity issues
Provide access to quality education for all. Strengthen lifelong skills formation, especially for vulnerable groups. Improve on-the-job training, including traineeships and apprenticeships.	Mitigate the impact of political instability through establishment of medium-to-long-term strategic and spending priorities . Ensure fiscal sustainability.	Enhance market competition and innovation, including by: streamlining/reducing administrative procedures for market entry, and moving towards competitive neutrality for SOEs.	Close the gaps in transport and other infrastructure for international and domestic connectivity. Improve access to quality public infrastructure and services (e.g., transport, digital network, water and sanitation, district heating, solid waste management, social benefits and social services) for the poor, the vulnerable, and those in rural areas. Accelerate decarbonization, improve regional interconnections, and ensure energy security.

Financial inclusion and digitalization of financial services

POLICY AREA	SPECIFIC ACTIONS	TIMELINE
Improve access to finance for MSMEs by digitalizing financial services	Adopt a comprehensive approach to financial literacy, with targeted initiatives for MSMEs.	LT
	Assess scope, targeting, and additionality of public credit guarantee programs.	ST
	Facilitate further financial institutions' access to government data on MSMEs or alternatively consider establishing a database with verified MSME financials.	MT

Financial sector for the green transition

POLICY AREA	SPECIFIC ACTIONS	TIMELINE
Enable the financial sector to finance the green transition	Incorporate green finance into broader financial sector strategies/roadmaps, leverage stakeholders.	ST
	Continue to provide supervisory guidance to financial institutions and encourage expansion of innovative green financial instruments.	ST/MT
	Ensure a critical role for the new NDB as champion of the green agenda.	MT

EXPECTED OUTCOMES

Higher Private Capital Mobilization
More and Better Jobs
More Dynamic Private Sector
More Sustainable & Inclusive Growth

Note: CCR= Central Credit Registry; CfD= Contract for difference; ESCO=Energy Service Companies; MSMEs=Micro-, Small and Medium Enterprises; NDB= National Development Bank; PPA=Power Purchase Agreement; PPPs = Public-private partnership; RE = Renewable energy; SOE = State-owned enterprise; MT= medium term; ST = short term; LT= long term.

Notes

1. World Bank. 2018. From Uneven Growth to Inclusive Development: Romania's Path to Shared Prosperity. Systematic Country Diagnostic; Washington, DC: World Bank. http://hdl.handle.net/10986/29864
2. World Bank. 2023. Romania - Systematic Country Diagnostic Update. Washington, DC. http://hdl.handle.net/10986/40192.
3. NBR, 2019
4. World Bank. 2023. Poland Country Economic Memorandum: The Green Transformation in Poland – Opportunities and Challenges for Economic Growth. Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/099855010032219698/P1776730bee10d096087ca0b19e448af8e1
5. As of May 2023, Romania is a candidate.
6. Data from European Central Bank (ECB) data warehouse.
7. SME Finance Forum, https://www.smefinanceforum.org/sites/default/files/Data%20Sites%20downloads/MSME%20Report.pdf
8. There is a high share of loss-making companies in Romania – accounting for about 32 percent of active companies in the economy in 2020. These firms reported negative results during the last three years.
9. For more details, see Romania Country Climate Development Report, http://hdl.handle.net/10986/40500.
10. National Bank of Romania (BNR). 2021., Climate risk dashboard for the banking sector in Romania 2021, https://www.bnr.ro/PublicationDocuments.aspx?icid=31984
11. World Bank. 2023. Romania - Systematic Country Diagnostic Update. Washington, DC. http://hdl.handle.net/10986/40192.
12. World Bank. 2020. Markets and People: Romania Country Economic Memorandum. International Development in Focus; Washington, DC: World Bank. http://hdl.handle.net/10986/33236

IFC
2121 Pennsylvania Avenue, N.W.
Washington, D.C. 20433 U.S.A.

CONTACTS

Mariya Maerkova
mmaerkova@ifc.org

Emilija Timmis
etimmis@worldbank.org

ifc.org

WORLD BANK GROUP
THE WORLD BANK
IBRD • IDA

IFC International Finance Corporation