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BETTER POLICIES FOR BETTER LIVES

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Foreword

This Survey is published under the responsibility of the Secretary-General of the OECD. The draft report was discussed at a meeting of the Economic and Development Review Committee on 25 October 2021, with the participation of representatives of the Romanian authorities and representatives of the Czech Republic and the United-Kingdom as lead speakers. The draft report was then revised in the light of the discussions.

The 2022 OECD Economic Survey of Romania was prepared by Caroline Klein, Sahra Sakha and Yosuke Jin, under the supervision of Pierre Beynet. Sections of this Survey also benefitted from contributions by by Pierre Lesuisse and Paula Adamczyk. Statistical research assistance was provided by Paula Adamczyk. Jean-Rémi Bertrand and Gemma Martinez provided editorial support.

The previous OECD Economic Survey of Romania was issued in October 2002. Information about the latest as well as previous Surveys and more information about how Surveys are prepared is available at http://www.oecd.org/eco/surveys.

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Basic statistics of Romania, 2020*

(Numbers in parentheses refer to the OECD average)**

LAND, PEOPLE AND ELECTORAL CYCLE					
Population (million)	19.3		Population density per km	83.8	(38.6)
Under 15 (%)	15.5	(17.8)	Life expectancy at birth (years, 2019)	75.5	(80.2)
Over 65 (%)	19.2	(17.4)	Men (2019)	71.8	(77.6)
International migrant stock (% of population, 2019)	2.4	(13.2)	Women (2019)	79.3	(82.9)
Latest 5-year average growth (%)	-0.5	(0.6)	Latest general election	December	2020
ECONOMY					
Gross domestic product (GDP)			Value added shares (%, OECD: 2019)		
In current prices (billion USD)	249.0		Agriculture, forestry and fishing	4.3	(2.7)
In current prices (billion RON)	1 055.5		Industry including construction	29.5	(26.2)
Latest 5-year average real growth (%)	3.3	(0.8)	Services	66.2	(71.1)
Per capita (000 USD PPP)	31.9	(46.3)			
GENERAL GOVERNMENT (Per cent of GDP)					
Expenditure	42.2	(48.8)	Gross financial debt (OECD: 2019)	59.4	(109.0)
Revenue	32.8	(38.2)	Net financial debt (OECD: 2019)	32.6	(68.1)
EXTERNAL ACCOUNTS					
Exchange rate (RON per USD)	4.24		Main exports (% of total merchandise exports)		
PPP exchange rate (USA = 1)	1.70		Machinery and transport equipment	48.3	
In per cent of GDP			Manufactured goods	16.0	
Exports of goods and services	37.3	(50.6)	Miscellaneous manufactured articles	14.7	
Imports of goods and services	41.7	(47.2)	Main imports (% of total merchandise imports)		
Current account balance	-5.0	(0.0)	Machinery and transport equipment	36.9	
Net international investment position	-54.7		Manufactured goods	18.9	
			Chemicals and related products, n.e.s.	14.8	
LABOUR MARKET, SKILLS AND INNOVATION* **					
Employment rate (aged 15 and over, %)	52.3	(55.1)	Unemployment rate, Labour Force Survey (aged 15 and over, %)	5.0	(7.1)
Men	62.0	(63.0)	Youth (aged 15-24, %)	17.3	(15.0)
Women	43.2	(47.7)	Long-term unemployed (1 year and over, %)	1.5	(1.3)
Participation rate (aged 15 and over, %)	55.1	(59.5)	Tertiary educational attainment (aged 25-64, %)	18.7	(39.0)
Average hours worked per year	1,795	(1,687)	Gross domestic expenditure on R&D (% of GDP, 2018)	0.5	(2.6)
ENVIRONMENT					
Total primary energy supply per capita (toe, 2019, OECD: 2020)	1.7	(3.7)	CO_2 emissions from fuel combustion per capita (tonnes, 2018, OECD: 2019)	3.7	(8.3)
Renewables (%, 2019, OECD: 2020)	18.3	(11.9)	Renewable internal freshwater resources per capita (1 000 m, 2017)	2.2	
Exposure to air pollution (more than 10 g/m of PM 2.5, % of population, 2019)	98.0	(61.7)			
SOCIETY					
Income inequality (Gini coefficient, 2019, OECD: latest available)	0.339	(0.318)	Education outcomes (PISA score, 2018)		
Relative poverty rate (%, 2019, OECD: 2018)	17.0	(11.7)	Reading (2015, OECD: 2018)	428	(485)
Median disposable household income (000 USD PPP, 2018, OECD: 2017)	11.9	(25.4)	Mathematics	430	(487)
Public and private spending (% of GDP)			Science	426	(487)
Health care (2018)	5.6	(12.4)	Share of women in parliament (%)	21.9	(31.5)
Education (% of GNI, 2019)	2.8	(4.4)	Net official development assistance (% of GNI, 2017)	0.1	(0.4)

* The year is indicated in parenthesis if it deviates from the year in the main title of this table.

** Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exist for at least 80% of member countries.

*** Labour market data refers to the pre-2021 LFS methodology.

Source: Calculations based on data extracted from databases of the following organisations: OECD, International Energy Agency, International Labour Organisation, International Monetary Fund, United Nations, World Bank.

Executive summary

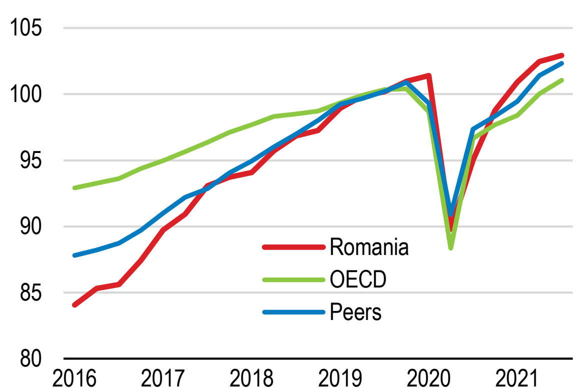
Economic growth is strong, but risks are high

The COVID-19 pandemic put a halt to fast improvements in living standards. While the recovery has been strong, virus resurgence clouds growth prospects, as the vaccination rate is low.

Before the pandemic, the economic performance of Romania was impressive. In less than 20 years, Romania has reduced the gap in GDP per capita to the OECD average by half, from close to 70% to around 35%. The population at risk of poverty or social exclusion had fallen to 30% in 2020, from around 50% thirteen years before.

Figure 1. The pandemic hit the economy hard

Real GDP, index 2019=100



Note: Peers consists of Czech Republic, Estonia, Hungary, Latvia, Lithuania, Slovakia, Slovenia, and Poland.
Source: OECD Economic Outlook database.

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Growth is set to remain strong, but risks are high. The crisis hit the economy hard as GDP fell by 3.7% in 2020 before surpassing its pre-crisis level in 2021. The pursuit of the recovery will critically hinge on the developments of the pandemic and the government's capacity to weather possible future economic shocks. Due to low uptake, the vaccine rollout has been too slow to protect the population against future waves of infection and should accelerate.

Table 1. GDP growth will remain robust

	2021	2022	2023
Gross domestic product	6.3	4.5	4.5
Consumer price index	5.0	6.6	3.6
Unemployment rate (%)	5.4	5.2	4.8
Fiscal balance (% of GDP)	-8.0	-6.6	-5.3
Public debt (Maastricht, % of GDP)	50.3	54.1	57.1

Source: OECD Economic Outlook database and updates.

Pursuing supportive macro-economic policies

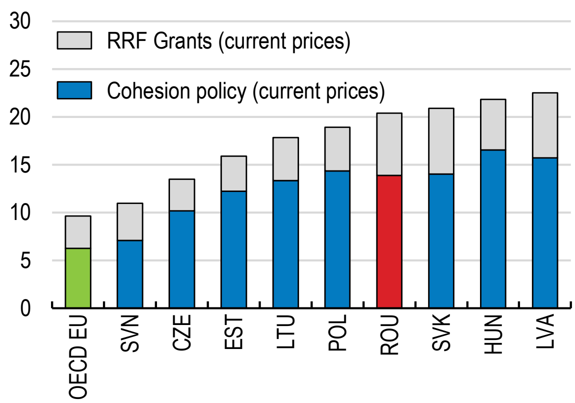
Macroeconomic policies have rightly supported the economy since 2020. The sizeable risks to the outlook call for a prudent normalisation.

Monetary policy has been rightly accommodative in 2020, but inflation pressures should continue to be closely monitored. Inflation has exceeded the upper bound of the target band of the central bank on the back of increases in energy and food prices. The central bank has increased policy rates since October and should continue raising them if needed to avoid that inflationary pressures become entrenched.

Fiscal policy should adapt to economic developments in an agile manner. Support measures should be directed at the most affected, but viable, sectors and firms. A credible medium-term consolidation plan should be established to allow a gradual reduction of the fiscal deficit, should the recovery develop as expected. Such a plan should include reforms to accelerate the absorption of EU funds, raise revenue collection, and improve the financial sustainability of the pension system, which are necessary to maintain the sustainability of public finances.

Figure 2. Romania will receive large amounts of EU funds

Total allocation of EU funds, % of GDP



Source: OECD calculations.

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Romania should make the most of EU funds, seizing the opportunity offered by the NextGeneration EU Plan. Under this scheme, Romania will receive a large amount of grants that will be used to finance the national Recovery and Resilience Plan. An effective implementation of these plans will require strengthening administrative capacity, notably for the oversight of projects, while implementing the associated structural reforms.

Reforming the pension system is urgent. The 2019 pension law is being reconsidered, as it undermines the sustainability of public finances and limits resources available for education, healthcare, social assistance, and infrastructure, which would be more effective at supporting the recovery. Incentives to expand working lives and policies to improve the employability of old-age workers need strengthening.

Reforms can improve efficiency and equity in the tax system. Accelerating the on-going modernisation of the tax administration as planned is crucial to improve tax collection. Removing inefficient tax expenditures and increasing less distortive taxes could be used to reduce more distortive taxes, boosting growth potential.

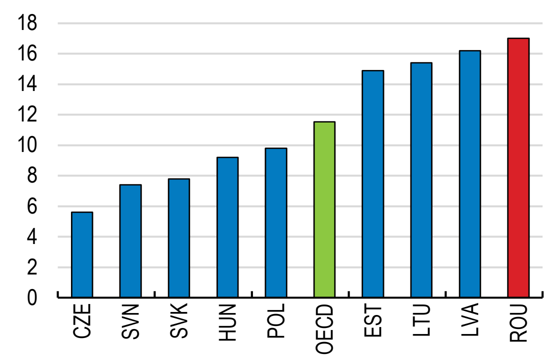
Fostering an inclusive and sustainable recovery

Improving access to high-quality healthcare, education and jobs is key to resume progress in living standards. Meeting environmental challenges should be a priority.

Regional disparities in living standards and economic opportunities are large and widening like in many EU countries. While Bucharest and many secondary cities have become hubs of prosperity and innovation, poverty remains widespread in rural areas. The COVID-19 crisis has aggravated poverty risks, especially in marginalised communities.

Figure 3. Poverty remains elevated

Percentage of population, 2019



Source: OECD Income Distribution Database.

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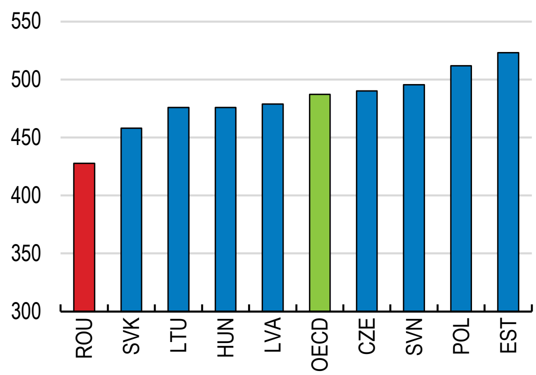
Like in OECD countries, the integration in the formal labour market of people with a low level of educational attainment, especially youth, women and Roma, is difficult. Low participation rates coexist with labour shortages. High inequality in educational outcomes and modernisation needs in vocational education partly explain skills mismatch. The insufficient provision of childcare and long-term care is also detrimental to women participation in the labour market.

Providing adequate skills to all citizens is a precondition to improve labour market performance. The impact of socioeconomic background on educational outcomes is large. School closures in 2020 and 2021 have disproportionally affected disadvantaged students, increasing learning gaps. Participation in adult education is very low, despite fast changing labour market needs. Efforts should concentrate on vulnerable students and low skilled adults, and the government rightly plans to allocate more resources to disadvantaged schools.

Figure 4. Educational outcomes are below the OECD average

PISA score in reading, 2018



Source: OECD PISA 2018 Results, Volume I.

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Public support to job seekers needs strengthening. The COVID-19 crisis has exacerbated barriers for individuals with low employability to integrate the labour market. A large number of unemployed do not use public employment services, calling for developing reach-out mechanisms. Effectiveness and targeting of active labour market policies can improve, not least by offering appropriate up-skilling and re-skilling options to the unemployed.

Health outcomes have improved over the past decades, but access to healthcare remains constrained for many citizens due to acute shortages of medical staff and low public health insurance coverage. Unmet medical needs and the death rates from preventable and treatable causes are high. The pandemic put strong pressure on hospitals.

Tackling air pollution is a priority to improve citizens' health as it contributes to a relatively large number of premature deaths in Romania. Romania has made remarkable progress in decoupling greenhouse gas emissions from economic growth, but meeting the current 2030 target to reduce emissions by 2% with respect to 2005 levels requires further investments in low-emission technologies and improvements in energy efficiency. The Recovery and Resilience Plan should be used to foster such investments, while financial incentives to change behaviours and reduce environmental damages should be strengthened.

Creating a thriving business sector

Productivity growth has been impressive, but has decelerated over the past decade. Reforms supporting business dynamism and addressing infrastructure gaps are central to foster productivity gains.

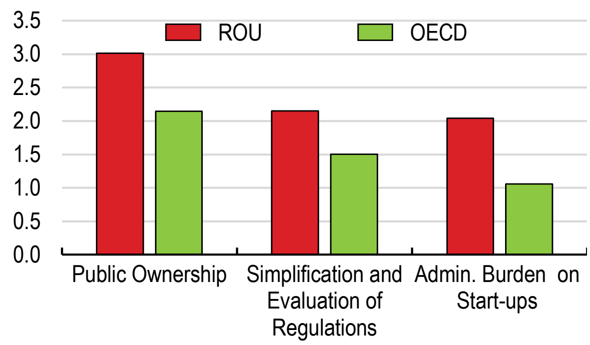
Improving the competition and regulatory framework can help to boost productivity. In spite of some progress made to reduce the administrative burden, the complex licence and permit system still imposes a heavy burden on businesses. Entry barriers in professional services remain high. The presence of low-performing state-owned enterprises distorts the allocation of resources.

Inefficiencies in the insolvency regime are hindering creative destruction. Many non-viable firms survive to the detriment of new, more creative ones. Successful reorganisation of indebted companies is rare because companies enter the insolvency process late. Institutional reforms, such as the introduction of early warning mechanisms and out-of-court proceedings can facilitate the reorganisation of viable firms and the exit of the others.

While access to finance is good overall, young innovative firms and SMEs in remote areas face financing difficulties. Start-ups can be better supported by targeted grants or the introduction of an investment fund for venture capital financing. The national development bank envisaged in the Recovery and Resilience Plan could support SMEs by addressing some dysfunctions in the financial markets and improve access to finance in rural areas.

Figure 5. The regulatory framework can improve

Index 0 (worst) – 6 (best), 2018



Source: OECD PMR Indicators.

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Unpredictability of the regulatory environment can hold back business investment. The extensive use of emergency ordinances without proper impact assessment and stakeholders' consultation in the past increased uncertainty with adverse effects of economic activity. Recent progress should continue, as the Recovery and Resilience Plan aims to strengthen policy stability.

Trust in institutions is low and corruption remains a major issue. The recent legal amendments affecting the judicial system and pressures on the National Anti-corruption Directorate (DNA) have weakened the fight against corruption. The amendments should be repealed as planned and the DNA should have the necessary resources, authorised power and independence to conduct investigations.

Transport infrastructure gaps are large. Addressing them can have a substantial positive impact on regional development and the integration in global value chains. Despite some improvement, the absorption of EU funds for large infrastructure investments remains slow, due to the low quality of projects preparation. It is essential to ensure policy consistency between the long-term infrastructure strategy and the implementation of investment plans and to improve the administrative capacity to deal with large projects.

MAIN FINDINGS	KEY RECOMMENDATIONS
Macroeconomic and financial policies	
Despite a fast recovery, risks to the outlook are high, notably due to the new wave of the pandemic.	Reactivate fiscal support if the economic situation deteriorates, while targeting measures to the most vulnerable and affected.
While public debt is still low, it has increased fast, reducing fiscal space and increasing financing risks.	Establish a credible medium-term consolidation plan and gradually reduce the fiscal deficit to maintain the sustainability of public finances, should the recovery develop as expected.
The administrative capacity to absorb EU funds has been limited compared to peers, as reflected in the weakness in the implementation of public investment projects. This could negatively affect the absorption of the NextGeneration EU funds, which are key to support the recovery.	Ensure an effective implementation of the NextGeneration EU plan by strengthening coordination among stakeholders and monitoring mechanisms.
Inflationary pressures and the risk of inflation expectations de-anchoring from the central bank's target have accentuated. The central bank has started increasing the policy interest rate.	Continue to gradually increase the policy interest rate if needed to keep inflation expectations well anchored within the target band.
The non-performing loan ratio is likely to increase following the end of support measures, as some firms are highly indebted.	Strengthen the insolvency regime to facilitate debt restructuring, notably by introducing out-of-court mechanisms.
The pension system is in deficit and the replacement rates are low. The government has started a revision of the public pension system to restore financial sustainability and improve adequacy under the Recovery and Resilience Plan.	Increase incentives to work longer, notably by harmonising the legal retirement age of women to that of men and increasing it in line with life expectancy gains. Revise the benefit formula to ensure the financial sustainability of the pension system, while preventing old-age poverty as planned.
Tax revenue is low due to poor compliance, which weakens fiscal sustainability. There is also room to increase taxes that are less distortive to growth, notably property taxes, and to broaden the tax base.	Continue the modernisation and computerisation of the tax administration to improve tax collection, notably through higher tax compliance. Eliminate inefficient reduced tax rates and special tax provisions. Consider increasing recurrent taxes on immovable property, while exempting the poorest households.
Improving well-being, inclusiveness and green growth	
The vaccine rollout has been slow and the vaccination rate remains relatively low, especially in rural areas. Access to some activities is conditioned to the presentation of a COVID-19 certificate attesting vaccination or a negative test.	Consider extending the COVID-19 certificate to access a broader range of activities and for some professions. Intensify efforts to reach out the rural population, by multiplying the number of mobile vaccination centres and engaging local actors.
Too few unemployed register with public employment services. Spending on active labour market policies is low, especially on training programmes.	Dedicate more resources to reach vulnerable jobseekers, especially in marginalised communities, and to training programmes.
Too many youth leave school without attaining an upper secondary education level. School closures have deepened learning gaps and accentuated inequality in access to education. The national Recovery and Resilience Plan includes a number of measures to address these issues.	Accelerate measures to support students at risk of dropping out of school and to address learning gaps, especially in disadvantaged areas.
Enrolment in early childhood education is low, especially among Roma and in rural areas. Long-term care services are underdeveloped, undermining women's labour market participation. Investment in care services is envisaged in the national Recovery and Resilience Plan.	Provide affordable and good-quality early childhood education and care and long-term care services.
Exposure to very high levels of air pollution and the related number of premature deaths significantly exceed OECD averages. Burning of solid fuels for heating and cooking is a big contributor.	Expand support to households to transition away from polluting stoves and improve isolation of buildings.
The energy mix is highly dependent on coal, while the share of renewable energy, excluding biomass, is still low.	Increase investments in renewable electricity generation such as wind and solar, by extending support to new installations.
Strengthening productivity growth and business dynamism	
Political pressure on the National Anti-Corruption Directorate has weakened fight against corruption.	Provide the National Anti-Corruption Directorate the necessary resources, authorised power and independence to conduct investigations.
Legislative instability deteriorates the business climate.	Reduce further the use of emergency decrees and conduct a proper impact assessment before implementing new laws.
The licence and permit system imposes burden on businesses.	Simplify the licence and permit system, enhancing the use of online services.

1 Key Policy Insights

Caroline Klein, OECD

Sahra Sakha, OECD

Yosuke Jin, OECD

Paula Adamczyk, OECD

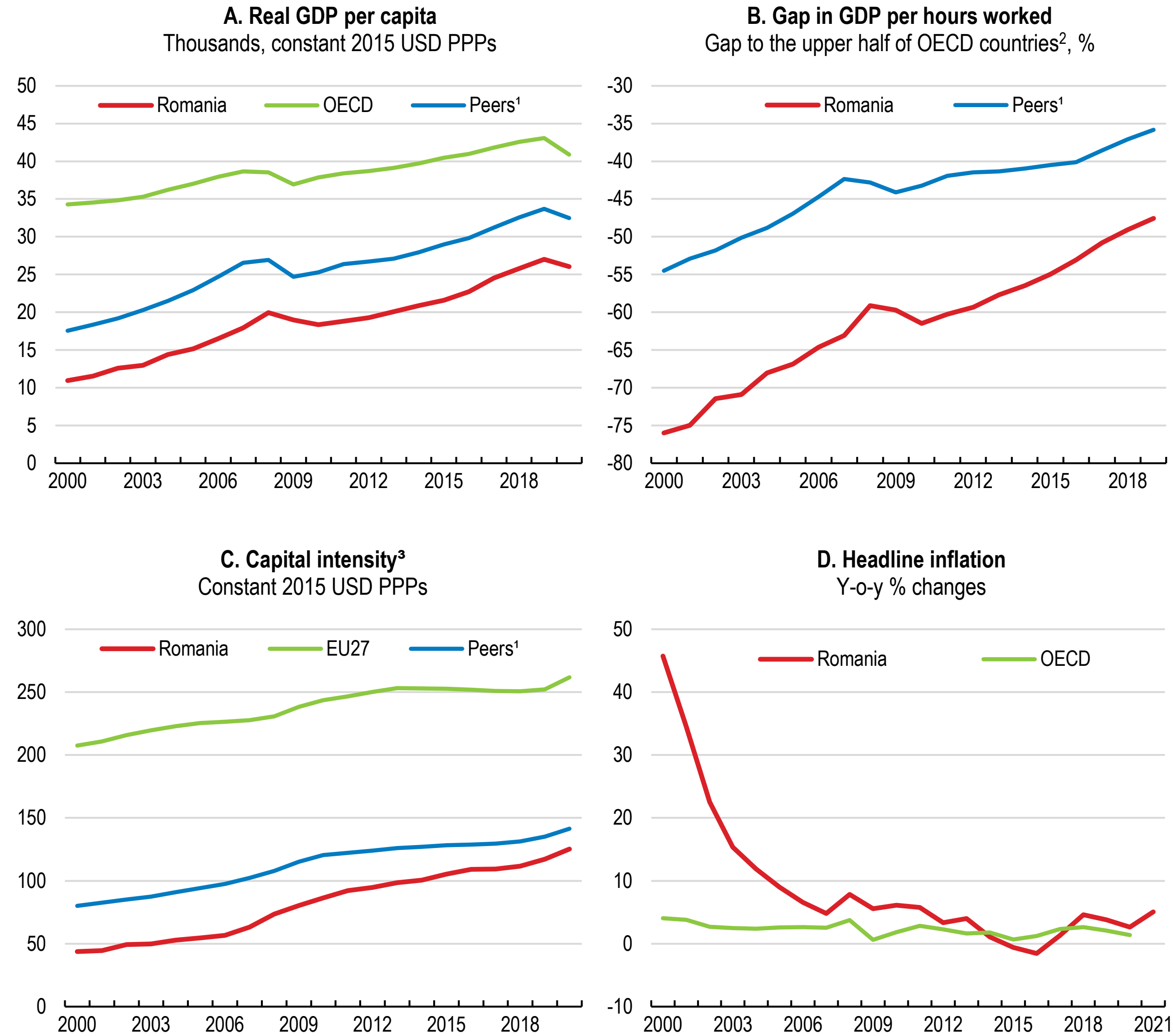
The pandemic has put a halt to impressive improvements in living standards

Romania's economic performance in recent years has been impressive. GDP per capita has reached 63% of the OECD average in 2019, from around 30% in the early 2000s (Figure 1.1, Panel A & B). After being hit hard by the global financial crisis and before the outset of the coronavirus pandemic, Romania's convergence in living standards progressed rapidly, with GDP and productivity growth rates persistently exceeding the OECD average supported by strong capital accumulation and efficiency gains (Figure 1.1, Panel C). Labour market conditions improved, with the unemployment rate reaching a historically low level in 2019 and wages converging to EU average standards. Inflation, which was very high in the early 2000's, has slowed down since 2000 (Figure 1.1, Panel D).

Since the transition from a planned to a market economy initiated in 1990, and especially after joining the European Union in 2007, the Romanian economy has become increasingly sophisticated and open, on the back of high levels of foreign direct investment. Structural reforms related to the EU accession, including in state-owned enterprises and in judiciary, and a prudent monetary policy contributed to its strong economic performance. The economy is still characterised by relatively large agriculture and manufacturing sectors, but services account for a fast increasing share of output. The information and communications sector, in particular, amounted to 6.3% of GDP in 2019, above the EU average. Romania remains a dual economy, though, where high-performing foreign-owned companies coexist with low-productivity domestic firms. Local firms are relatively small, under-capitalised and not well integrated in global value chains (Chapter 2).

The pandemic has slowed down the convergence process, but the recovery from the initial hit has been fast. After declining by 3.7% in 2020, GDP reached its pre-crisis level at the beginning of 2021. At the same time, the COVID-19 crisis poses large risks to future economic developments. The recovery hinges on the capacity to contain the pandemic, which is complicated by the spread of more contagious COVID variants and the slow vaccine rollout.

Figure 1.1. Income convergence was fast before the pandemic



Note: 1. Peers is the unweighted average of Czech Republic, Estonia, Hungary, Latvia, Lithuania, Slovakia, Slovenia, and Poland. 2. Percentage gap with respect to the weighted average using population weights of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2015 PPPs). 3. Capital intensity is defined as net capital stock per person employed.
Source: OECD National Accounts Database; OECD Calculations based on OECD (2021), Economic Policy Reforms 2021: Going for Growth; and the Secretariat's calculation based on the European Commission AMECO database.

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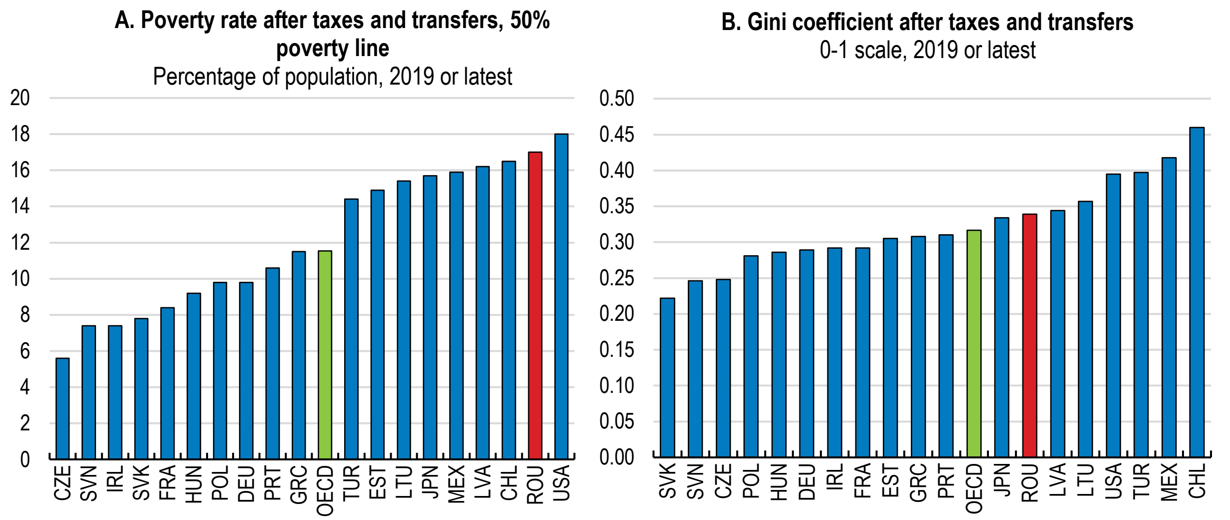
Poverty has declined significantly over the past decades. Around half of the Romanian population was at risk of poverty or social exclusion before the global financial crisis, down to 30% in 2020. Nevertheless, poverty remains relatively high compared to OECD countries (Figure 1.2, Panel A). The share of the population living with less than 50% of the median income has stabilised since 2017 at around 18%. Poverty risks are particularly high for people living in rural areas and Roma. Income inequality, measured by the Gini coefficient, remains above levels seen in many OECD countries (Figure 1.2, Panel B).

The pandemic has deepened inequalities, by hitting more vulnerable population groups hard, including marginalised communities. Women have been more affected by the COVID-19 crisis as they are over-represented in heavily impacted sectors and less secure forms of employment (World Bank, 2021a). While the gender pay gap is among the lowest in the EU, indicators point to relatively high gender inequality, in particular in terms of access to quality employment (European Institute for the Gender Equality, 2019).

Figure 1.2. Poverty and income inequality remain elevated



Source: OECD Income Distribution Database.

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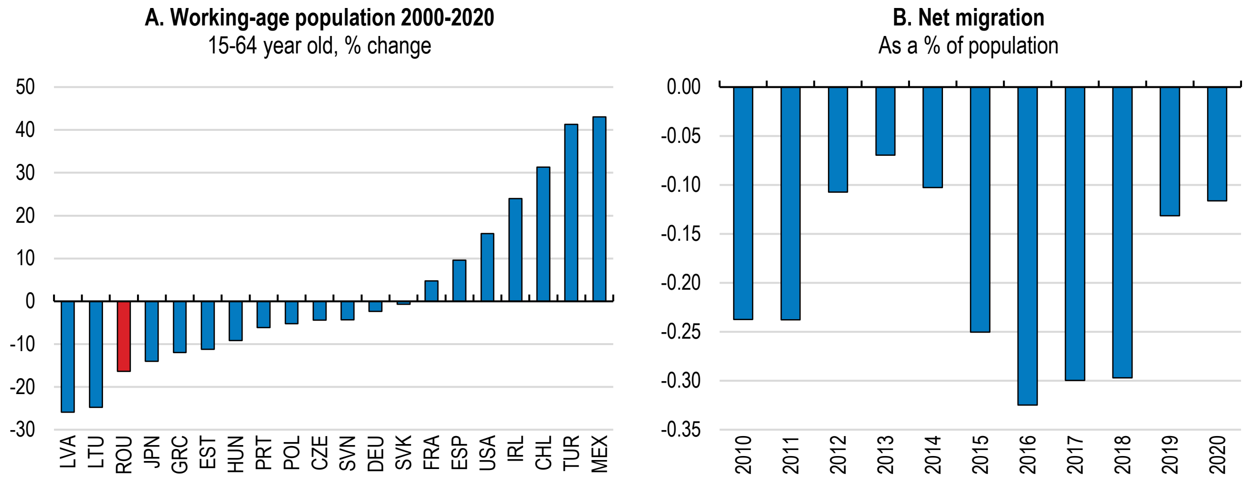
Despite substantial improvements, Romania still lags behind most OECD countries in terms of access to high-quality education, healthcare, housing, transport infrastructure, and a clean environment. In the absence of effective and timely policy action, the COVID-19 crisis risks aggravating pre-existing vulnerabilities in these areas. Early school leaving is a challenge, and around 15% of the youth were neither in employment nor in education or training in 2019. Lockdowns and school closures have widened learning gaps, especially in disadvantaged groups. Health outcomes improved before the pandemic, but amenable mortality – mortality that could have been avoided through appropriate healthcare interventions – was the highest in the EU in 2019 (OECD/EOHSP, 2019). The pandemic put huge pressure on the health system, highlighting the urgent need to invest in this sector and to address structural shortages, especially of health professionals. Housing conditions are still poor in particular for low-income families with children. Overcrowding and the lack of access to basic sanitation affect health outcomes and have likely contributed to greater spread of COVID-19 within disadvantaged communities (OECD, 2021a; Ahmad et al, 2020). Romania managed to decouple greenhouse gas emissions from economic growth. However, air pollution is high and associated with a relatively high number of premature deaths by international norms (OECD, 2021e).

Depopulation, due to ageing and emigration, undermines economic development, notably by exacerbating labour shortages. Romania lost around 3.7 million inhabitants since 1991 and had one of the strongest declines in the working age population over the past decade (Figure 1.3). Around 17% of the Romanians were estimated to live in OECD countries in 2015-16, making the Romanian diaspora the fifth largest in the OECD (OECD, 2019a). Adverse impacts of emigration go beyond labour market issues. In December 2020, around 75 000 children in Romania were missing at least one parent because they were working abroad, with negative consequences on children's wellbeing and development (Salvati Copiii, 2021; UNICEF, 2008).

The impact of the COVID-19 crisis on migration flows remains unclear and will mainly depend on economic prospects in Romania compared with emigration countries. Substantial differences in wages and job prospects have been the main reasons to emigrate in the past, while shortcomings of public services and the perceived lack of meritocracy also played an important role (European Commission, 2019a). Policy measures that strengthen the business environment, foster jobs opportunities, and improve the rule of law can contribute to retaining potential emigrants.

Figure 1.3. Romania's working age population is decreasing fast



Source: United Nations Population Statistics; Eurostat.

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Romania needs to find new growth drivers, while ensuring all citizens benefit from future economic developments. Increasing labour market participation from current low levels and the quality of jobs can help to compensate for the fast decline in working age population and to tackle poverty issues (Chapter 3). Furthermore, the reform process should resume to help Romania pursue the convergence process, notably by supporting the transition to a knowledge-based economy and the expansion of high-value-added goods and services production.

The government's priorities, outlined in the national Recovery and Resilience Plan, aim at addressing these challenges. However, in the past, the lack of policy continuity has delayed the implementation of policies. Romania should seize the opportunity of the Next Generation EU Plan to support the recovery, improve the resilience of the economy to future shocks, including new waves of COVID-19 infections, and implement long-awaited structural reforms. In this context, the main messages of the Survey are:

- The low vaccination rate and the new pandemic wave pose important growth risks. In this context, fiscal policy should timely adapt to the pandemic and target the most affected sectors. At the same time, structural reforms of public spending and the taxation system are needed to maintain the sustainability of public finances.
- Reducing inequalities, offering quality jobs, addressing skills shortages and adapting to population ageing require reinforcing active labour market policies and improving access to quality vocational and adult education.
- Reviving productivity growth involves reducing competition barriers, raising human capital, enhancing the regulatory framework, and improving transport infrastructure.
- Finally, improving the rule of law and fighting corruption are crucial to pursue economic convergence to the highest OECD standards.

The economic recovery has been strong, but vulnerabilities are large

The pandemic triggered a major health crisis

Like in Central and Eastern European (CEE) OECD countries, the second and third waves of the pandemic hit Romania hard (Figure 1.4, Panel A and B). The pandemic put the healthcare system under huge pressure, due to past under-investment, shortages of health professionals, and lack of adequate protective and medical equipment (Dascalu, 2020). In response to the virus surge, strict containment measures were put in place, including a national lockdown in spring 2020 and substantial resources were allocated to hospitals for the purchase of equipment and the expansion of capacity. In the first half of 2021, restrictions have been more targeted and were gradually relaxed as the health situation improved. The number of infections and hospitalisations surged from September 2021 due to the fast progression of the Delta variant in Europe, which has been declining toward the end of the year. However, due to the progression of the more infectious Omicron variant, the number of infections has risen again since the beginning of 2022, posing additional risks going forward. Targeted containment measures have been put in place at the local level, including curfews and reduced opening hours.

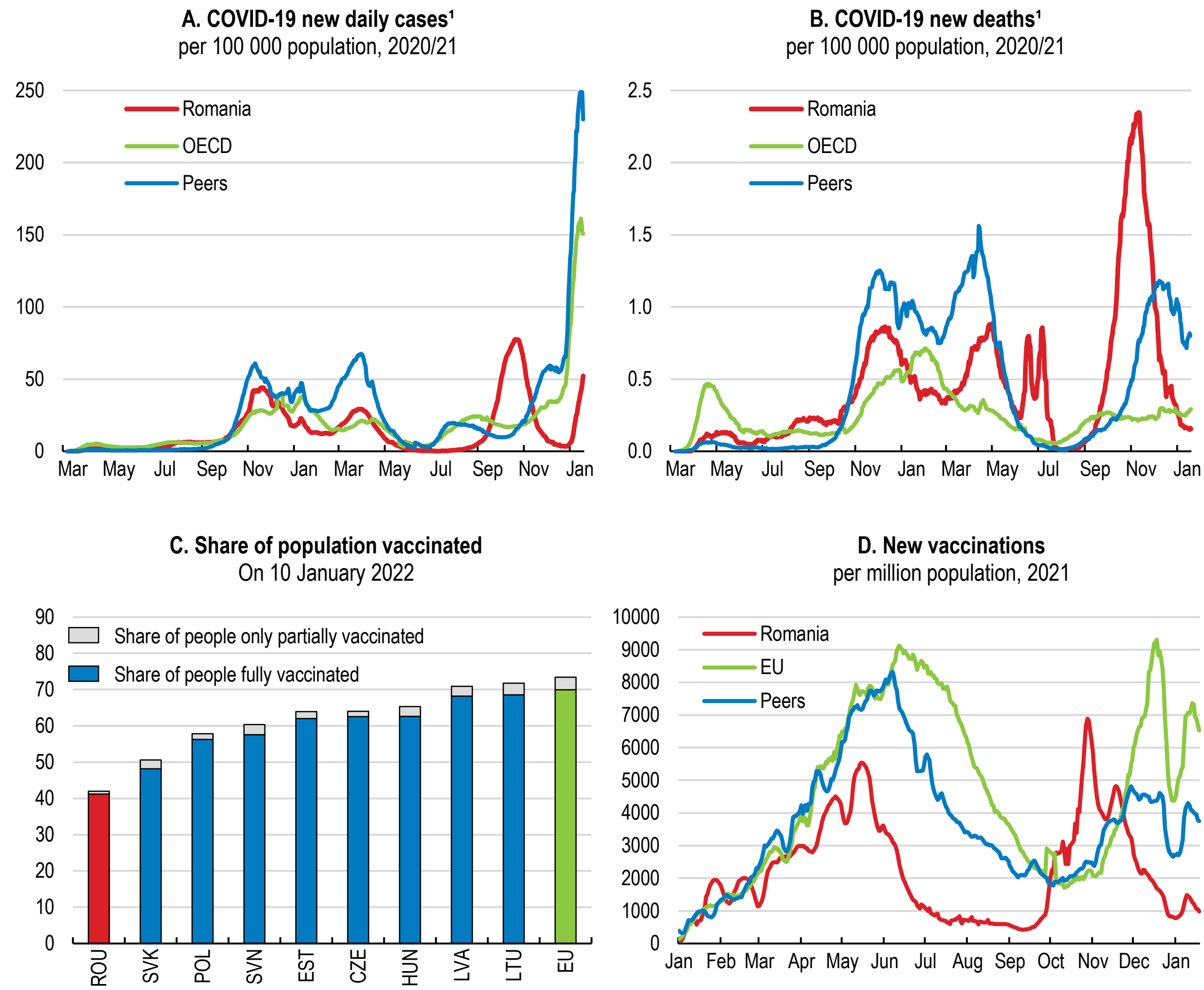
After a good start, the vaccine rollout has slowed down dramatically between May and September 2021, with the number of daily doses administered standing well below the EU average (Figure 1.4, Panel C and D). Despite initiatives to encourage vaccine uptake, the government's objective of vaccinating half the population by end-September was not reached. Accelerating vaccination is crucial to avoiding new waves of infections and requires more information campaigns and targeted incentives.

Difficulty in reaching the rural population (44% of the total) partly explains the low vaccination rate and calls for strengthening mechanisms of outreach to isolated people and marginalised communities, notably by multiplying mobile vaccination centres and involving trusted community voices, as in Israel, for instance (OECD, 2021b). At the same time, in major cities where access to vaccines is easy, only around half of the population is vaccinated. This reflects low vaccine confidence among the Romanian population. Evidence-based and transparent educational campaigns aimed at improving public trust in vaccines and tackling disinformation should be reinforced. Vaccination or recent negative test was required to access some activities at the local level when the infection rate exceeded 3/1000. In response to the fast rise in infections and hospitalisations, this measure has been imposed at the national level on a more general basis as in France or Germany. Mandating vaccines for some professions as in Italy should also be envisaged, if uptake does not improve rapidly.

The pandemic has hit the economy hard

The pandemic triggered a deep economic contraction in 2020, albeit milder than in the OECD and the EU on average (Figure 1.5, Panel A). After peaking at around 7% in 2017 and exceeding 4% in 2018 and 2019, GDP growth declined by 3.7% in 2020, close to levels seen in the OECD and OECD CEE countries. Consumption, which was the main driver of growth before the pandemic, dropped due to containment measures and low consumer confidence (Figure 1.5, Panel B). Exports fell on the back of factory closures and supply chains disruptions. Still, investment was resilient, sustained by strong activity in the construction sector. Fiscal stimulus rightly helped weather the shock. Measures to support households and firms included a short time work scheme, non-refundable grants, credit guarantees and tax deferrals for a total amount of around 5% of GDP (Box 1.1).

Figure 1.4. The new pandemic wave has gained momentum while the vaccine rollout is slow



Note: 1. 7-day moving average. Peers refers to the weighted average of Czech Republic, Estonia, Hungary, Latvia, Lithuania, Slovak Republic, Slovenia and Poland. 2. The stringency index score is an index averaged across eight closure and containment policy components and scaled from 0 (no restriction) to 100 (highest category of restrictions).

Source: Our World in Data; OECD calculations based on the Oxford Covid-19 Government Response Tracker https://covidtracker.bsg.ox.ac.uk/.

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Box 1.1. Romania's policy measures in response to the COVID-19 crisis

The Romanian authorities have introduced a wide range of measures to tackle the health and economic crisis. These measures (excluding contingent liabilities) amount to RON 38 billion in 2020 and RON 14.4 billion in 2021 (3.6% and 1.4 % of GDP respectively).

Health expenditure

Health expenditure increased by RON 6.7 billion in 2020 and RON 4.7 billion in 2021, notably to finance bonuses for health workers, emergency medical equipment, and the National vaccination programme.

Direct support to workers and firms

Employment measures include, among others, a job retention scheme (with a compensation for employees at 75% of their gross salary), a 3-months wage subsidy for the resumption of activity, and an allowance for the self-employed. The government also provided subsidies for hiring jobseekers aged over 50 or below 30 or Romanian citizens returning to the country. These measures amounted to RON 8.0 billion in 2020 and RON 1.9 billion in 2021. Grants to microenterprises, SMEs and firms in the tourism, accommodation and food sectors were also introduced in 2021.

Tax measures

Tax measures amounted to RON 21.9 billion in 2020 and mainly consisted in deferrals of tax payments, the acceleration of VAT refunds and an exceptional rebate of the corporate income tax. The government also introduced the possibility to cancel interests and penalties on outstanding corporate tax liabilities (in place until January 2022) and to reschedule corporate tax liabilities for 12 months (in place until September 2021).

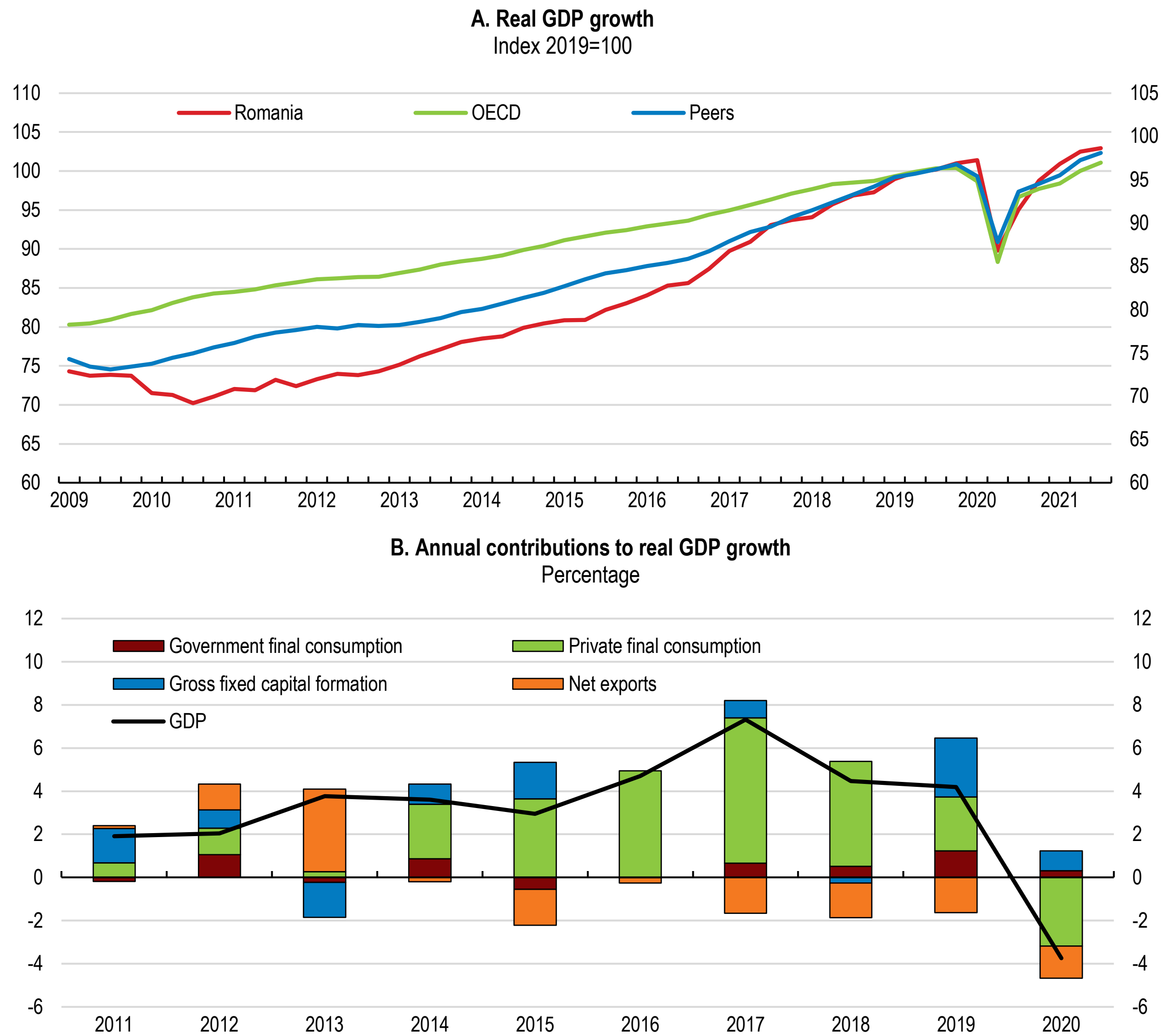
State guarantees and moratorium

The government has introduced a new loan guarantee scheme "IMM-Invest" in which the State guarantees up to 80% of loans for SMEs and 90% of loans for microenterprises and subsidises interest payments as well as the management and risk fees. As of end of September 2021, the total amount of guarantees issued amounted to RON 19.09 billion, with two guarantees having been called so far.

A moratorium allowed to postponing debt repayments by up to 9 months for non-financial corporations and households (in place until March 2021).

Source: The Secretariat's elaboration based on information provided by the Romanian authorities.

Figure 1.5. The pandemic triggered a sizeable economic contraction, but the rebound is strong



Note: Peers consists of Czech Republic, Estonia, Hungary, Latvia, Lithuania, Slovakia, Slovenia, and Poland.
Source: OECD Economic Outlook database.

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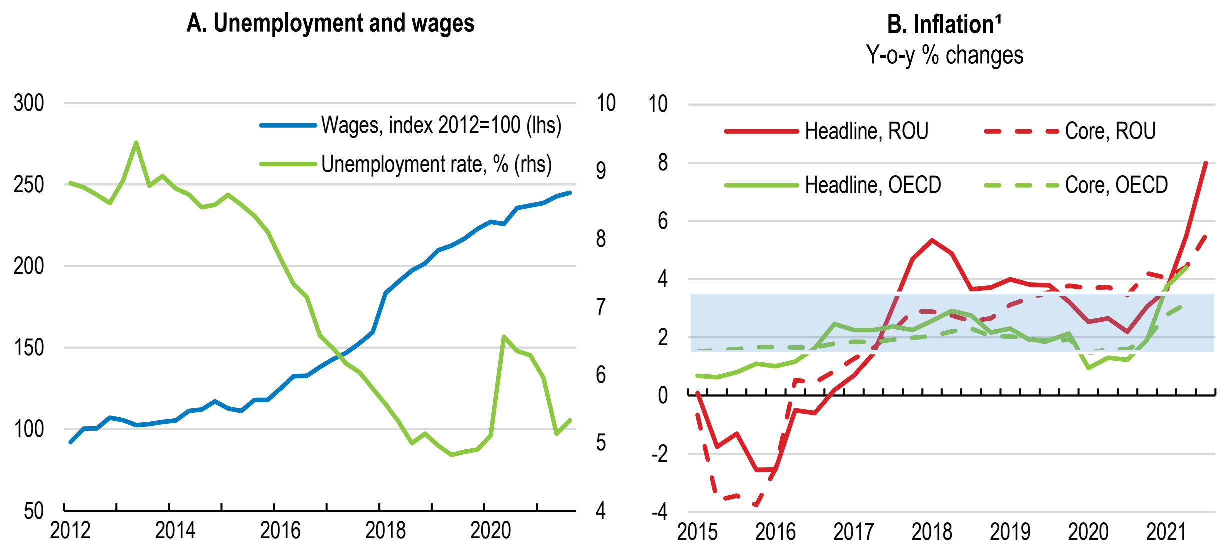
Job retention measures limited the rise in unemployment (Figure 1.6, Panel A). The unemployment rate, measured according to the ILO definition, reached 6.7% at its peak, from 5.0% at the beginning of 2020. After increasing by around 33% at its height, the number of registered unemployment has almost returned to its pre-crisis toward mid-2021. Contrasting with many OECD countries, labour market participation has not declined and working hours have dropped moderately. Intensifying recruitment difficulties amid strong emigration of skilled labour before the pandemic can partly explain job retention in some sectors. Labour market developments have been uneven though, with large downsizing in the sectors affected by the COVID-19 crisis (manufacturing, tourism, personal and cultural services).

Wage inflation decelerated significantly, due to some moderation in public and minimum wages growth since 2020, but remains strong (Figure 1.6, Panel A). At 8.2% in December 2021, headline inflation has largely exceeded the upper bound of the target band of the central bank (2.5 percent ±1 percentage point), mainly driven by electricity and fuel prices (National Bank of Romania, 2021a). Core inflation has accelerated (Figure 1.6, Panel B), mostly on the back of supply side shocks, including increases in commodity prices, persistent bottlenecks in production and supply chains, but also due to increasing demand. Against this background, the central bank increased its policy rate by 25 basis points three times from October 2021 to January 2022 to 2%.

Figure 1.6. The labour market has been resilient and inflationary pressures remain strong



1. The shaded area represents the target band of the National Bank of Romania.
Source*:* OECD Economic Outlook: Statistics and Projections.

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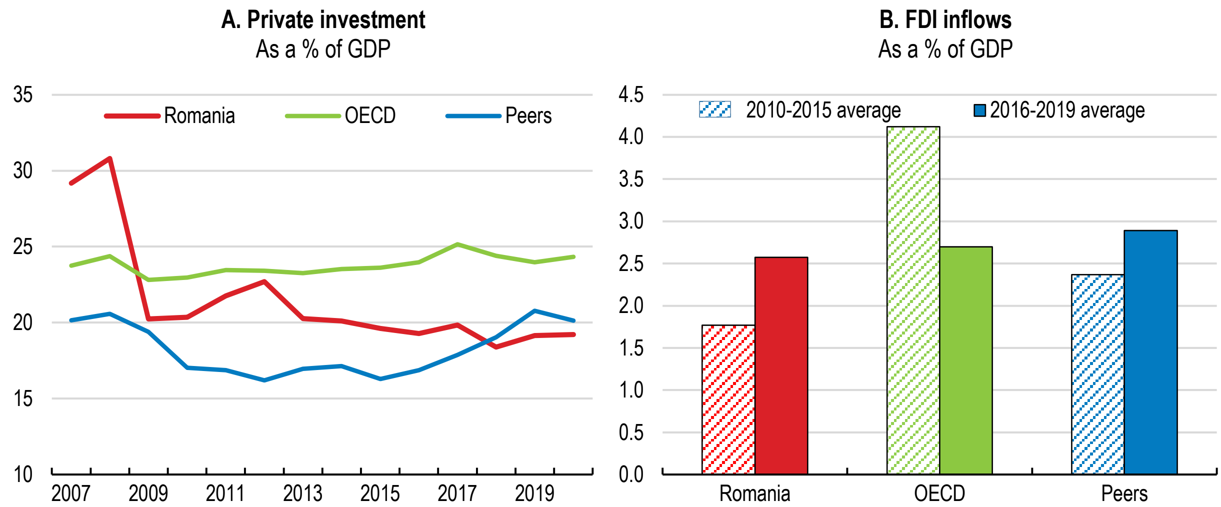
Supported by favourable financing conditions and despite a challenging economic environment, private investment has stalled in 2020 as a percentage of GDP (Figure 1.7). Nevertheless, the ratio of private investment to GDP remains below the OECD average and levels seen before the global financial crisis. Romania's inward FDI position is still much weaker than that of OECD CEE peers and inflows have remained mainly skewed toward reinvested profits from existing investors (National Bank of Romania, 2020a). The underlying reasons are manifold, including the fragile balance sheets of domestic firms. Political instability and legal uncertainty that erode business confidence played a role (Chapter 2, IMF, 2019a). After a drop in 2020, FDI inflows bounced back in 2021, but a large share accounted for deferred tax payments.

Figure 1.7. Business investment has stalled



Note: Peers consist of Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia.
Source: OECD Economic Outlook database, and OECD International Direct Investment Statistics.

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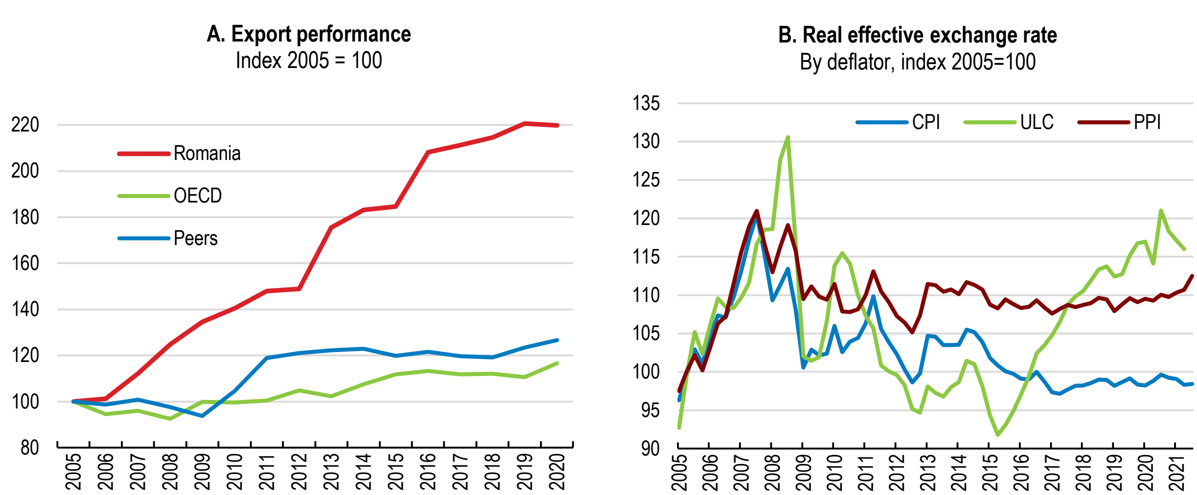
Exports fell sharply in 2020, as international mobility restrictions triggered major supply chains disruptions and external demand collapsed, but they recovered their pre-crisis levels in early 2021. Imports fell less than exports leading to a deterioration of the trade balance. Before the COVID-19 crisis, trade openness increased significantly, with 85% of exports directed to EU countries in 2019 (Box 1.2). Exporters gained market shares at a fastest pace than CEE competitors, despite some losses in price competitiveness (Figure 1.8, Panel A). Increases in unit labour costs have only partly passed through export prices. The national currency has been slightly depreciating, moderating increases in the real effective exchange rate (Figure 1.8, Panel B).

Figure 1.8. Export performance has been solid so far



Source: OECD Economic Outlook, and ECB.

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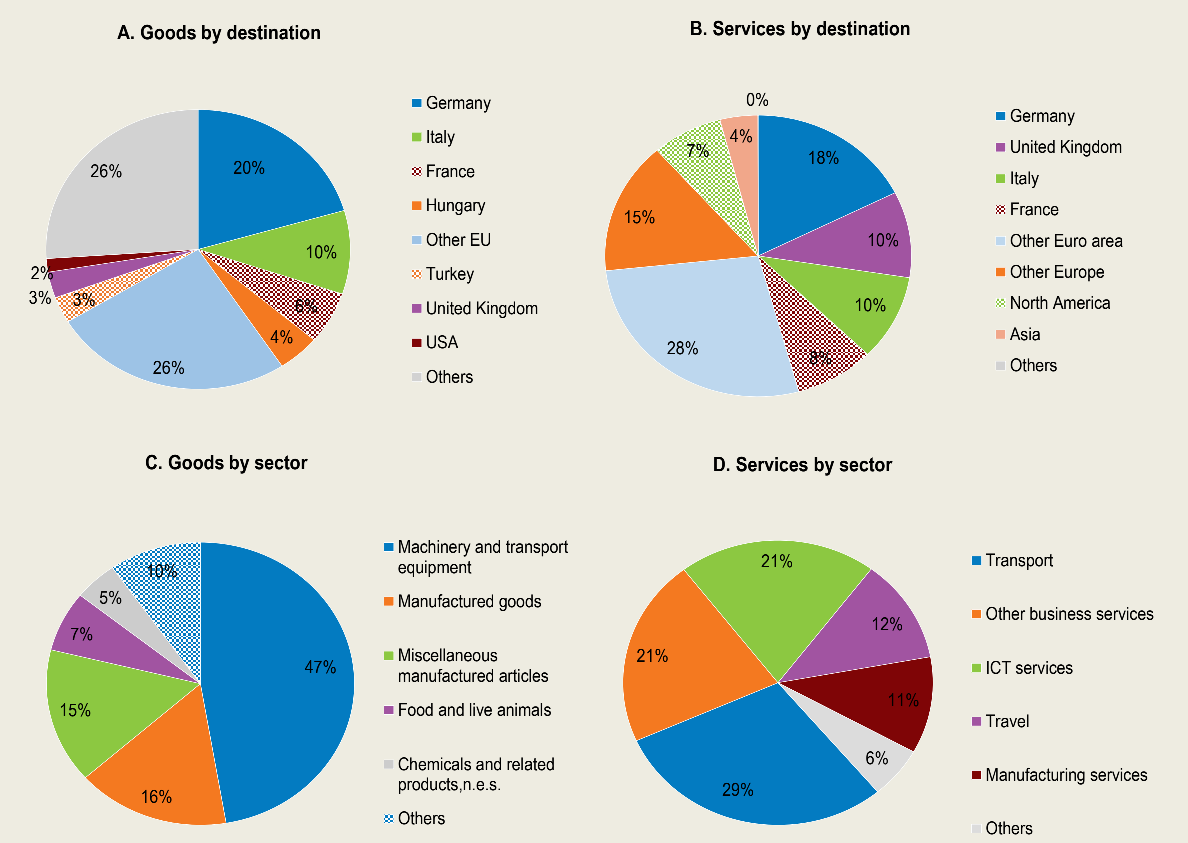
Box 1.2. Romania's exports composition and destination

Supported by the EU membership, exports grew strongly over the past decades, with export of good and services accounting for 40% of GDP in 2019 from around 25% in early 2000's. They remain lower than for many fast converging CEEC peers though. Around 85% of exports are directed to EU countries, Germany, Italy and France being the main destinations (Figure 1.9, Panel A and B).

Romania successfully diversified its export basket from labour-intensive, low-technology sectors (textile industry, raw material) toward medium-technology products and more advanced sectors (automotive, machinery, and electronic equipment, and information and communication services; World Bank, 2018a; Figure 1.9, Panel C and D). However, the shift to higher value-added activities has been slower than in OECD CEE countries, with agriculture still accounting for a large share of exports. Romania's integration in global value chains lags behind its peers with relatively less use of foreign inputs in its exports. While the relative large size of the Romanian economy can partly explain higher reliance on domestic markets, performance of OECD economies of similar size suggests Romania has ample room to deepen integration in global value chains.

Figure 1.9. Europe is Romania's main export destination

Share of exports by sector and destination, 2019



Note: Panel C: Others include beverages and tobacco, crude materials, mineral fuels, and animal and vegetable oils. Panel D: Others include construction services, maintenance and repair, financial services, cultural services, and insurance and pension services. Miscellaneous category includes other services, construction and insurance and pension services.
Source: INSSE and Eurostat, International trade in services.

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Risks to the outlook remain high

GDP growth is projected to reach 4.5% in 2022 and 2023 (Table 1.1). Assuming the pandemic is contained and restrictions are gradually lifted, private consumption are expected to accelerate on the back of pent-up demand and accumulated household savings. Exports should gain momentum as supply chains and trade in main trading partners recover. Labour market conditions will gradually improve and shortages in some sectors will accentuate, driving wages upwards. Despite policy measures to cap energy prices and subsidies for energy consumption, inflation is set to remain strong in 2022 and is subject to significant upside risks. In 2023, inflation is projected to remain close to the upper bound of the target band of the central bank at around 3½, even assuming increases in energy and food prices will recede. Monetary policy is expected to continue to normalise. The fiscal support will contract starting from 2022, but the disbursements of EU funds will stimulate investment.

Table 1.1. Macroeconomic indicators and projections

Annual percentage change, volume (2010 prices)

	2018 Current prices (billion RON)	2019	2020	2021	2022	2023
Gross domestic product (GDP)	**951.7**	**4.2**	**-3.7**	**6.3**	**4.5**	**4.5**
Private consumption	607.3	3.9	-5.1	4.1	4.5	4.1
Government consumption	160.1	7.3	1.8	1.6	2.6	2.1
Gross fixed capital formation	200.4	12.9	4.1	7.5	8.3	9.8
Final domestic demand	967.8	6.3	-1.9	4.6	5.1	5.2
Stockbuilding[1]	16.4	-0.6	-0.3	3.0	-0.5	0.0
Total domestic demand	984.2	5.6	-2.2	7.6	4.4	5.0
Exports of goods and services	398.4	5.4	-9.4	11.3	6.1	4.9
Imports of goods and services	430.9	8.6	-5.2	14.6	5.6	5.9
Net exports[1]	-32.5	-1.6	-1.5	-1.9	-0.1	-0.7
Other indicators (growth rates, unless specified)						
Potential GDP		3.7	3.6	3.4	3.3	3.3
Output gap[2]		3.0	-4.4	-1.7	-0.6	0.6
Employment		0.6	-1.3	0.7	0.2	0.4
Unemployment rate		4.9	6.1	5.4	5.2	4.8
Consumer price index		3.8	2.6	5.0	6.6	3.6
Core consumer price index		3.2	3.7	4.5	4.8	3.6
Current account balance[4]		-4.9	-5.0	-6.5	-6.1	-6.1
General government fiscal balance[4]		-4.4	-9.3	-8.0	-6.6	-5.3
Underlying general government fiscal balance[2]		-5.3	-7.6	-7.5	-6.8	-6.3
Underlying government primary fiscal balance[2]		-4.4	-6.5	-6.3	-5.4	-4.7
General government gross debt (Maastricht)[4]		35.3	47.2	50.3	54.1	57.1
General government net debt[4]		22.1	32.5	35.6	39.4	42.3
Three-month money market rate, average		3.0	2.2	1.7	1.8	2.3
Ten-year government bond yield, average		4.5	3.9	3.6	4.1	4.6

1. Contribution to changes in real GDP.
2. As a percentage of potential GDP.
3. As a percentage of household disposable income.
4. As a percentage of GDP.

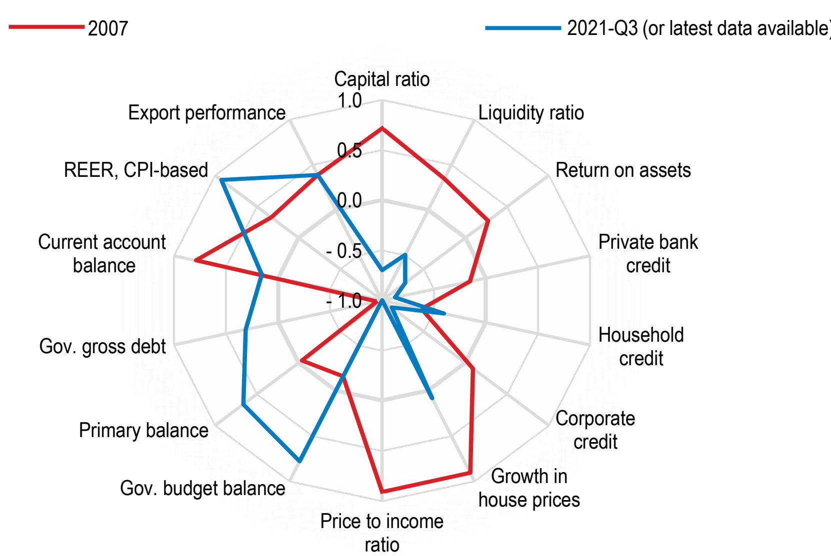
Source: OECD (2021), OECD Economic Outlook: Statistics and Projections (database) with projections from "OECD Economic Outlook No. 110", December and updates.

Risks to the outlook mainly stem from the evolution of the COVID-19 pandemic and the vaccine rollout. Should the vaccination rate remain low and the number of infections increase fast, new restrictions will be needed to limit transmission and avoid overwhelming hospitals. New containment measures in Europe would weigh on Romanian exports and investment (Table 1.2). Persistent increases in commodity prices would dampen domestic and external demand, by eroding price competitiveness. In the same vein, further supply chain disruptions would undermine exports growth. By contrast, timely policy action to support the economy, including a fast and effective absorption of available EU funds would help to sustain the recovery while improving economic potential.

Many macroeconomic vulnerabilities have receded since 2007 (Figure 1.10). At the same time, before the pandemic, demand-driven growth led to the build-up of macroeconomic imbalances, with a marked widening of fiscal and external deficits (Figure 1.11). The COVID-19 crisis aggravated these imbalances, with a strong deterioration of the fiscal position and the current account. The current account deficit poses a risk since its funding has shifted from relatively stable sources to ones that are more volatile. External financing needs grew faster than FDI inflows, increasing the share of capital flows financed through debt.

Figure 1.10. Macroeconomic vulnerabilities have receded since 2007

Index scale of -1 to 1 from lowest to greatest potential vulnerability, where 0 refers to long-term average



Note: Indicators are normalised to range between -1 and 1, where -1 to 0 represents deviations from long-term average resulting in less vulnerability, 0 refers to long-term average and 0 to 1 refers to deviations from long-term average resulting in more vulnerability. Long-term averages are calculated since 1995 or the latest year available. Financial dimension includes: capital ratio (regulatory capital to risk-weighted assets) (inverted), return on assets (inverted), and domestic sovereign bonds (% of total assets). Non-financial dimension includes: total private credit (% of GDP), household credit (% of GDP), household foreign currency denominated liabilities (% of GDP) and corporate credit (% of GDP). Fiscal dimension includes: primary budget balance (% of GDP) (inverted), government gross debt (% of GDP), and government debt denominated in foreign currency (% of gross government debt). External dimension includes: current account balance (of % GDP) (inverted), real effective exchange rate (based on consumer price index), and export performance (exports of goods and services relative to export market for goods and services) (inverted).
Source: OECD Calculations based on: OECD Economic Outlook database; IMF Financial Soundness Indicators; World Bank, Quarterly Public Sector Debt; ECB; INSSE; and National Bank of Romania.

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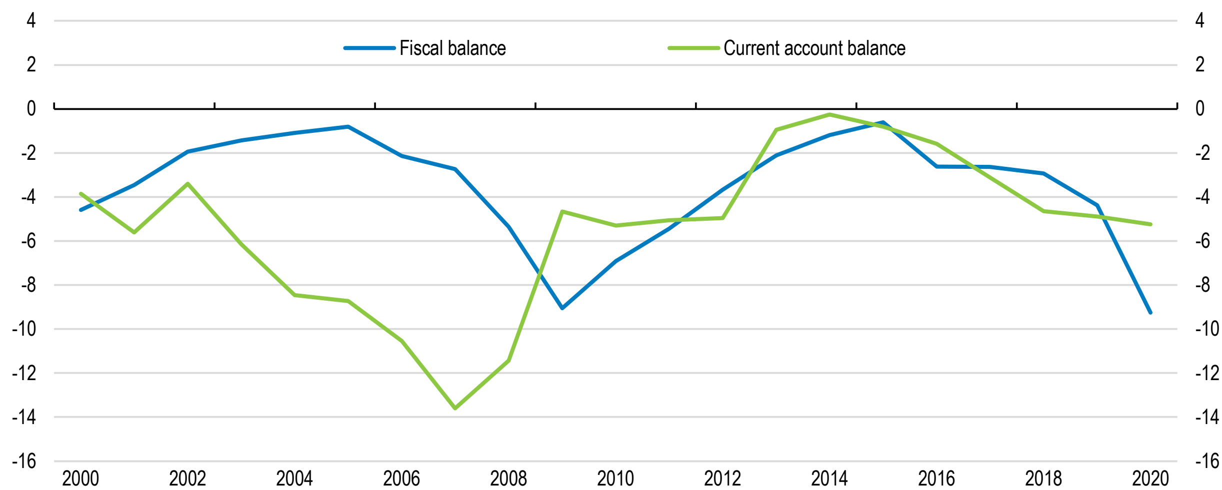
High external deficits increase Romania's exposure to external shocks. Estimates from the Romanian central bank indicate that a one-percentage point deterioration of the current account balance as a share of GDP increases by five percentage points the probability of a foreign currency crisis (National Bank of Romania, 2019). Heightened global financial volatility and lower investors' appetite for emerging economies could lead to capital outflows (Table 1.2; see below). Subsequent increases in borrowing costs would hamper business investment and induce negative wealth effects on households' consumption. Steep rises in sovereign spreads could severely affect the banking sector due to large sovereign exposure. The influence of global financing conditions on real activity in Romania is significant, although less pronounced than in other CEE countries (Hajek and Horvath, 2018; Kubinschi and Barnea, 2016; Saman, 2016).

Figure 1.11. Fiscal and current account deficits have widened

Percentage of GDP



Source: OECD Economic Outlook database.

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Table 1.2. Low-probability events that could lead to major changes in the outlook

Shock	Possible impact
Recurrent COVID-19 outbreaks due to ineffective vaccination rollout	Strengthening of containment measures and repeated local and national lockdowns could trigger a surge in bankruptcies and job losses.
Severe financial strains	Sudden capital outflows could lead to sharp currency depreciation and a tightening of monetary policy to contain inflation risks. Increases in financing costs could negatively affect business investment and debt-servicing issues for indebted firms and households.
Loss of fiscal credibility	Strong deviation from fiscal rules could worsen market sentiment, increase financing costs and hit domestic banks highly exposed to sovereign risks.

In this context, it is important to implement reforms that could sustain a strong and sustainable recovery. The OECD has estimated the potential benefit of some reforms that are recommended in this Survey. The table below shows that those reforms could help revive Romania's economic performance in the medium and long term (Table 1.3). The next sections detail how such reforms could be implemented.

Table 1.3. Illustrative GDP impact of recommended reforms

Difference in GDP per capita level, %

Measure	Description	1 year after the reform	10 years after the reform
Improvement in the rule of law	Closing half of the gap to the OECD average	0.5	2.4
Lower regulatory barriers (PMR)	Closing half of the gap to the OECD average	0.6	2
Increased public investment	Closing half of the gap to the OECD CEECs average in pp of GDP (+1 pp)	0.5	1.1
Increased spending on active labour market policies	Closing half the gap to the OECD average for spending per unemployed in percentage points of GDP per capita (+12.4 pp)	0.6	1.3
Increased women legal retirement age	Harmonising legal retirement age of women to that of men	0.3	0.8

Note: Model simulations based on the framework of Guillemette, De Mauro and Turner (2018), assuming a gradual convergence by 2030. Scenarios depict the effect on the level of GDP per capita 1 year and 10 years after the reform is complete (in 2031 and 2040 respectively) as compared to a baseline scenario with no policy changes.
Source: Calculations based on OECD (2019), OECD Economic Outlook: Statistics and Projections (database).

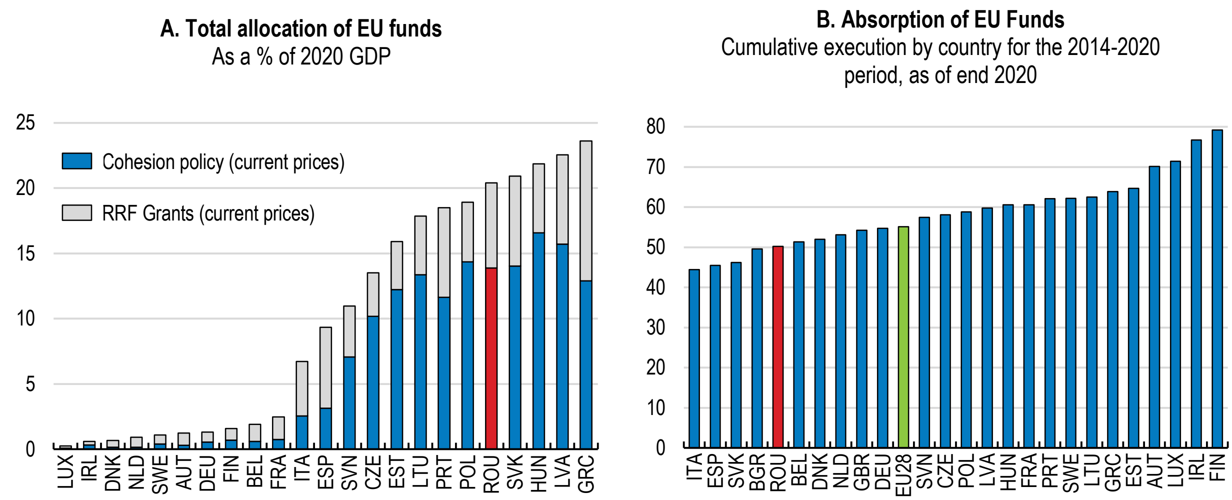
Macroeconomic policies for a strong and sustainable recovery

Mobilising fiscal policy and EU funds to sustain the recovery

Romania should seize the opportunity offered by the Next Generation EU plan to support the recovery and implement long-awaited reforms. Under this plan, Romania could receive EUR 18 billion (around 8% of GDP) in grants by 2026, of which EUR 14.2 billion from the Recovery and Resilience Facility (Figure 1.12). The national Recovery and Resilience Plan rightly focuses on areas where policy action is urgently needed (Box 1.3). In line with EU guidelines, it dedicates 41% of the budget to measures addressing environmental challenges and 21% to the digitalisation of the economy and includes structural reforms based on country-specific recommendations by the European Commission. The Plan was submitted to the European Commission in May 2021 and was approved in September 2021.

Timely and effective implementation of the Recovery and Resilience Plan can support the economy when it is most needed. According to estimates of the National Commission for Strategy and Prognosis, it could increase GDP by 5.4% cumulatively over the period 2021-26 should Romania obtain 100% of grants and loans allocated to the country. However, the Plan poses new challenges. Firstly, the government has to commit 70% of grants by the end of 2022. This calls for strengthening the administrative capacity to coordinate with various stakeholders including those who conduct investment projects on the ground and to monitor these projects throughout investment cycles. Secondly, the disbursement of the funds by the European Commission is conditioned to the progress of structural reforms. The governance structure for the Recovery and Resilience Plan will play a central role. The Romanian authorities rightly plan to set up a centralised unit under the remit of the Prime Minister's Office to coordinate and monitor the implementation of the structural reforms. Sticking to the reform agenda defined in the plan will require strong political commitment and policy continuity.

Figure 1.12. Romania should make the most out of the EU Funds



1. "Cohesion Policy" stands for the European Social Fund, European Regional Development Fund, Cohesion Fund, and support for the European Territorial Co-operation. Total allocation over the period 2021-27 in current prices is expressed as a % of 2020 GDP. "RRF Grants" refer to the maximum grant allocations from the Recovery and Resilience Facilities over the period 2021-26, which is expressed as a % of 2020 GDP.
2. The cumulative execution of the EU funds is expressed as a % of total allocations.
Source: The Secretariat's calculation based on the information from the European Commission's website; European Commission (2021) "Analysis of the Budgetary Implementation of the European Structural and Investment Funds in 2020".

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In parallel to the Recovery and Resilience Plan, national measures to support the economy should keep adapting in an agile manner to the pandemic by remaining timely and targeted. To limit losses in productive capacities and avoid further rises in unemployment, it is crucial to maintain fiscal support directed at firms and individuals in most affected sectors until the recovery is firmly established. In particular, public employment services should be strengthened to support workers with the weakest employability, by developing counselling services, providing targeted hiring incentives and scaling up reskilling options (Chapter 3). Should the pandemic intensify again and require restrictions to economic activity, the short time work scheme should be reactivated and tax facilities provided.

Box 1.3. Romania's Recovery and Resilience Plan

Romania's National Recovery and Resilience Plan is designed to ensure a balance between the European Union's priorities and Romania's development needs, in the context of the recovery from the COVID-19 crisis. Under the Recovery and Resilience Facility, the maximum amounts allocated to Romania reach EUR 14.2 billion in grants (6.5% of GDP) and EUR 14.9 billion in loans (7% of GDP).

The NRRP is structured around 6 pillars:

- **Pillar I: Green transition (EUR 15.9 billion)**, promoting reforms and investments in green technologies and capacities, including biodiversity, energy efficiency, building renovation and the circular economy.
- **Pillar 2: Digital transformation (EUR 1.9 billion)**, promoting reforms and investments for the digitalisation of public services, the development of digital and data infrastructures, digital innovation centres, and open digital solutions.
- **Pillar 3: Smart, sustainable and inclusive growth (EUR 2.8 billion),** aiming at strengthening growth potential, with diverse objectives including the promotion of entrepreneurship and the social economy.

- **Pillar 4: Social and territorial cohesion (EUR 2.3 billion)**, promoting reforms and investments for the creation of high-quality jobs, the inclusion of disadvantaged groups, and the strengthening of social dialogue, social infrastructure and services, as well as social protection.
- **Pillar 5: Health and economic, social and territorial resilience (EUR 2.8 billion)**: aiming at strengthening resilience in health and increasing crisis preparedness and response capabilities of the public institutions.
- **Pillar 6: Policies for the next generation (EUR 3.6 billion)**: enhancing policies for children and youth, including in the areas of education and skills.

The investment projects are associated with specific reforms identified by the Country Specific Recommendations over the period 2019-20 by the European Commission (Government of Romania, 2021), which cover 9 broad policy areas:

- Public finances and taxation
- Pension system and long-term fiscal sustainability
- Health
- Public administration, business environment and labour market
- Poverty reduction and social inclusion
- Education
- R&D
- Green transition
- Digital Transition

Source: The Secretariat's elaboration based on the information provided by the Romanian authorities; European Commission (2021d).

While most of financing options proposed to distressed firms during the crisis have been wound down, financial support should be reconfigured to support viable firms. Credit guarantees such as IMM Invest have helped to ease immediate financial constraints. They need to target those firms with high growth prospects but high risks (Chapter 2). The authorities should also develop equity-type financing further, which is particularly adapted to support firms involved in innovative activity and can include strengthening incentives for private sector participation in public support schemes (Chapter 2).

Public investment should be used to boost economic activity and is key to foster productivity, especially in catching-up countries like Romania where investment needs are large (Fournier, 2016). However, public investment in Romania has decreased significantly over the past decade, partly due to increases in other spending lines, especially public sector wages and pensions (Table 1.4). This downward trend stopped in 2019, but, at 4.6% of GDP in 2020, public investment still stands well below levels seen in OECD CEE countries (6.2%) or in some more advanced countries with a higher public capital stock. Investment in human capital has been shown to be a stronger predictor of regional long-term growth and innovation in Europe than other type of investment (Annoni and Catalina-Rubianes, 2016), but education, health and social assistance have been underfunded in Romania, posing multiple development issues as discussed in more detail below.

As Romania needs further public investment, it should improve the absorption of EU structural funds, in particular because the country will receive a large amount of EU funds over the 2021-27 programming period (Figure 1.12, Panel A). Their effective absorption will be challenging, as Romania's absorption rate has been among the lowest in the EU so far (Figure 1.12, Panel B). Investment cycles have been very long in the past, due to the low quality of the project preparation and political interference. The administrative capacity should be improved further within line ministries or strategic beneficiaries to design projects, using the available expertise from external bodies, such as international financial institutes. Moreover, ensuring policy consistency and proper prioritisation of the projects will be key to accelerate absorption and raise value for money (Chapter 2).

A EUR 10 billion investment plan financed by the State budget and directed to local governments has been under discussion. An information system is being developed for the coordination with EU-funded projects and to avoid fraud. Nevertheless, transparent procedures and criteria for the allocation of the funds will be needed to ensure value for money.

Table 1.4. Composition of public spending and tax revenue

% of GDP	2007	2014	2016	2019	2020	OECD - 2019
Public spending	37.5	35.3	34.6	36.2	42.4	40.6
Public investment	6.2	4.3	3.7	3.5	4.6	4.7
Interest spending	0.4	1.4	1.2	0.9	1.2	1.8
Public revenue	34.7	34.1	32.0	31.8	33.1	37.5
Personal income tax	3.4	3.9	4.0	2.6	-	9.4
Corporate income tax	3.1	2.3	2.4	2.3	-	3.3
Tax on production and imports	12.1	12.7	11.3	10.6	10.4	12.7
Environmental taxes	2.0	2.3	2.3	2.2	-	1.5
Property taxes	1.0	0.9	0.8	0.6	-	1.9
Headline deficit	-2.7	-1.2	-2.6	-4.4	-9.2	-3.1
Underlying deficit[1]	-4.0	-0.6	-2.2	-3.8	-4.8	-3.1
Maastricht debt	11.9	39.2	37.3	35.3	47.3	80.5

1. As a percentage of potential GDP.
Source: OECD Economic Outlook database; OECD Tax Revenue Statistics, and OECD Green Growth indicators.

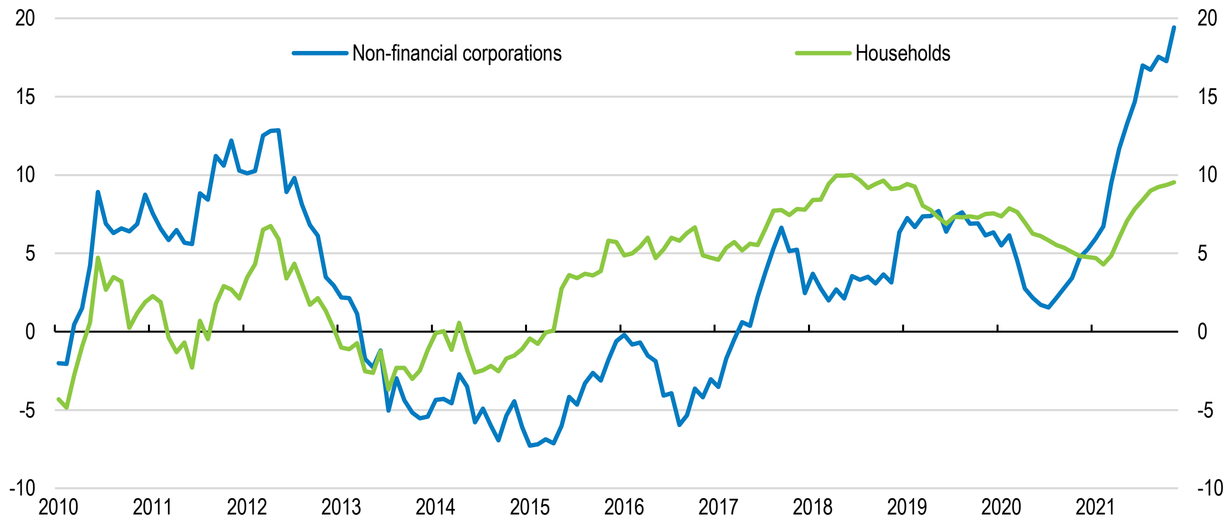
Maintaining prudent monetary policy

The National Bank of Romania reacted in a timely and decisively manner to the COVID-19 crisis, starting in March 2020 when the activity began to contract substantially and financial markets faced turmoil. The central bank reduced the policy interest rate by 50 basis points, proceeded to repo transactions and purchased government bonds on the secondary market. The limited scale and duration of bond purchases by the central bank was consistent with the objective to mitigate financial market dysfunction, provide liquidity, and repair monetary policy transmission mechanisms (IMF, 2021). As the pandemic continued to drag real activity, the central bank cut the policy interest rate further by 25 basis points three times to 1.25% in January 2021. These policy measures supported the recovery of credit to the private sector (Figure 1.13).

While keeping monetary policy on an accommodative stance to support the recovery, which remains vulnerable to adverse epidemic shocks, the central bank should gradually normalise monetary policy, to be consistent with the policy objective of maintaining price stability, as defined by the 2.5% ±1 percentage point inflation target. At 8.2% in December 2021, headline inflation has risen above the inflation target band, essentially driven by increases in energy prices. This surge is expected to be only temporary and to diminish in the near term (National Bank of Romania, 2021a), but can affect inflation expectations. In the medium run, should the economic recovery gain momentum as expected, the underlying inflation pressures would intensify. Inflation expectations at the 2-years horizon currently stand inside the target band, but above 2.5%. Against this background, the central bank raised the policy interest rate three times from October 2021 to January 2022, and it should continue to do so if needed to ensure that inflation returns and remains in line with the inflation target. By contrast, the central bank should maintain monetary policy accommodative enough, should the economy be severely hit by a new wave of the pandemic.

Figure 1.13. Credit growth has recovered

Y-o-y % changes



Source: National Bank of Romania.

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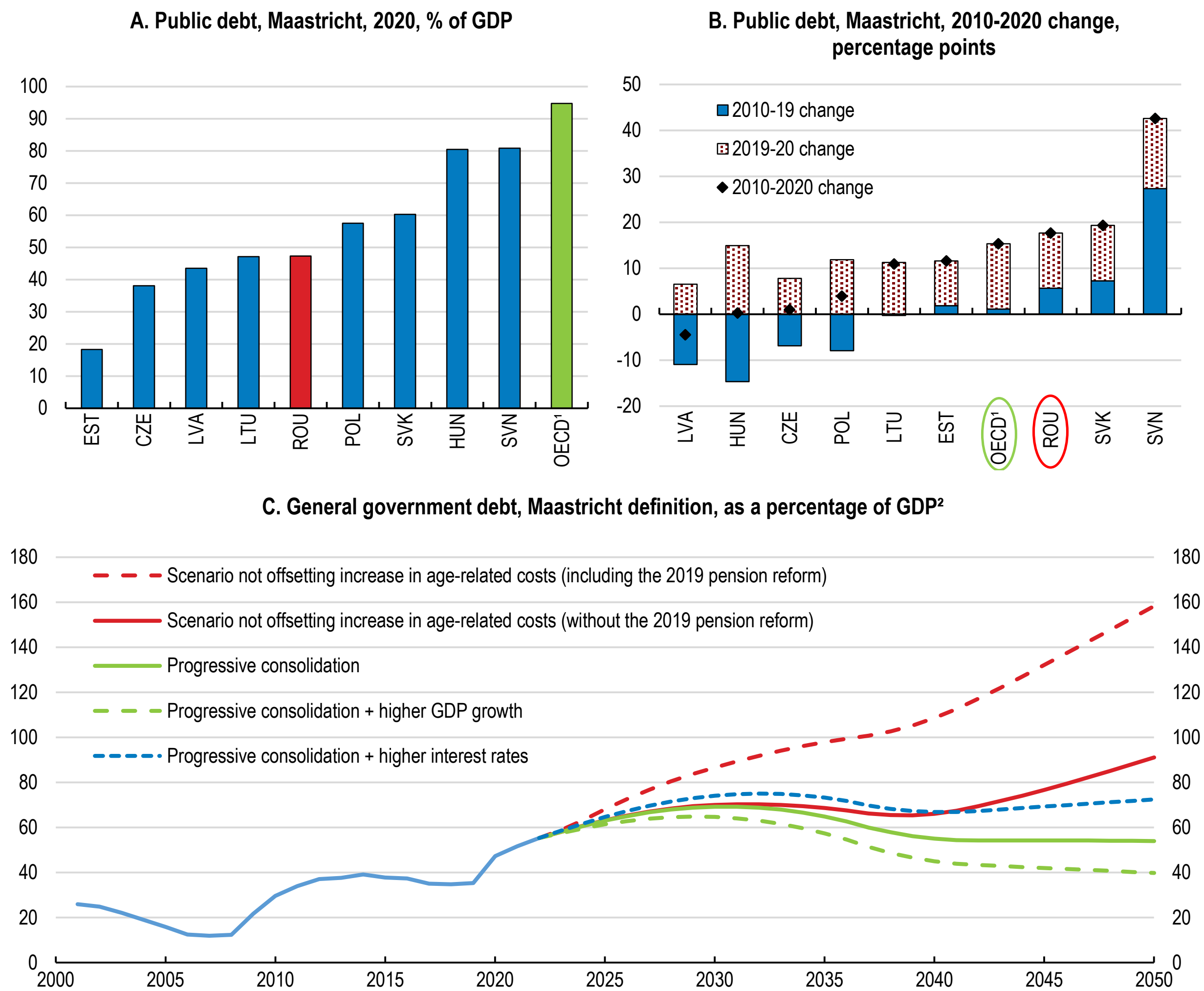
Raising policy rates can help to stabilise the exchange rate. Romania's exchange rate regime is a managed float. The exchange rate against the euro has remained relatively stable since the outbreak of the crisis, on the back of the relatively high policy interest rate, which had remained the highest among CEE countries, and policy measures to restore financial markets stability. In the medium run, a gradual rise in the policy interest rate would help guard against the depreciation of the Leu, as other CEE countries have begun to raise their policy interest rates firmly. The currency depreciation can induce strong inflation pressures due to the high foreign exchange pass-through. Moreover, given a high share of debt denominated in foreign currency, a depreciation could have contractionary wealth effects and undermine financial stability by increasing debt-servicing costs.

Putting public finances on a sustainable path

While still moderate, public debt has increased fast since the global financial crisis (Figure 1.14, Panel A and B). Fiscal support during the pandemic contributed to increase public indebtedness, but part of it was also due to past expansionary measures, including the 2019 pension reform (European Commission, 2021a). In the absence of fiscal consolidation, public debt is projected to increase to unsustainable levels over the next decades (Figure 1.14, Panel C). Under the national Recovery and Resilience Plan, the Romanian authorities have started a new reform of the pension system (Box 1.4). Without a reform, rising ageing costs could push public debt above 100% of GDP by 2040, should increases in these costs not be offset by consolidation measures.

Figure 1.14. Public debt is moderate, but on an unsustainable path



1. In Panels A and B, OECD refers to EU countries that are members of the OECD.
2. The "not offsetting increase in age-related costs" scenario consists of the Economic Outlook N°109 projections and includes European Commission projections for net total ageing costs (net public pensions, long-term care, health, and education, adding 5.5% of GDP to annual public spending in 2050 compared to 2022). The "not offsetting increase in age-related costs (before the 2019 pension reform)" scenario includes 2018 European Commission projections for net total ageing costs and does not include the impact of the 2019 pension reform. In the "progressive consolidation" scenario, the primary balance is projected to gradually improve (by 0.5 percentage point of GDP per year) until public debt reaches 60% of GDP then gradually converge to balance. The "progressive consolidation + higher GDP growth" scenario combines the "progressive consolidation" scenario with an increase of GDP growth by 1 percentage point over the projection period, starting from 2023. The "progressive consolidation + higher interest rate" scenario combines the "progressive consolidation" scenario with an increase in interest rates by 1 percentage point, starting from 2023.
Source: OECD Economic Outlook database; Panel C adapted from OECD (2021), OECD Economic Outlook: Statistics and Projections (database), May; Guillemette, Y. and D. Turner (2018), "The Long View: Scenarios for the World Economy to 2060", OECD Economic Policy Paper No. 22., OECD Publishing, Paris; European Commission (2021), "The 2021 Ageing Report - Economic and budgetary projections for the 28 EU Member States (2019-2070)" Directorate-General for Economic and Financial Affairs, European Commission (2018), "The 2018 Ageing Report - Economic and budgetary projections for the 28 EU Member States (2016-2070)" Directorate-General for Economic and Financial Affairs.

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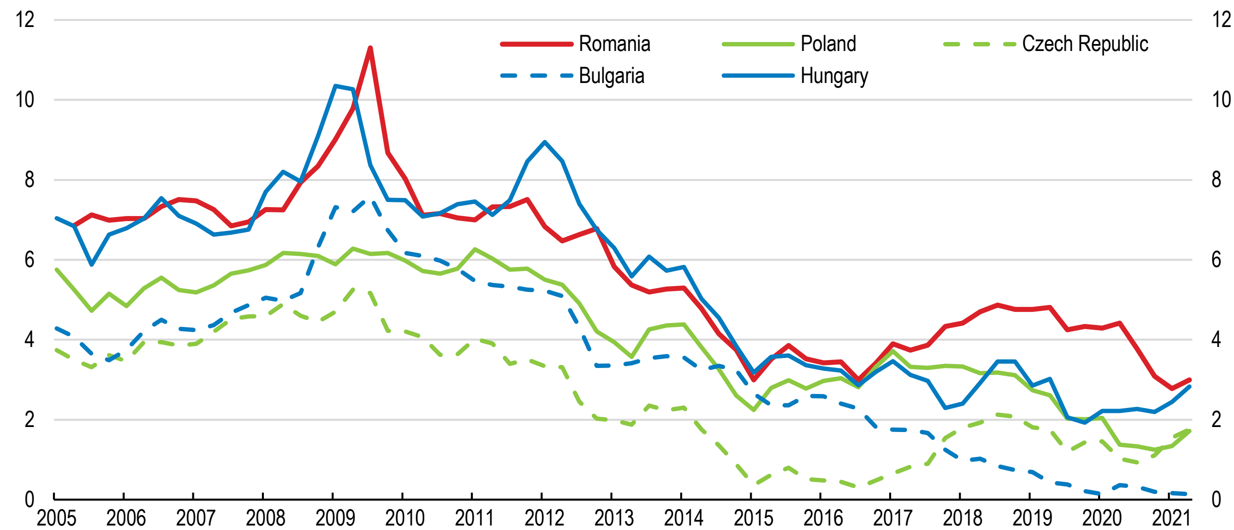
Keeping debt at a prudent level is crucial for the resilience of small catching-up economies exposed to global financial risks. Around half of the public debt is denominated in foreign currencies and 40% is held by non-residents, exposing Romania to adverse shocks, in particular in a context of increasing instability of financial markets. Borrowing costs are by far the highest in the EU, due to an above-average country risk premium (Figure 1.15). This reflects the perception of investors regarding Romania's fiscal situation with respect to other European countries.

Figure 1.15. The country credit risk premium remains elevated

10 years government bond yields



Source: OECD Economic Outlook database.

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Stabilising the debt-to-GDP ratio would require significant consolidation efforts (Figure 1.14, Panel C). The government rightly plans a progressive reduction in fiscal deficit to 2.9% by 2024, but offsetting measures have not been clearly identified yet. Consolidation should start in earnest from 2022, should the recovery be strong as expected. Measures that stimulate potential growth, such as those recommended in the Survey (Table 1.3) can mitigate fiscal pressures (Figure 1.14, Panel C). In particular, raising labour market participation and reducing informality can expand the tax base significantly (Chapter 3). In parallel, Romania has large room to improve revenue and spending efficiency (IMF, 2019a). This can be done by revising the pension system, as well as increasing tax compliance while making taxes less distortive. Fiscal reforms can help rebalance spending towards growth enhancing measures while reducing the deficit (Table 1.5).

Table 1.5. Illustrative fiscal impact of recommended reforms

Annual fiscal balance effect, % of GDP

Measure	
Deficit increasing measures	**5.1**
Allocate more resources to disadvantaged schools and students	1.2
Accelerate the vaccination campaign and spending on primary care, especially in rural areas	1.8
Strengthen the social assistance services and integrate them with other public services	0.8
Allocate more resources to active labour market policies, including training	0.2
Increase public infrastructure investment	1
Strengthened capacity of law enforcement agencies	0.1
Offsetting measures	**Up to 6.5**
More progressive increase in the value of the pension point	Up to 3.4
Increase property tax	0.6
Improve tax compliance	2.5

Note: Estimations are accounting effect on fiscal balance of measures 1. halving the gap to the OECD average in spending on education, health, social protection and active labour market policies, and property taxation and 2. halving the gap to the OECD CEE countries average for public investment and tax compliance. Source: OECD calculations.

Containing public spending on pensions

A thorough reform of the pension system is planned by the end of 2022 under the Recovery and Resilience Plan with the objective to improve its adequacy, equity and long-term financial sustainability. This reform is crucial to improve the sustainability of public finances. Without a reform, public pension spending is projected to grow by around 5% of GDP by 2030, due to measures voted in 2019, including a revision of the pension formula, increases in the value of the pension point and the planned recalculation of all pensions (European Commission, 2020a, Box 1.4).

Box 1.4. Recent reform of the Romanian public pension system

The Romanian pension system consists of three main components: a defined benefit public pension system (Pillar 1), a fully funded mandatory private defined contribution system (Pillar 2) and a fully funded voluntary defined contribution system (Pillar 3).

The first pillar is financed on a pay-as-you-go basis and faces major imbalances, not least due to the fast population ageing. Despite relatively high contributions rates, the deficit of the first pillar amounts to around 2% of GDP (European Commission, 2020a). The ratio between the number of pensioners and employment reached around 60% in 2019 and is projected to rise to 95.5% by 2060.

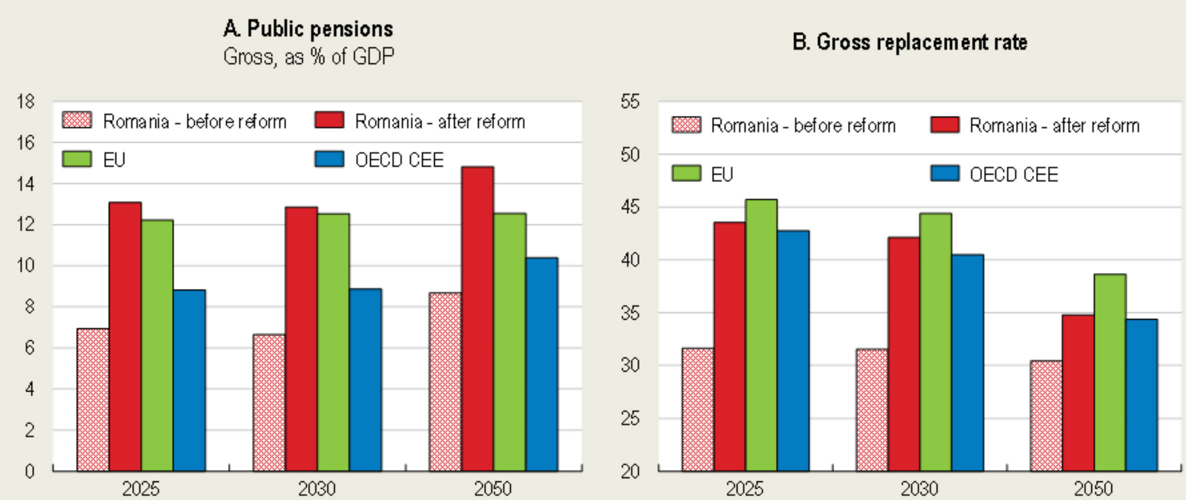
The latest pension reform, voted in 2019, aimed at addressing loopholes in the first pillar, but is excessively costly (Figure 1.16, Panel A). It was expected to bring the deficit of the public pension system above 6% of GDP, weighing on the government budget (see Figure 1.14). The authorities have partially delayed its implementation to 2023 and plan a broad revision of the public pension system, under the national Recovery and Resilience Plan, with the objective to improve adequacy, equity and long-term sustainability of the system.

Among others, the 2019 reform included significant ad-hoc annual increases of the value of the pension point between 2019 and 2022 (e.g. +40% in September 2020), changes to the indexation formula, and an upward recalculation of existing pensions from 2022 following the revision of the benefit formula. It also increased the level and the coverage of the minimum pension. Due to a lack of fiscal space, the government decided to increase the value of the pension point by 14% in September 2020 and to freeze it in 2021. Starting from 2022, the value of the pension point will be indexed to the average annual inflation rate and 50% of the real growth of average earnings.

In the first pillar, the calculation of the pension benefits is based on a point formula. Before the 2019 reform, the pension formula was complex, prone to ad-hoc adjustments and created inequities among pensioners. For instance, benefits varied significantly depending to the date of retirement and the gender of the pensioner. The 2019 reform aimed at addressing these issues, by ensuring all pensioners with the same entitlement receive the same pension level. The government plans to simplify the formula further. It envisages calculating the pension level by multiplying the number of points accumulated by the pensioners and the point value.

The 2019 and 2021 reforms also aim at improving pension adequacy. The former system entailed low replacement rates and pose old-age poverty issues. The net replacement rate of the pension system were low (around 40% in 2018), around 20 percentage points less than on average in the OECD (OECD, 2019h). The 2019 reform would have increased gross replacement rates temporarily (Figure 1.16, Panel B). The benefit ratio, measured by the ratio of the average net pension to the average net wage, would also have increased at around 42% by 2030, compared to around 27% in absence of reform (European Commission, 2020a).

Figure 1.16. The 2019 reform would have improved adequacy of the pension system, but is unsustainable



Source: European Commission, The Ageing Report.

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While increasing the pension level is a valuable goal as the replacement rates are relatively low, future increases in pension benefits should be more in line with economic fundamentals. In addition, a clear benefit formula should be established, including a bonus-penalty system to encourage longer contribution periods and automatic adjustment mechanisms to avoid ad-hoc adjustments. Measures envisaged in the national Recovery and Resilience Plan go in that direction (Box 1.4). For instance, starting from 2022, the pension point value will be indexed to inflation and wages. Finally, special pensions that apply to several occupational categories in the public sector and cover around 3% of the total number of pensioners should be eliminated to ensure a more equitable and transparent treatment of pensioners.

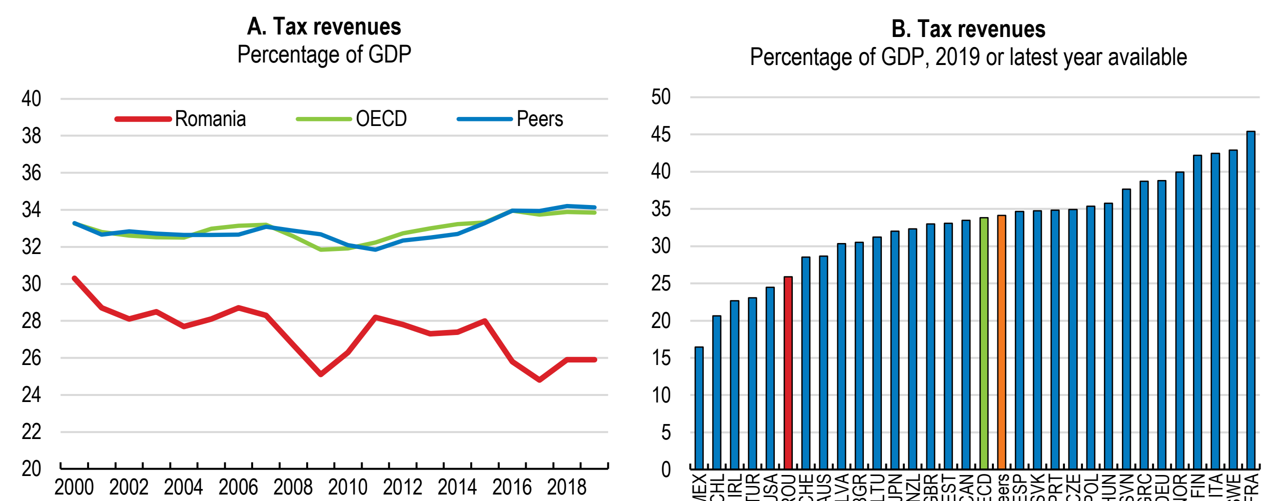
Strengthening incentives to prolong working lives can be a sustainable and cost-effective way to improve pensioners' living standards without increasing the tax burden. The pension system already includes financial incentives that have to be maintained. At the same time, women can retire earlier than men can (at around 61 vs. 65). Equalising statutory retirement ages at 65 and indexing them in line with life expectancy gains would be fairer and could help financing future pension costs. The minimum of 15 years of contributions to get a pension should be reduced as it entails inequity and strong disincentives to work for those with short working lives (for instance return migrants or workers with informal jobs). It could be fully eliminated like in the Netherlands or Switzerland, while ensuring that each additional year of contribution results in a higher minimum pension benefit. Early retirement options for certain groups of workers should also be reconsidered.

The average effective retirement age is close to the EU average (63 years old in 2019), but the employment rate among old-age workers is low, with less than half of the people aged 55 and over in employment in 2019. Improving the employability of older workers by raising participation in adult education, adapting the working environment to an ageing work force, and improving access to healthcare services, as detailed below and in Chapter 3, will also be key for prolonging working lives.

Making the tax system more effective and inclusive

Tax revenue is low due to poor tax compliance and low taxation levels (Figure 1.17). Major fiscal reforms implemented since 2017, including cuts in the value added tax (VAT), the personal income tax (PIT) and social security contribution rates have significantly reduced the tax level. A recent VAT reform is estimated to have cut revenue by around 1 percentage point of GDP (IMF, 2018a).

Figure 1.17. Tax revenue is low by OECD standards



Note: Peers consist of Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia. In panel B, data refer to 2016 for Australia and Japan.
Source: OECD Revenue Statistics; Eurostat; and OECD Productivity Indicators.

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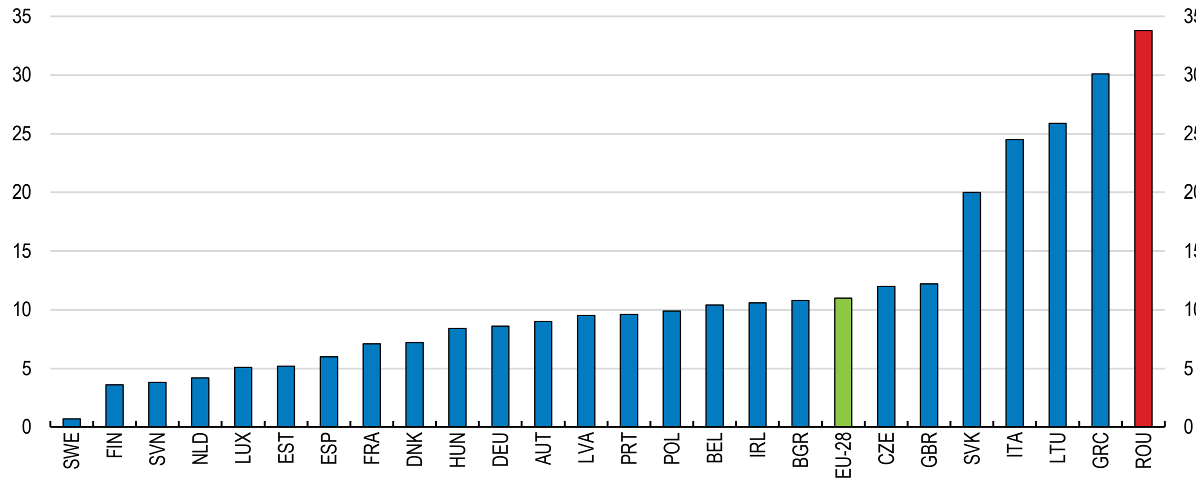
Despite some progress over the past few years, tax efficiency is much lower in Romania than in OECD countries. The VAT gap (i.e. the shortfall of VAT revenues compared with its potential) is the highest in the EU (Figure 1.18). This is mainly due to low compliance rather than to tax exemptions or reduced rates even if this component has increased over the past decades (IMF, 2018a). Improving tax collection would generate significant additional resources, estimated at 2.5% of GDP if efficiency is raised to the level of other CEE countries (IMF, 2018a).

Figure 1.18. Improving VAT compliance can bring large revenues

VAT gap, as a % of VAT total tax liability, 2018



Note: The VAT gap measures the difference between the expected VAT revenue and the amount actually collected.
Source: European Commission (2020), "VAT Gap in the 28 EU Member States".

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Improving tax collection requires modernising the tax administration. The government initiated a range of measures, including streamlining tax declarations and payments and restructuring the tax administration to allocate resources where they are most needed, with some positive effects (Romania Fiscal Council, 2019a). Progress continued during the pandemic, with the implementation of simplified procedures and information campaigns to encourage the use of digital services. A new comprehensive strategy for the modernisation of the tax administration is in place, and will be partly financed by the Recovery and Resilience Facility. Nevertheless, an extensive reform of the tax administration will require stronger political commitment than in the past. A World Bank Revenue Administration Modernization Project had been initiated in 2013, but was cancelled in 2019 due to the absence of progress in implementation.

Romania takes inspiration from other Central Eastern European countries, which recently implemented successful reforms. Developing inter-connectivity between the databases of public institutions can contribute to facilitate revenue collection. A modern compliance risk management approach can also facilitate and speed up the administration of tax recovery (IMF, 2018a) and the detection of frauds. Thus, the introduction of differentiated treatment of taxpayers and targeted tax audits based on data mining should continue as planned. Pilot projects and frameworks for desk audit have been recently put in place to develop risk management capacity, but it will be crucial to invest more and rapidly in digital equipment and training. Innovative analytical tools and collaboration with private experts, including from the IT sector, should be promoted, as they played a crucial role in Poland's success (Sarnowski and Selera, 2019).

Low trust in institutions negatively affects tax compliance (Torgler and Schneider, 2007, Daude et al., 2012). In Romania, a number of complex factors, including low enforcement capability, widespread tax evasion, tax breaks for large firms, and low spending on public services results in a tax system seen as unfair, which is reducing the willingness to pay taxes in return (Todor, 2018). The use of emergency ordinances with minimal consultation has damaged public confidence in policymaking (European Commission, 2019a). Reducing the frequency of fiscal policy changes and avoiding the allocation of tax exemptions and tax amnesties without proper justification could help restore trust. Promoting mechanisms, such as credit history that differentiate and reward responsible behaviour can also encourage compliance.

Broadening the tax base is crucial for raising revenue, calling for a comprehensive reform of the taxation system. Eliminating inefficient and regressive tax expenditures can bring additional revenues. Special tax regimes or tax exemptions have been increasingly used, with the introduction of 26 exemptions, incentives, and special rates between 2013 and 2018 (IMF, 2018a). They include specific tax regimes, notably for microenterprises (see Chapter 2) and specific sectors (e.g. construction, ICT), and exemptions from energy-related taxes. Scaling back tax expenditures would broaden the tax base and simplify the tax system. A thorough evaluation of their distributional and efficiency effects needs to be carried out as they are not transparent and were subject to reduced scrutiny in the past. The Recovery and Resilience Plan rightly includes a series of measures to address these loopholes, including a revision of the micro-enterprise regime and of income taxation of construction workers.

Shifting the tax mix towards taxes that are less distortive to growth is another avenue to boost the recovery. Taxes on immovable property have been found to have the lowest negative impact on growth (Johansson et al., 2008). However, they account for a low and decreasing share of total taxation (2.4% in 2019, around 3 percentage points less than the EU average), partly due to the weak link between recurrent taxes on immovable property and housing values. It is thus welcome that the Recovery and Resilience Plan includes an in-depth revision of property taxes.

Environmental tax revenue increased significantly and accounted for 8.3% of total tax revenue in 2019, around 3 percentage points more than the OECD average. However, contrasting with revenues from energy taxes, revenues from the taxation of road transport, pollution and the use of resources are low by international norms. Options to better price environmental damages caused by economic activity include introducing a landfill tax and a pollutant-dependent car registration tax. In addition, adjusting environmental taxes to better reflect the environmental damage they generate (i.e. the cost of pollution and CO_2 emissions) would help to incentivise investment in cleaner energy sources. Recent cuts in fuel excise rates are somewhat unwarranted, as they reduce incentives to opt for greener transportation means and further increase the gap in taxation between gasoline and diesel. Romania should gradually extend the coverage of the carbon tax to sectors not covered by the EU Emission Trading Scheme (EU-ETS) and harmonise its level. Additional revenues from environmental taxes should be used to foster the green transition, for instance by financing investment in low emission technologies and compensating those most affected by environmental policies.

Maintaining sound financial policies

Indicators suggest that the banking sector has remained sound during the crisis. Banks have maintained sufficient capital, liquidity and profitability (Figure 1.19; Panel A, B and C), which was supported by policy measures, such as the central bank's recommendation to limit dividend payouts and share buybacks, thus raising capital retention. It helped to keep channelling funding to economic activity, along with policy measures such as IMM Invest, a public loan guarantee programme (see Box 1.1). The non-performing loans ratio, which had decreased significantly over the last decade (from 21.5% at its peak in 2013 to 4.0% in April 2020), has remained contained so far since the outbreak of the COVID-19 crisis. The moratorium on debt repayment played a role, covering 14.6% of total loans in non-financial corporations at its peak in 2020 (see Box 1.1). However, the share of non-performing loans is high compared with other countries (Figure 1.19; Panel D) and likely to increase, as debt repayments resume following the end of the moratorium and the exposure of banks to financially vulnerable firms is high.

While private indebtedness is low in Romania, some firms and households face a significant problem of solvency. Total private debts levels – the stock of loans issued to households and non-financial corporations – stood at 47.8% of GDP in 2020, well below the OECD average. Prudential measures adopted by the authorities, such as the introduction of the cap on the debt-service-to-income (DSTI) ratio in 2019, helped to contain debt in the private sector. Nonetheless, banks' exposure to highly indebted clients is high. For instance, 55% of loans in the non-financial corporations sector are taken by highly indebted firms (with a debt-to-asset ratio of over 75%; National Bank of Romania, 2021b). Some firms are also vulnerable to currency and refinancing risks, which can add to difficulties in their debt repayments:

external debt accounts for 54% of the total and debts with a maturity of up to one year account for 41% of the total in the non-financial corporations sector (National Bank of Romania, 2020b). This call for keeping monitoring financial stability risks and ensuring sufficient capital adequacy, liquidity and loss provisions. Moreover, debt restructuring should be facilitated by reforming insolvency regimes through, for instance, the introduction of out-of-court mechanisms (Chapter 2).

Figure 1.19. Indicators suggest the banking sector has remained sound

2021Q3 or latest

Source: IMF Financial Soundness Indicators.

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The increasing reliance on external markets to finance public debt poses a major risk to financial stability. The government's financing needs increased significantly in 2020 (to 14% of GDP) and will remain high in 2021 (around 11.5% of GDP). As a significant share of the debt is financed externally, the government's external debt, mostly denominated in the euro and the US dollars, rose to 26% of GDP in 2020 (from 18% in 2019). Financing conditions (bond yields and maturity) through external financing can be volatile, as they are sensitive to policy changes elsewhere and investors' sentiment. The financing of a growing stock of debt against the background of Romania's relatively high and volatile borrowing costs raises concerns and warrants close monitoring (European Commission, 2021a). These calls for designing a medium-term fiscal consolidation plan and implementing it once the recovery is well established (see above).

The increasing exposure of banks to sovereign debt is another important risk to financial stability. The sovereign exposure of the banking sector (including State guarantees on loans) is 32.4% in Romania. This limits their capacity to absorb government bonds further and makes them vulnerable to a shock to government yields, which would affect the valuation of their assets adversely. Banks' exposure to the government has increased notably due to the state guarantees provided in response to the pandemic (see Box 1.1). Maturity mismatch amplifies banks' vulnerability to sovereign spreads and interest rate hikes (National Bank of Romania, 2021b). The vulnerability of banks could be aggravated by deepening macroeconomic imbalances resulting in further increases in spreads.

Non-banking loans to non-financial corporations have been rising fast albeit from low levels, which could be another risk to financial stability. The central bank draws particular attention on potential systemic effects that may arise from the non-bank financial sector, whose capital levels are thin and lending practices risky (National Bank of Romania, 2020b). This calls for closely monitoring risks from this sector, especially regarding foreign currency lending, and developing prudential tools including higher capital buffers.

Over the longer term, policy should support financial institutions to adopt business models generating higher value-added. Firstly, policy uncertainty needs to be eliminated. In December 2018, the government introduced a tax on financial assets of credit institutions. This tax was repealed in 2020, but such policy instability weighs on the activity of financial institutions. Secondly, financial intermediation remains very limited (around 40% of GDP). It should expand to finance firms with high growth prospects. To do so, policy can strengthen banks' capacity to assess credit worthiness of businesses, for instance by extending the coverage of the Central Credit Registry to include information on debt collection, in particular, loans sold to debt recovery companies (World Bank, 2018c). In this vein, in 2020, a Cooperation Agreement between the National Bank of Romania, the National Authority for Consumer Protection and the Romanian Association of Banks was signed to improve the quality and expand the coverage of credit reporting activities. Moreover, the creditors' rights should be ensured in effective terms by enhancing the insolvency regime. This will encourage financial institutions to take appropriate risks, which can result in a better allocation of capital across firms (Chapter 2).

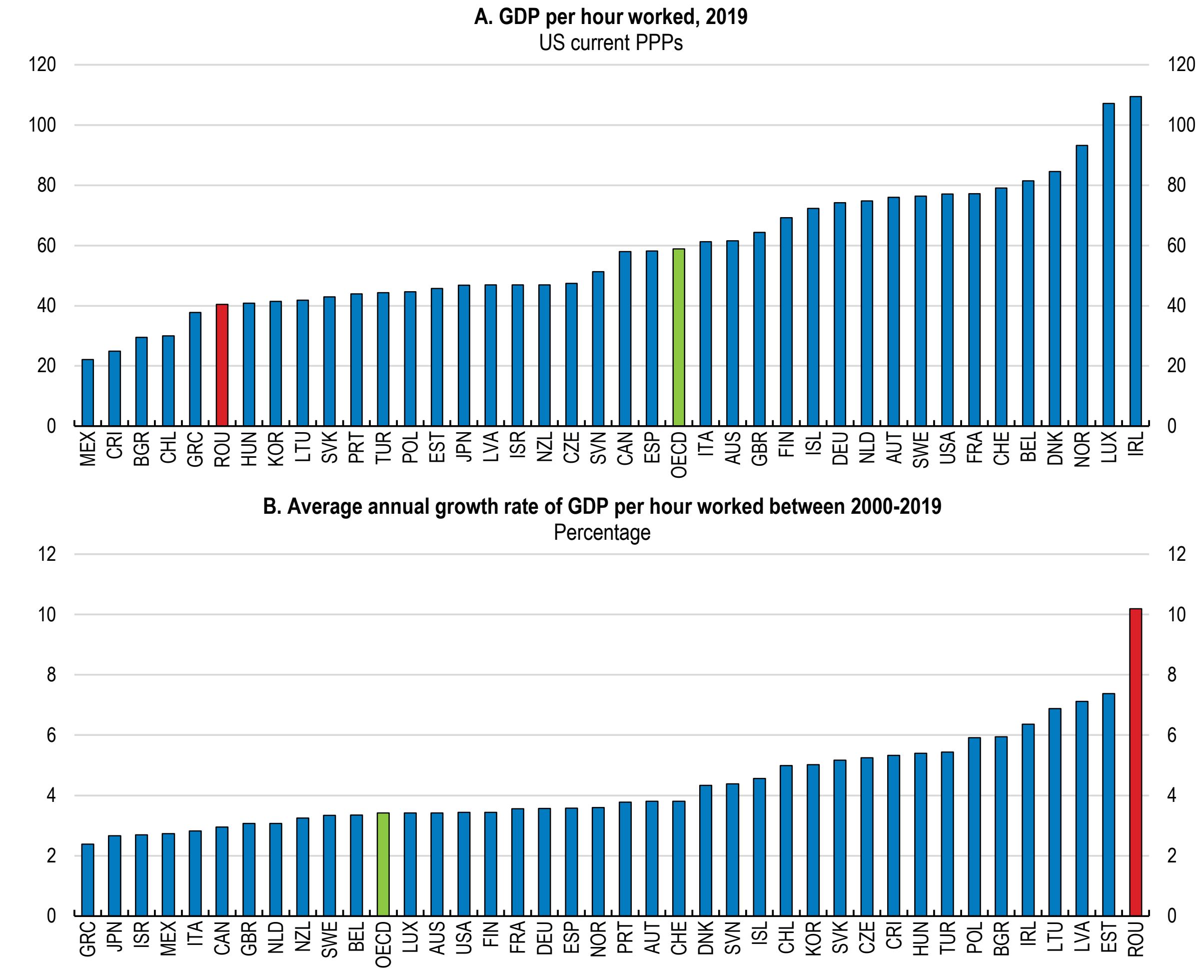
Reforms for a faster, inclusive and green convergence

Productivity growth needs to resume

Productivity growth is key to improve living standards. Productivity has increased at a fast pace over the past decades, but still remains low (Figure 1.20). This reflects the lack of business dynamism, as the entry of new and innovative start-ups is limited while many low-performing firms (including state-owned enterprises) subsist in the market. In order to boost business dynamism, the regulatory burden should be reduced, financing difficulties in some segments, such as SMEs in local areas and innovative firms, be addressed and transport infrastructure be improved. Moreover, unpredictability of policy-making, frequent regulatory changes, and law enforcement issues negatively affect the business climate. A set of structural policies can improve the business environment to support productivity growth in all sectors of the economy, including SMEs and entrepreneurs, as detailed in Chapter 2.

The role of national productivity boards has become more important to ensure sustainable productivity growth in the context of the recovery from the COVID-19 crisis. They can support the development of policy measures tailored to the individual needs of each country, including in the process of the implementation of the Recovery and Resilience Plans (European Commission, 2021b). As part of the reorganisation of the National Commission for Strategy and Forecast, Romania wound down the Economic Programming Council, which had a broader range of missions than what a national productivity board usually has. It intends to introduce a national productivity board following consultation and discussion to find its best remit.

Figure 1.20. Room for productivity gains is large



Source: OECD Productivity Indicators.

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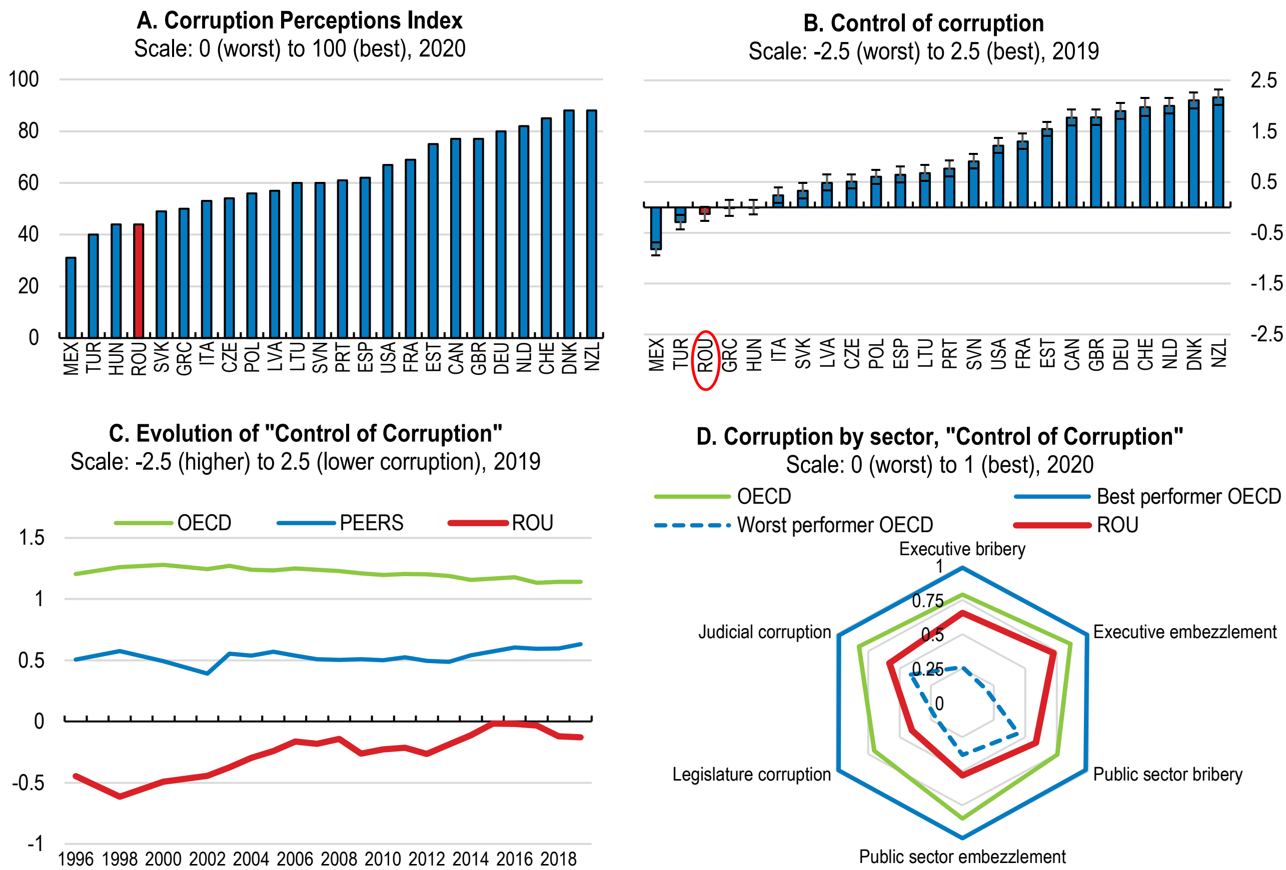
Addressing tensions in the labour market is also crucial to sustain productivity, as they tend to affect investment capacity and knowledge diffusion. Labour shortages, together with rises in administered wages, had driven wage inflation above productivity growth prior to the pandemic (D'Adamo et al., 2019). Increases in unit labour costs reduce financial room for investment. Labour market shortages also threaten Romania's attractiveness for foreign investors: international companies, especially those investing in knowledge intensive services, tend to move to markets, which offer skilled workforce (Carstensen and Toubal, 2003; Doh et al., 2009). Finally, shortages of skilled workers hamper technological adoption due to complementarity between the availability of highly skilled workers and investment in knowledge-based and technology-intensive capital (OECD, 2013). Raising labour market participation and offering reskilling options to the Romanian workforce to adapt to fast changing labour market needs and technologies is thus a policy priority, as identified in Romania's new National Employment Strategy for 2021-2027 and discussed in Chapter 3.

Resuming the fight against corruption

Romania has made significant progress with anti-corruption policies over the last two decades, but corruption is still perceived as a major issue, well above the average in OECD and peer countries

(Figure 1.21). According to Eurobarometer (European Commission, 2019b), 88% of companies consider corruption is a problem when doing business in Romania and 83% consider corruption in public procurement is widespread, the highest rates in the EU. Corruption negatively affects economic activity by affecting the business climate, distorting markets, hindering the functioning of institutions, and imposing high social costs (Mauro, 1995, Rose-Ackerman and Soreide, 2012). It can also discourage labour market participation and incentivise emigration (Cooray and Dzhumashev, 2018; Cooray and Schneider, 2016; Ariu and Squicciarini, 2013).

Figure 1.21. Corruption is still perceived as high



Note: Panel A: the "Corruption Perceptions Index" by Transparency International is subsumes several sub-indicators. Panel B: the indicator is one of the subcomponents of the World Bank "Control of Corruption" indicator. The "Control of corruption" indicator in the World Bank Worldwide Governance Indicators (WGI) is also a composite indicator. For details, see Kaufmann et al., (2010). Public sector embezzlement stands for theft, or any kind of diversion of public resources for private gains in the public sector.
Source: World Bank; Transparency International; Varieties of Democracy Institute, University of Gothenburg, and University of Notre Dame.

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The Romanian integrity system is still fragmented, and has large room for improvement, especially regarding incompatibility and conflicts of interest (European Commission, 2019c). The National Anti-Corruption Strategy 2016-20 aimed at enhancing public integrity and corruption prevention. This comprehensive programme adopted a multi-disciplinary approach and involved a wide range of public institutions, non-governmental organisations, business associations as well as state-owned and private companies. Progress has been uneven (European Commission, 2021c), and slow in some areas, such as the health sector. The OECD is carrying out an overall evaluation of the strategy and will provide recommendations for the new one, including to improving the technical capacities of the Romanian government to monitor its implementation (OECD, 2022, forthcoming). The Strategy 2021-25 will aim at improving performance in the area of law enforcement by strengthening criminal and administrative sanctions. The OECD is providing technical assistance in this area, by assessing Romania's institutional framework against certain OECD anti-bribery standards.

Despite an impressive performance track record in fighting high-level corruption, especially in public procurement (DNA, 2017; DNA, 2018), control mechanisms need further strengthening. The National Anti-Corruption Directorate (DNA) has been subject to considerable political pressure in the last few years, notably by the amendments related to the Justice Laws adopted by a former government. These amendments were related to the introduction of dissuasive seniority thresholds for appointments of DNA prosecutors, limiting the recruitment capacity, and the introduction of a new section within the prosecution service for investigating criminal offences within the judiciary, which risks being prone to political pressures (European Commission, 2021c). These amendments created pressures on judges and prosecutors and could have changed the course of high-level corruption cases. The new section within the prosecution service should be abolished (GRECO, 2021; European Commission, 2021c). The justice system, including the DNA, should have adequate resources, powers and independence to conduct investigations in corruption cases effectively.

Romania ranks relatively poorly when it comes to corruption in the legislature (see Figure 1.21). Conflicts of interest, which are a breeding ground for corruption, need to be effectively controlled. The sanctions applicable to incompatibilities (public officials from holding other positions or exercising other function) are strict, but incompatibilities cover only a part of conflicts of interest in a general sense. There has been some progress, as a new code of conduct for members of Parliament was adopted in 2017. However, it lacks an effective enforcement mechanism and a framework for monitoring compliance (GRECO, 2019), in particular, as it does not clearly describe situations that constitute a conflict of interest and indications on how declaration is controlled or approved are missing. To address these shortcomings, Romania should provide guidance for the identification and management of conflicts of interest and set clear and proportionate procedures for the enforcement of public integrity standards through an effective disciplinary system.

The lack of transparency and predictability in the decision-making and legislative process renders this process more vulnerable to corruption. There are a number of difficulties in practice in having access to parliamentary sessions, including very short notices for registration (GRECO, 2015). The amendments to the criminal code and the special law on corruption were made by Parliament through urgency procedure in 2019, thus avoiding public scrutiny. These amendments risked undermining anti-corruption efforts by lowering penalties, shortening the statute of limitations for some offences, and decriminalising negligence in office. They were subsequently judged as unconstitutional by the Constitutional Court in July 2019 and rejected by Parliament in 2021. Government Emergency Ordinances, which enable the government to quickly pass legislation without consulting stakeholders or conducting ex-ante impact assessments, were frequently used in the past (Chapter 2; Council of Europe, 2019). The use of Government Emergency Ordinances has been limited over the past two years, which should be continued, as frequent changes in systems create uncertainty.

Transparency of the legislative process should be improved further by developing the rules to engage stakeholders, implement open government and access to information measures, as well as measures on lobbying to ensure transparency and integrity in public decision-making. Effective lobbying regulations would ensure equitable access to the policy-making processes and avert the risks of undue influence and policy capture. Romania has adopted the Single Transparency of Interests Register, a platform whereby citizens can obtain information on senior government officials meeting with interest groups. Going further, comprehensive lobbying rules should be adopted, setting clear definitions for "lobbyists" and "lobbying", and regulating the engagement of members of Parliament with lobbyists and other third parties who seek to influence the legislative process. After being established, the effective enforcement of these rules should be monitored thoroughly.

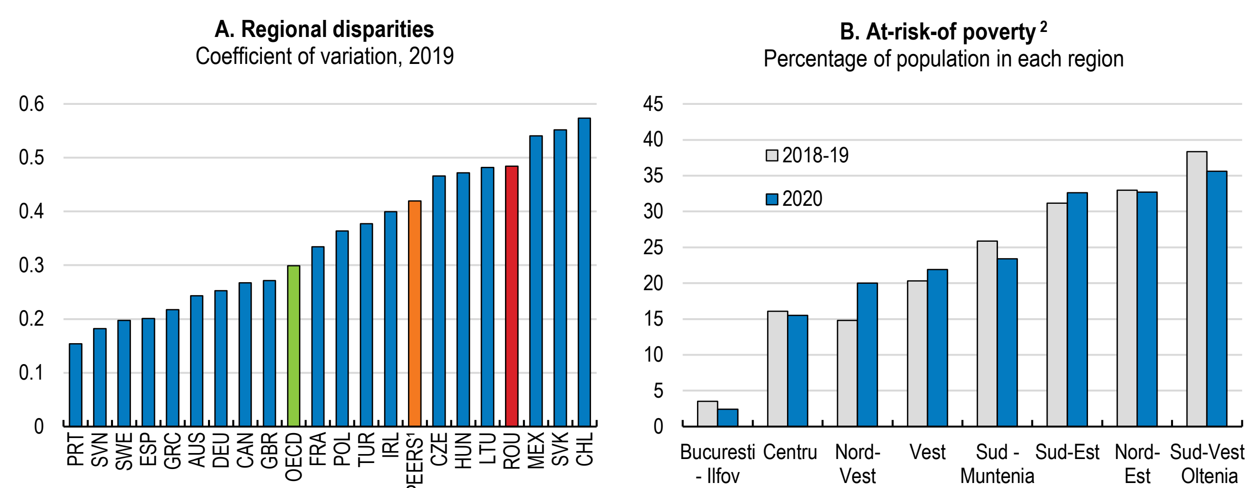
Evidence-based principles should be at the core of the public decision-making process, which can help to de-politicise the public governance framework. The OECD Recommendation on Regulatory Policy and Governance stresses the importance of consulting broadly, ensuring that all relevant impacts are assessed and that rules are periodically reviewed and open to legal challenge. Rules can be significantly improved when those impacted are involved, allowing for alternatives to be found, assumptions to be tested, and helping to build trust in government action (OECD, 2021g). According to the OECD Indicators of Regulatory Policy and Governance (iREG), Romania lacks a systematic approach for reviewing existing regulations. Ex-post evaluation should be undertaken on a systematic basis, with solid oversight and methodological guidance, in a transparent manner.

Reducing poverty and social exclusion

Regional disparities are high and rural areas lag behind

Despite strong economic performance, Romania faces important challenges to make economic convergence faster and more inclusive. Regional development has been uneven. Regional disparities, in terms of GDP per capita are much higher than in the OECD on average (Figure 1.22, Panel A). Strong economic growth benefitted mostly urban centres, notably Bucharest, Cluj, Timisoara and Sibiu. While GDP per capita in the capital expressed in purchasing power standards exceeds the levels seen in Berlin or Madrid, the Southern and North-Eastern regions are among the poorest in the EU. Around a third of the population in these regions were at-risk of poverty in 2020 (Figure 1.22, Panel B). The government is designing a comprehensive strategy for social inclusion and against poverty. Devoting public resources to the implementation of planned measures, especially the reform of social assistance detailed below, will require increasing fiscal space, by raising more tax revenues and reducing spending on pensions (as discussed above).

Figure 1.22. Regional disparities are high with pockets of poverty in rural areas



1. PEERS consists of Czech Republic, Hungary, Lithuania, Poland, and Slovakia.
2. The at-risk-of-poverty is the share of people with an equivalised disposable income (after social transfers) below 60 % of the national median equivalised disposable income after social transfers.
Source: OECD Regional Economy database; and Eurostat.

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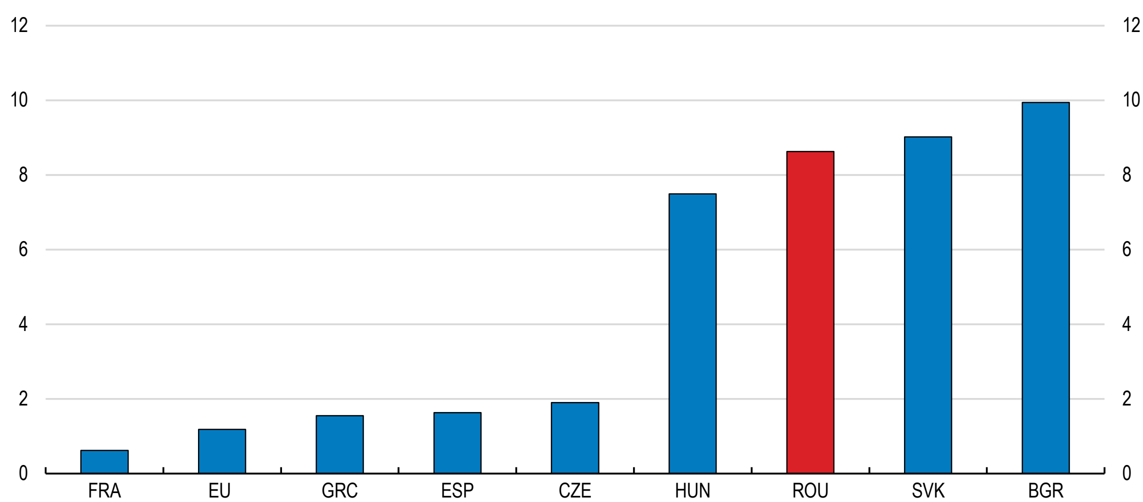
Pockets of poverty are concentrated in rural regions (Figure 1.22, Panel B). Urban/rural disparities are by far the most pronounced in the EU reflecting uneven access to jobs and infrastructure (education, healthcare, and transport). The risk of poverty is particularly high for families with children, people with low work intensity, low education level, or with disabilities, and Roma. Child poverty has declined dramatically, but remains the highest in the EU, with 38% of children at risk of poverty or social exclusion in 2018 (from 53% in 2012). The rate of child poverty is over three times higher in rural areas than in urban areas.

Facilitating access to quality jobs can reduce poverty in rural areas, where informality and reliance on agriculture are relatively large (Chapter 3). Increasing productivity in the agriculture sector from current low levels can also improve farmers' living standards and make agriculture more attractive to young entrepreneurs. Investment in productivity-enhancing technologies has been low due to the small size of farms and limited access to credit. National and European development programmes have aimed at modernising agriculture by encouraging investment, merging lands and developing farmers' training. Developing advisory services at the local level would contribute to raising awareness of farmers on available support programmes and ease the absorption of EU funds (Toderita and Meirosu, 2019).

The Roma population needs specific support as they are particularly affected by poverty and social exclusion. The Roma are the second largest ethnic minority in Romania after the Hungarians. Estimates differ, but it is assumed that they account for around 9% of the population (Figure 1.23). Like in OECD CEE countries, and despite some progress over the last decade, poverty has been particularly prevalent in Roma communities, affecting almost every aspect of everyday life (Gatti et al., 2016, Chapter 3). The at-risk of poverty rate decreased from 84% in 2011 to 70% in 2016, but remains three times higher than the average in Romania. The prevalence of poverty among the Roma is exacerbated by their relatively high geographical concentration in deprived areas where high-quality public services are missing. The differences in outcomes between Roma and non-Roma in employment, housing, health, and education are striking (Table 1.6). The COVID-19 crisis has deepened existing vulnerabilities in these marginalized communities (World Bank, 2021b).

Figure 1.23. Romania is among the EU countries with the largest Roma population

As a percentage of population



Note: The presented shares represent the average of different estimates for 2012.
Source: Bednarik et al. (2019).

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Table 1.6. Selected socio-economic indicators

2016 (%)

	Roma	Total population
At-risk of poverty rate	70	25
Employment rate	28	53
Employment rate, women	13	44
NEET rate – neither in work nor in education, aged 16-24,	63	18
Dropout rate from education	77	16
Share of households living without a toilet, bathroom and shower inside the dwelling	80	31
People who do not seek healthcare when needed	42	25

Note: The employment rate definition slightly differs for the Roma population, it includes all persons in Roma households aged 16 years or over; for total population, the measure includes every person aged 15 and over.
Source: FRA (2016), Second European Union Minorities and Discrimination Survey, Roma – Selected findings, European Union Agency for Fundamental Rights; Eurostat LFS (2017-18); EC (2018).

Barriers to social inclusion are complex, multiple, and interconnected (Bednarik et al., 2019). The EU-2020 strategy and the National Roma Integration Strategy 2015-2020 draw a framework to eliminate poverty among the Roma population, but policy action remained fragmented. A whole-of-government approach is needed with better coordination of individual policies and policy continuity as the exclusion is so severe that isolated interventions are ineffective. International experience also shows that involving Roma in policy interventions increases the chance of success (Bednarik et al., 2019). More Roma trained personnel, such as Roma teaching assistants or Roma health mediators, should therefore be hired in public services to facilitate dialogue and cooperation between the Roma population and public institutions. It is also crucial that Roma are well represented in high-level bodies, as done for instance in Australia for Aborigines in the Productivity Commission.

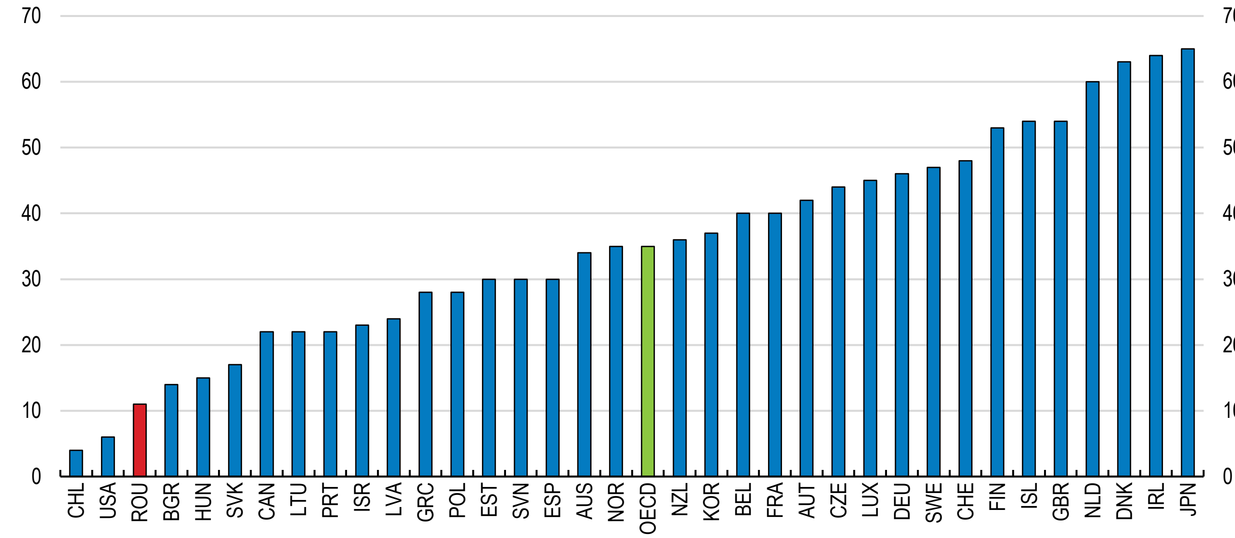
The social safety net needs strengthening

The tax and benefit system does not adequately protect citizens against poverty. The combination of direct and indirect taxes and transfers tends to increase poverty for some vulnerable groups, as direct cash transfers to poor households are not large enough to compensate the burden of indirect taxes, especially for rural households and families with children (Inchauste and Militaru, 2018). During the pandemic, public support has helped to mitigate the negative impact of restrictions on household income, but consisted mostly in employment-targeted programs. Budgets allocated to social policies rose significantly, but most of the increase relates to the pension reform.

Poverty risks for the jobless have steadily expanded since 2010. Poor adequacy and coverage of social assistance benefits have played a role. The minimum income benefits amount to around 20% of the poverty line for a single person (Figure 1.24). The take-up rate of social assistance is relatively low and only around 18% of the poorest households received the guaranteed minimum income in 2018 (OECD SOCR database).

Figure 1.24. The minimum income benefits do not sufficiently protect against poverty

Level of minimum income benefits % a percentage of the median disposable income in the population, 2018 or latest



Note: Data refers to single person without children, and includes housing benefits. 2017 for Korea and Canada; 2016 for Chile.
Source: OECD Benefits, Taxes, and Wages Database.

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Social assistance is fragmented with different eligibility criteria for each programme, inducing high administrative and application costs. In addition, benefits were not automatically adjusted to wages and prices, but anchored to the social reference index, which did not increased between 2008 and 2018 (Vasilescu, 2018). As a result, the values of social benefits eroded in real terms. Automatic indexation would avoid erosion over time and increase the redistributive power of the social protection system. It is thus very welcome that an indexation mechanism is introduced in 2022. In addition, measures to address energy poverty entered in force in November 2021.

A number of other measures aimed at strengthening social assistance have been delayed. A programme to consolidate social transfers, improve targeting, increase the benefit level, and introduce activation elements (i.e. the Minimum Social Insertion Income programme) initially planned for 2018 and postponed, partly because the IT infrastructure needed for its implementation is not in place, will be implemented under the Recovery and Resilience Plan. The government also planned to establish social services in deprived areas, as only approximately 20% of administrative territorial areas have licensed social services (SGI, 2020). Pilot projects to integrate social, health and education services in disadvantaged communities started in 2019, and showed promising results. The development of integrated public services should continue, and will critically depend on the capacity to hire and train social workers.

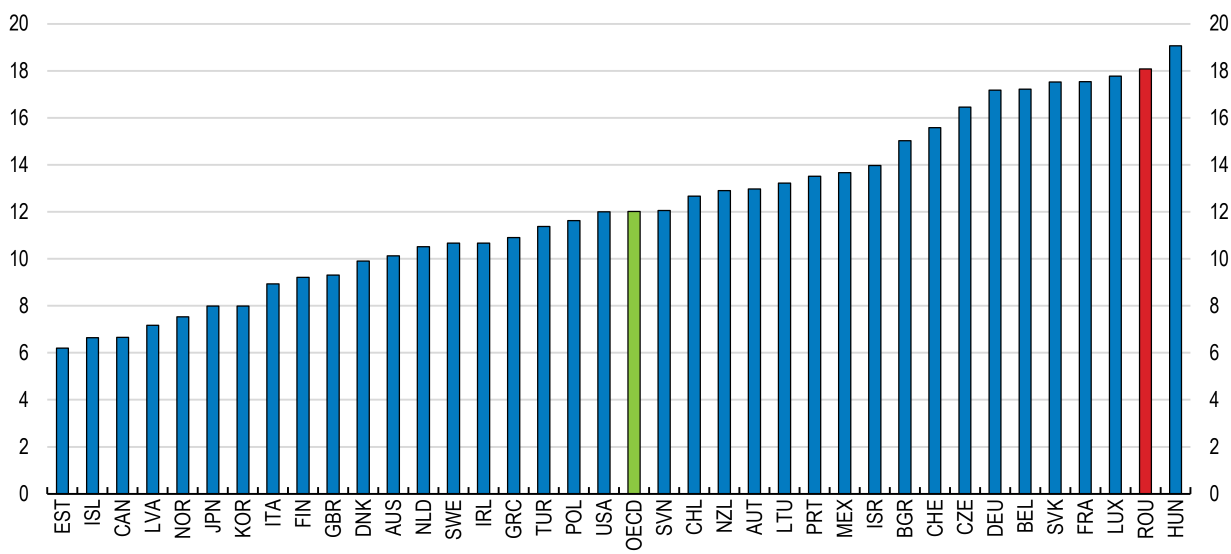
Offering quality education to all

Educational performance has stagnated over the past years at a low level and risks deteriorating with the COVID-19 crisis. In 2018, 41% of 15-year-old students were unable to achieve a minimum level of proficiency in reading (OECD, 2019b). Illiteracy might significantly rise after 2020, as school closures have deepened learning gaps (World Bank, 2020a). Enhancing the education level is a key priority to establish equality of opportunities. Poverty hits disproportionally those with low educational attainment levels. Half of the low educated were at-risk of poverty in 2018, while only 1.3% of tertiary educated lived with less than 60% of the median income, the highest gap in the EU.

Access to education is uneven across the country with large urban/rural gaps in educational attainment and learning outcomes. 35% of the 30-34 years old have below upper secondary education levels in the North-East region, three times the level in Bucharest. The gap in PISA performance between rural and urban regions is mainly explained by differences in socio-economic status. The impact of the socio-economic status on educational outcomes is high by international standards, equivalent to around 3 years of schooling, perpetuating income inequalities from generation to another (Figure 1.25). These challenges have been identified in the new strategic framework for education and training for the period 2021-2027 and the "Educated Romania" project launched in 2021 could be a first step towards a reform of the governance of the education system to address – among others – inequality issues.

Figure 1.25. The socioeconomic status has a large impact on educational outcomes

Percentage of variance in reading performance explained by socio-economic status[1]



1. ESCS refers to the PISA index of economic, social and cultural status.
Source: OECD PISA 2018 Results (Volume II).

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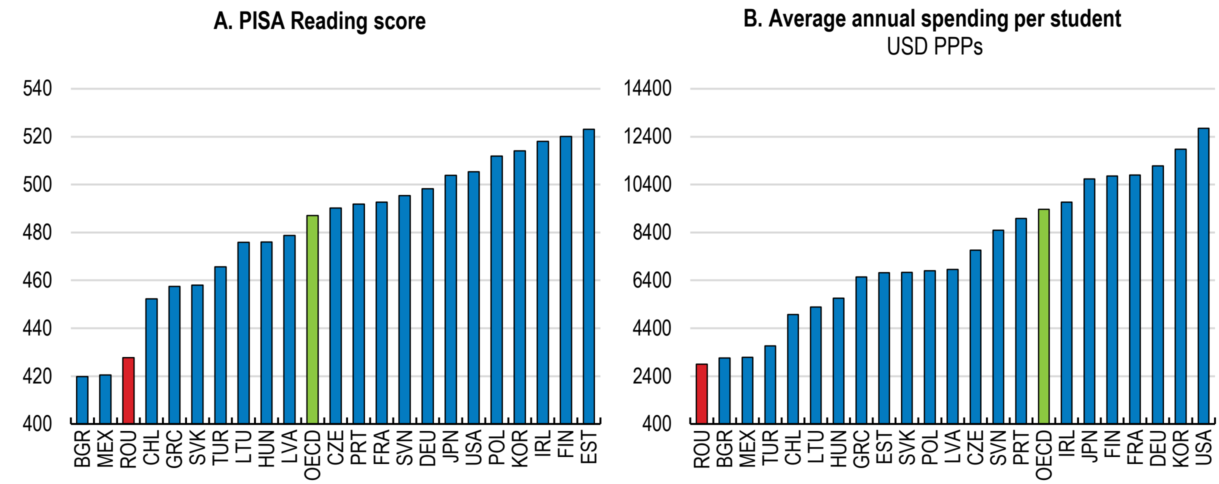
School closures have disproportionally affected vulnerable children in rural areas due to poor access to digital equipment and preparedness to remote teaching. Since March 2020, significant effort has been made to provide additional ICT equipment and training to adjust to restrictions. The "School after school" programme to compensate for learning losses due to the disruptions of face-to-face learning was in place for around 6 months in 2021 in primary and secondary schools and was complemented by remedial activities in the upper secondary education. The need for further support should be evaluated on a regular basis, remedial courses provided and coordinated with other on-going initiatives to tackle school dropout (Chapter 3). The programme "Caring for children" launched to tackle the effect of the pandemic on children's wellbeing in an integrated way is welcome.

More resources should be allocated to schools located in disadvantaged areas at the pre- and primary education levels. Public spending on education is relatively low, accounting for only 3.6% of GDP in 2019, vs. 4.7% in the EU. Moreover, spending per student in primary and lower secondary education amounted to less than a third of the EU average. International experience suggests that improving educational performance without increasing spending would be difficult to achieve (Figure 1.26).

Figure 1.26. Improving education outcomes requires increasing spending



Source: OECD PISA 2018 Results, Volumes I and II.

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Disadvantaged schools do not necessarily receive extra financial support. Basic financing, which accounts for around 92% of schools financing, is allocated by the central government based on a capitation formula that does not take into account the socio-economic vulnerabilities of schools (World Bank, 2018b). Municipalities complement basic funding, which leads to increased inequalities between rich and poor municipalities. As a result, schools in rural and disadvantaged areas have lower resources for educational material and attract less experienced teachers than schools in urban areas (Echazarra and Radinger, 2019). Since 2021, the funding formula allocates more resources to schools in rural areas. The National Recovery and Resilience Plan includes the provision of grants to disadvantaged school and the "Educated Romania" project envisages a reform of funding mechanisms.

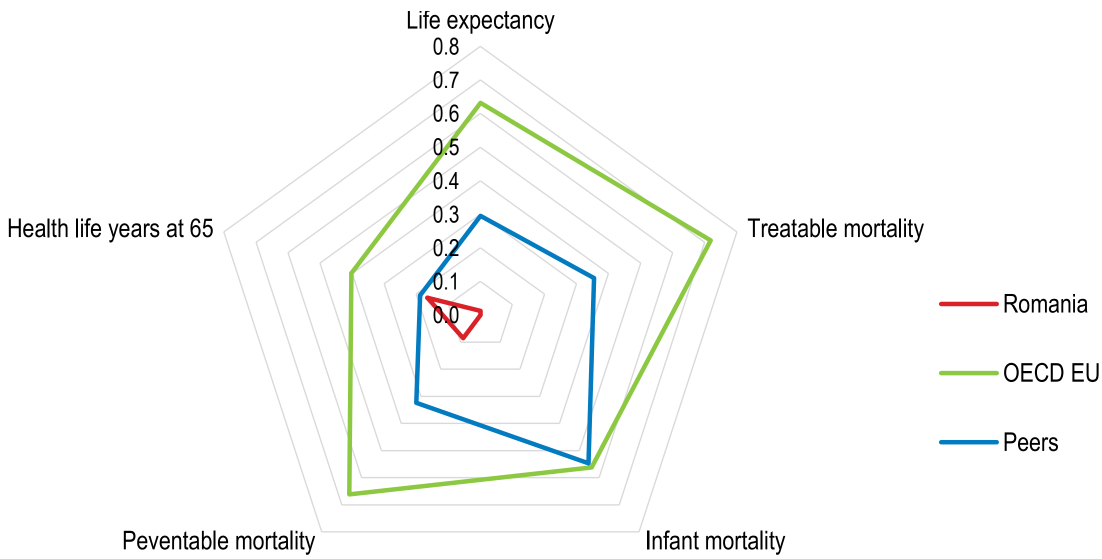
There is a need to attract experienced and well-trained teachers to disadvantaged areas. Incentives to work in a difficult environment are low, as teachers' pay increases with seniority and the share of students passing grade. EU funded programmes "Motivated Teachers in Disadvantaged Schools", were initiated recently to address this issue, which is welcome. Teachers should be better prepared to work with disadvantaged students. Teachers' participation in lifelong learning is lower than in many OECD countries and a relative large share of teachers feel that they lack training to teach students with special needs (OECD, 2019d). Continuing professional development has to be better connected to teachers' needs and evaluation (OECD, 2020; Kitchen et al., 2017). In particular, school-level learning opportunities, focusing on teachers' classroom practice, should be strengthened (OECD, 2019c).

Improving access to quality healthcare

The health status of Romanians has improved, but remains well below OECD standards (Figure 1.27) and is characterised by large inequalities. Life expectancy reached 75 years in 2018, 5 years lower than the OECD average, with substantial differences by gender and education level. Men live on average eight years shorter than women do and those with the highest level of education live seven years longer than those with the lowest education. Life expectancy of Roma is 6 years lower than the national average (World Bank, 2014). The number of years Romanians can expect to spend in good health at age 65 is low and has improved only slowly. Infant mortality was almost twice the EU average in 2018. The pandemic aggravated challenges in the health sector by complicating access to care, especially for the poorest (World Bank, 2021a).

Figure 1.27. Health indicators suggest large scope for progress

Index 0-1 (worst-best), 2019 or latest year available



Note: 0 represents the worst performing country, while 1 represents the best performing country. OECD EU average refers to OECD countries that are also members of the EU. Peers consist of Czech Republic, Estonia, Hungary, Latvia, Lithuania, Slovakia, Slovenia, and Poland. Data on "healthy life years at 65" refers to 2018.
Source*:* OECD Health Statistics; and Eurostat Health Statistics.

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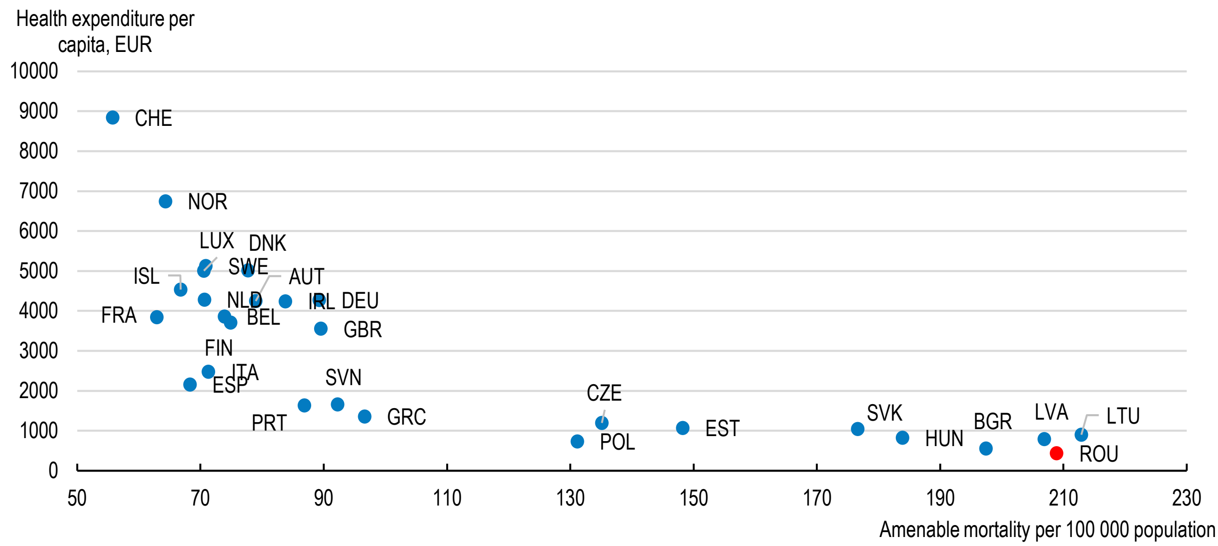
Preventable mortality was the third highest in Europe in 2017. More than half of all deaths can be attributed to behavioural risk factors including smoking and alcohol use, as well as dietary risks and low physical activity (OECD/EOHSP, 2019). Prevention accounts for a low share of total healthcare spending (1.4% of total, vs. 2.5% on average in OECD CEE countries in 2018) and no impact assessment of prevention programmes has been carried out.

While Romania's mortality rate related to alcohol abuse is the highest among EU countries, a national plan on alcohol is missing. The childhood immunisation rates are among the lowest in the EU and have declined dramatically. Lack of systematic cancer screening and low participation contribute to poor cancer survival rates. Planned measures to increase vaccination rates and screening programmes should be implemented swiftly. Prevention programmes should be expanded and evaluated. The most effective ones should be embedded in the national public health programme.

Amenable mortality is the highest in the EU (OECD/EU, 2020). Mortality from cervical cancer (a good indicator of the performance of the healthcare system as it can be cured if diagnosed and treated rapidly) was four time the EU average in 2016 (World Bank, 2018a). This reflects low performance of health care that can be linked to underfunding issues (Figure 1.28). While having increased fast, reaching 5% of GDP in 2019, public spending on healthcare remains well below the OECD average and is among the lowest in the EU.

The allocation of resources in the healthcare sector could be improved. The link between planning decisions and population health needs is deemed weak, partly owing to the lack of appropriate information systems. Bed occupancy in some public hospitals are low, calling for the restructuring of the hospital network. In addition, the lack of coordination between healthcare providers leads to suboptimal service provision (World Bank, 2018a). Current plans to increase public investment in the health sector, using EU funds, while implementing efficiency-enhancing measures, such as the creation of an integrated health information management framework and improvement in the governance of hospitals, are thus highly welcome. Establishing a body in charge of managing priority infrastructure investments in the health sector as planned would be another step in the right direction.

Figure 1.28. Low spending is associated with poor health outcomes



Note: The figure represents health expenditure per capita and amenable mortality rates in OECD countries, Romania and Bulgaria.
Source: Eurostat Health Statistics.

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Unmet medical needs have fallen significantly over the past decade, but remain above the EU average and highly unequally distributed in the population (Figure 1.29). The pandemic triggered additional delays in consultations, treatments, and monitoring (World Bank, 2021a). Access to healthcare is limited, mainly for poor people living in rural areas, due to affordability issues and lack of accessible medical services.

Affordability issues relate to the relatively low coverage of the social health insurance system. Around 11% of the population is not covered and uninsured people (i.e. Roma population with no identity cards, workers in the agricultural and the informal sectors, non-registered unemployed) only have access to a minimum benefits package, which only covers life-threatening emergencies, the treatment of communicable diseases and care during pregnancies. Insured people, i.e. those who contribute to the health fund, have access to a comprehensive benefits package. This two-basket system should be revised to allow all residents to access a wider range of basic medical services. The government’s plan to offer the uninsured population access to free primary health care is thus very welcome, and should include access to preventive health services.

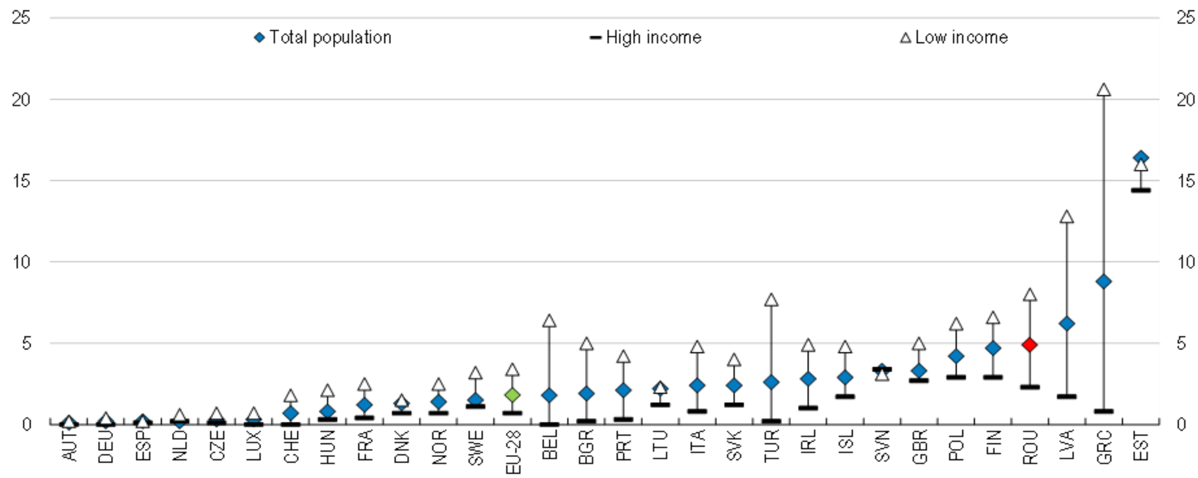
Access to healthcare is also limited by growing shortages of medical staff. The numbers of doctors and nurses per capita are among the lowest in Europe with high regional disparities. Underfunding of the healthcare system encouraged large outmigration of health professionals, which was particularly pronounced in rural areas. The National Health Strategy includes a number of programmes to tackle shortages of healthcare workers and plans to reorganise the healthcare system at the regional level. The on-going implementation of integrated community services, investment in community health centres, and grants to local authorities to hire community health nurses and Roma health mediators are steps in the right direction.

Health mediations programmes proved useful to encourage Roma’s access to medical services, and have a positive effect on health status, infant mortality in particular (Mitrut and Tudor, 2018). 42% of Roma do not seek healthcare when needing it, mostly due to a lack of health insurance and of information about free of charge health services, transportation costs, and discrimination (Farcasanu, 2018; FRA, 2016).

Other barriers include language barriers and low trust toward healthcare providers. Efforts to provide integrated health and social services at the community level and the recruitment of community nurses should thus intensify.

Figure 1.29. Unmet medical needs must be addressed

Percentage of population reporting unmet medical needs, 2018 or latest



Note: The data refer to unmet needs for medical examination or treatment due to costs, distance to travel or waiting times. Data refer to 2017 for Ireland, Slovakia, the United Kingdom, Turkey, and 2016 for Iceland.
Source: Eurostat Health Statistics.

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Spending on primary care accounted for only around 8% of total health spending in 2018, well below international norms. Plans to increase allocations from the National Health Insurance House to primary care combined with implementation of performance-based payments are thus welcome, and should include stronger incentives for doctors to work in underserved areas. Another option to address doctors' shortages is to enlarge the role and responsibilities of nurses for minor illnesses and prevention as done in Sweden, Denmark and the UK (OECD, 2016). While shortages of nurses are large, training duration and remuneration levels are much lower than for doctors. Developing telemedicine, by allowing remote consultations and online prescriptions as in 2020, would reduce administrative burden and facilitate access to care in remote areas.

Wages of medical staff have been increased significantly as a retention policy. Retaining medical staff also requires improving working conditions and investing in infrastructure and modern equipment. The availability of imaging equipment in hospitals, as measured by the number of magnetic resonance imaging units and scanners per capita – is among the lowest in the EU.

Tackling environmental challenges

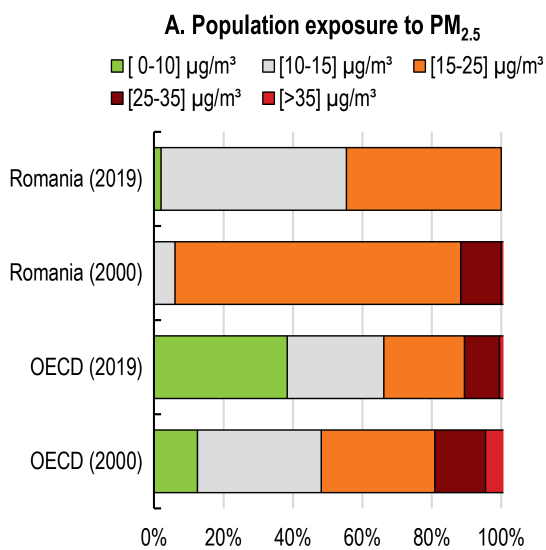
Air pollution

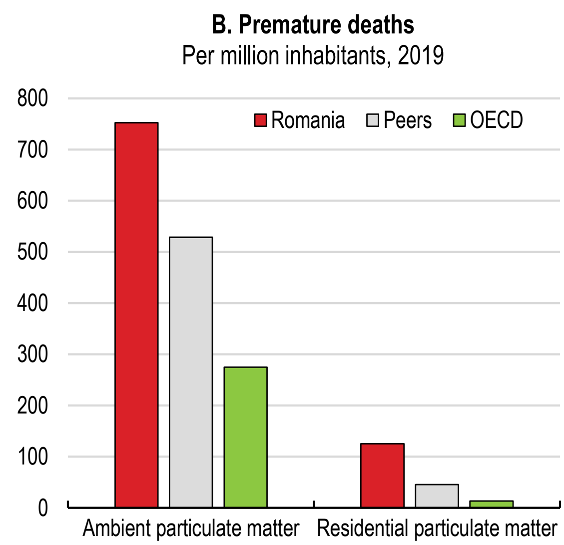
Air pollution is a major environmental and health hazard in Romania. Despite a slight improvement since 2000, the vast majority of the population is exposed to fine particles above the 10 micrograms per cubic metre level, the maximum threshold recommended by the World Health Organisation (WHO, Figure 1.30, Panel A). Air pollution has been found to be a risk factor in cancers, cardiovascular, cerebrovascular and respiratory diseases (Roy and Braathen, 2017) and to have a negative impact on children's early development and learning outcomes (Heissel, Persico and Simon, 2019; Lavy, Ebenstein and Roth, 2014).

Air pollution can incur a significant cost to the Romanian society. In 2017, the welfare costs of premature deaths associated with air pollution amounted to 5.9% of GDP from outdoor pollution and 1.9% of GDP from indoor pollution, against an OECD average of 3% and 0.01% respectively (OECD, 2021e).

Outdoor air pollution, caused mainly by the carbon-intensive industry, transport and residential sectors, is high in Romania and to a varying degree across regions (OECD, 2021f). It results in almost twice as many premature deaths in Romania than the OECD average (Figure 1.30, Panel B). Moreover, unlike in the OECD and peer countries, this number has not decreased in the past decade. As a result, a few Romania's cities, including Bucharest, are among the most polluted in Europe (IQAir, 2018). Increased use of passenger cars and trucks has contributed to rising emissions of pollutants. Diesel, which is more polluting than petrol, is the most popular engine fuel and Romania has one of the oldest car fleets in the EU.

Figure 1.30. Air pollution is high and contributed to a large number of premature deaths





Source: OECD Green Growth Indicators.

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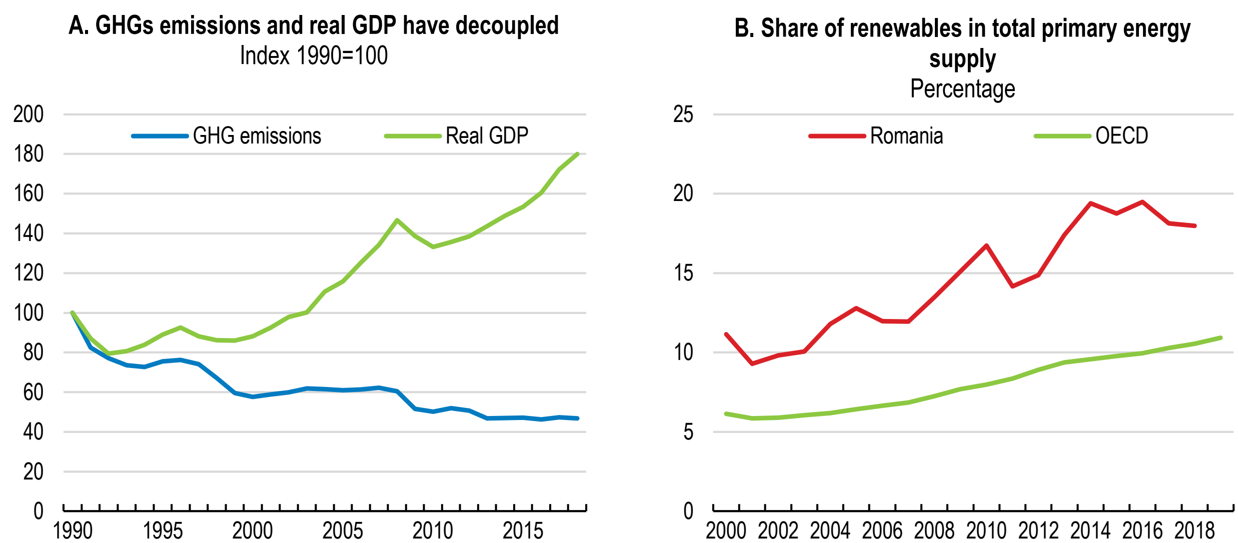
A programme for renewing the national car fleet, called "Rabla", has been in place for the last 15 years, offering subsidies for the replacement of old cars and the purchase of hybrid vehicles. This has not been sufficient to prevent the emissions from increasing and the share of new cars using alternative fuels was less than 2% in 2018. Taxing vehicles according to their emissions and banning old polluting cars from city centres could help to encourage the use of cleaner vehicles. Cheap but very polluting second hand cars should be taxed sufficiently high. The National Recovery and Resilience Plan aims to introduce a new taxation system on vehicles according to the polluter pays principle. These measures should be combined with investment in public transport, as is also planned in the National Recovery and Resilience Plan (see chapter 2), to avoid increases in transportation costs for low-income households and ensure access to affordable mobility.

The risks associated with indoor air pollution are also alarming. In 2017, the number of premature deaths per million inhabitants associated with residential particulate matter was over ten times as much as in the OECD (see Figure 1.30). Indoor air pollution arises typically from the burning of solid fuels for cooking and heating within houses and disproportionately affects more vulnerable groups, such as children, women and older people. 45% of dwellings (90% in rural areas) use firewood for heating (Ministry of Energy, 2016). The Green House ("Casa Verde") programme subsidises the modernisation of traditional heating systems with solar panels and heat pumps. Market instruments including soft loans can complement this programme at a reduced fiscal cost.

Climate change mitigation

Romania has made a remarkable progress in decoupling greenhouse gas emissions from economic growth (Figure 1.31). Deindustrialisation during the transition to a market economy and a shift towards cleaner forms of energy sources have underpinned the performance. However, the economy remains very carbon intensive due to high reliance on fossil fuels across all sectors. According to the National Energy and Climate Plan, meeting the current 2030 targets for greenhouse gas emissions (2% reduction compared with 2005 levels) and renewable energy sources (30.7% of total energy sources) will require an investment of EUR 150 billion (European Commission, 2020b). The National Recovery and Resilience Plan, with its emphasis on green transition, focuses on such areas as transport, energy, forest/biodiversity and buildings.

Figure 1.31. The economy has become relatively greener



Source: Eurostat; World Bank; OECD, Green Growth Indicators.

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Romania's energy mix is quite diversified, but fossil fuels still make up three quarters of the energy supply. The share of renewables is almost double the OECD average (see Figure 1.31), but they consist mostly of biomass relying on firewood. In terms of electricity supply, coal and oil accounted for 24% of the total in 2019, well above an intermediate benchmark of less than 2% for 2030, which would be consistent with the Paris Agreement's objective to keep the global average temperature increase well below 2°C above pre-industrial levels (OECD, 2021f). In contrast, the share of wind power in total electricity supply was 11% in 2019, which can be further raised to be consistent with the Paris Agreement's objective (OECD, 2021f).

The National Recovery and Resilience Plan includes investments in renewable electricity generation such as wind and solar. However, according to the Plan, there is no further support scheme for new installations, which the government should consider introducing to the extent that such renewables help to achieve the medium term target for greenhouse gas emissions. The Plan also envisages an electricity market reform, to replace coal in the energy mix and a legislative and regulatory framework that stimulates private investment in renewable electricity generation. Going further, the authorities can also consider introducing competitive tenders or procurement auctions that allow governments to retain control over renewable energy capacity and its cost, like done Germany or Poland.

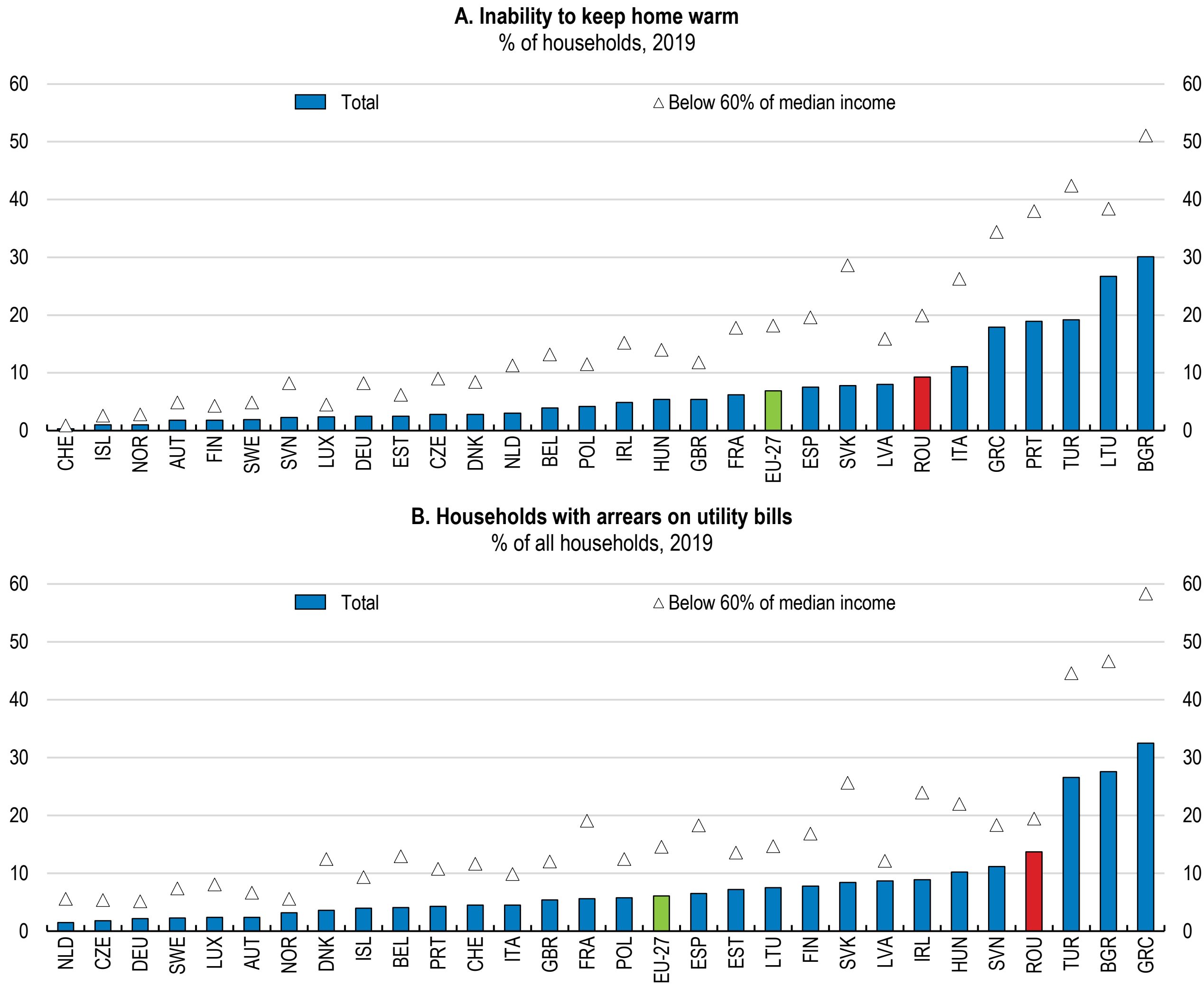
The production of energy relying on firewood releases hazardous pollutants. While illegal logging is intensive in Romania, it can be used as biomass for heating, in which case biomass cannot be considered as ‘renewable’ in a strict sense. Illegal logging reduces the natural carbon sink of forests, significantly damages biodiversity, and increases disaster risks. In spite of a series of measures that have been adopted over the past years, the authorities estimate the volume of wood lost by illegal logging remains substantial. The National Recovery and Resilience Plan aims to reform the management and governance system of forest and protected natural areas. The reform should lead to strengthening the control bodies and to increasing transparency in relation to forests activities

The energy intensity of the Romanian economy remains high. Reducing it would be a cost-effective way of boosting competitiveness, increasing energy security and reducing the country’s environmental footprint (IEA, 2018). Improving energy efficiency of buildings can bring significant benefits, as the energy intensity of heating is one of the highest in the EU (IEA, 2018). In addition to energy efficiency standards for new buildings, retrofitting old buildings is critical to achieve efficiency gains as most of the buildings in Romania were built before 1990 and over 35% of housing units need urgent repairs (World Bank, 2018a).

The National Long-Term Renovation Strategy aims at renovating about 77% of the total building stock by 2050. There are multiple barriers to energy-efficient investments, such as the lack of land rights by municipalities or the existence of multiple owners in multi-storey buildings, of whom a significant share face financial constraints. This calls for subsidising refurbishment of the building stock like done for instance in Hungary, Poland and Slovakia. In Romania, two main financial programmes provide low-interest loans with government guarantees to finance the thermal rehabilitation of the housing stock, but weak administrative capacity and lack of involvement of homeowners in the projects have hampered investments. The National Recovery and Resilience Plan envisages a reform modernising and simplifying the regulatory framework in the construction sector and measures to support building renovation, such as the introduction of a national digital register of buildings.

Energy efficiency gains in the building sector would also help to improve energy affordability. Even if the situation has greatly improved during the past decade, almost 10% of households report not being able to keep their home adequately warm (Figure 1.32, Panel A). Heating benefits and social tariffs support vulnerable consumer groups, but the share of households with arrears on utility bills is one of the highest in the EU (Figure 1.32, Panel B). In addition, the current system does not incentivise the use of less polluting energy sources, as the compensation level is based on the energy bill and the household income. A law passed in mid-September 2021 increases eligibility thresholds and heating benefits. It introduces differentiated compensation rates for vulnerable energy consumers depending on the type of heating system used as well as subsidies for the purchase of energy-efficient equipment. Going forward, the heating subsidies should be integrated into consolidated social assistance benefits so that cash transfers are not earmarked to energy consumption. This would encourage households to reduce energy consumption.

Figure 1.32. Energy affordability is an important challenge



Note: Data for Iceland and the United Kingdom refers to 2018.
Source: Eurostat.

StatLink https://stat.link/h7q8f3

Table 1.7. Recommendations on macroeconomic and selected structural policies

MAIN FINDINGS	RECOMMENDATIONS (key in bold)
Macroeconomic and financial policies	
Despite a fast recovery, risks to the outlook are high, notably due to the new wave of the pandemic.	**Reactivate fiscal support if the economic situation deteriorates, while targeting measures to the most vulnerable and affected.**
While public debt is still low, it has increased fast, reducing fiscal space and increasing financing risks.	**Establish a credible medium-term consolidation plan and gradually reduce the fiscal deficit to maintain the sustainability of public finances, should the recovery develop as expected.**
The administrative capacity to absorb EU funds has been limited compared to peers, as reflected in the weakness in the implementation of public investment projects. This could negatively affect the absorption of the NextGeneration EU funds, which are key to support the recovery.	**Ensure an effective implementation of the NextGeneration EU plan by strengthening coordination among stakeholders and monitoring mechanisms.**
Inflationary pressures and the risk of inflation expectations de-anchoring from the central bank's target have accentuated. The central bank has started increasing the policy interest rate.	**Continue to gradually increase the policy interest rate if needed to keep inflation expectations well anchored within the target band.**
The non-performing loan ratio is likely to increase following the end of support measures, as some firms are highly indebted.	**Strengthen the insolvency regime to facilitate debt restructuring, notably by introducing out-of-court mechanisms.** Keep monitoring financial stability risks while ensuring sufficient capital adequacy, liquidity and loss provisions.
The pension system is in deficit and the replacement rates are low. The government has started a revision of the public pension system to restore financial sustainability and improve adequacy under the Recovery and Resilience Plan.	**Increase incentives to work longer, notably by harmonising the legal retirement age of women to that of men and increasing it in line with life expectancy gains.** **Revise the benefit formula to ensure the financial sustainability of the pension system, while preventing old-age poverty as planned.**
Tax revenue is low due to poor compliance, which weakens fiscal sustainability.	**Continue the modernisation and computerisation of the tax administration to improve tax collection, notably through higher tax compliance.**
There is also room to increase taxes that are less distortive to growth, notably property taxes, and to broaden the tax base.	**Eliminate inefficient reduced tax rates and special tax provisions.** **Consider increasing recurrent taxes on immovable property, while exempting the poorest households.**
Improving well-being, inclusiveness and green growth	
The vaccine rollout has been slow and the vaccination rate remains relatively low, especially in rural areas. Access to some activities is conditioned to the presentation of a COVID-19 certificate attesting vaccination or a negative test.	**Consider extending the COVID-19 certificate to access a broader range of activities and for some professions.** **Intensify efforts to reach out the rural population, by multiplying the number of mobile vaccination centres and engaging local actors.**
Unmet medical needs are high for population living in deprived areas, for those not covered by the public health insurance and for Roma.	Improve access to healthcare services in underserved areas, notably by hiring more community nurses and developing telemedicine. Give all residents full access to prevention and primary care services
The coverage and generosity of social assistance are low. Policies to address social exclusion are fragmented, especially those targeted at Roma. A reform of social assistance is envisaged under the Recovery and Resilience Plan.	Expand the provision of integrated social assistance services. Increase the coverage and adequacy of social assistance benefits.
Disadvantaged schools receive too little financial support. A reform of schools' funding mechanisms is envisaged.	Revise the funding formula for schools, taking into account the socio-economic vulnerabilities of pupils.
The energy mix is highly dependent on coal, while the share of renewable energy, excluding biomass, is still low.	**Increase investments in renewable electricity generation such as wind and solar, by extending support to new installations.**
Exposure to very high levels of air pollution and the related number of premature deaths significantly exceed OECD averages. Burning of solid fuels for heating and cooking is a big contributor.	**Expand support to households to transition away from polluting stoves and improve isolation of buildings.**
Financial incentives to prevent or reduce environmental damage are too low.	Set tax rates on vehicle and energy use at a level that better reflects the environmental damage they generate. Extend the coverage of the carbon tax to non-EU ETS sectors and harmonise its level, while providing compensation for poor households and developing public transport infrastructure.

Tackling corruption	
Political pressure on the National Anti-Corruption Directorate has weakened fight against corruption.	**Provide the National Anti-Corruption Directorate the necessary resources, authorised power and independence to conduct investigations.**
Investigating members of Parliament is complicated by the lack of a clear definition of conflict of interest.	Provide guidance for the identification and management of conflicts of interest for members of Parliament.
Effective enforcement mechanism of the public integrity standards is missing.	Strengthen the enforcement of public integrity standards, notably by consolidating procedures.
There are no rules on how members of Parliament engage with lobbyists.	Introduce a code of conduct for the engagement of members of Parliament with lobbyists.

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2 Strengthening the business environment for productivity convergence

Sahra Sakha, OECD

Yosuke Jin, OECD

While Romania's speed of convergence to the average income levels of the OECD has been impressive since the early 2000s, significant gaps to higher income countries remain. This mostly reflects the poor performance of domestically-oriented firms, with a large and increasing productivity gap between exporting firms and domestically-oriented ones. To reinvigorate productivity growth in the domestic business sector, structural reforms are needed to address three main policy challenges. Firstly, regulatory barriers to firm entry, especially in professional services, are high and governance of SOEs is poor. Removing impediments to competition and promoting better governance are vital to boost productivity growth. Secondly, reforms to reduce inefficiencies of the insolvency regime and the judicial system are urgently needed to facilitate the exit of non-viable firms and restore a dynamic business environment. These challenges have become even more imminent following the COVID-19 crisis, which most likely requires some reallocation of activities. Thirdly, poor quality of transport infrastructure exacerbates regional disparities and undermines economic prosperity. Increasing public investment through improved absorption of EU Funds is essential to close infrastructure gaps.

Romania's speed of convergence to the average income levels of the OECD has been impressive over the past decades, boosted by significant policy reforms related to EU accession in 2007 (see Chapter 1). Privatisation and restructuring of state-owned enterprises (SOEs), regulatory and judiciary reforms, and access to EU structural funds contributed to high productivity growth. Between 2010 and 2019, labour productivity growth averaged 3.5% in Romania, while the OECD average was 1.0%. Moreover, the opening of Romania's economy to international trade, its integration into global value chains, and increased foreign direct investment (FDI), particularly in manufacturing and knowledge-intensive services (i.e., Information and Communications Technology (ICT) sector), contributed to productivity growth by bringing in new technologies, modern processes and access to external markets (Altomonte and Pennings, 2009; World Bank, 2018). The Romanian ICT sector considerably grew over the past 10 years, accounting for 7.0% of gross value added in 2020 (up from 4.4% in 2010) or EUR 13.8 billion.

While Romania's productivity growth has been strong, significant gaps with higher income countries remain. Romania is at risk of falling into the middle-income trap, according to which economies stagnate and fail to graduate into the ranks of high-income countries (Aiyar et al., 2013). Despite the rapid expansion of knowledge-intensive sectors, like many emerging markets, the Romanian economy retains a dual structure. Innovation is concentrated among multinational firms with high integration in global value chains. Those high-productivity firms coexist with low-productivity domestic (including informal) firms. This poses a challenge to further productivity growth due to the weak capacity of domestic firms to absorb technology, despite the large presence of multinational firms. Following the COVID-19 crisis, the digital transformation of the economy has accelerated, which can be an opportunity to boost investments and productivity, but a challenge for laggard firms that will be at the risk of lagging further behind if they fail to adopt technologies (OECD, 2021a). In this context, the necessity to strengthen market discipline and the reallocation of resources across firms has become all the more important.

Key measures to lift productivity growth are essential to boost economic prosperity. In this context, the chapter investigates recent trends of Romania's productivity performance. It then examines policy reforms to lift the performance of the business sector. Policies that promote favourable business dynamics, allowing productive and innovative firms to thrive, such as competition policies, access to finance, judicial system and insolvency regimes are crucial in this regard. Better transport infrastructure plays a critical role in the transition from a middle- to high-income economy as it addresses social and territorial imbalances and improves enabling conditions. Labour market policies that increase employment, influence incentives for workers or firms to invest in training, and improve the quality of job matches, also affect labour productivity and are discussed in Chapter 3.

The business sector in Romania: a dual structure with slowing productivity growth

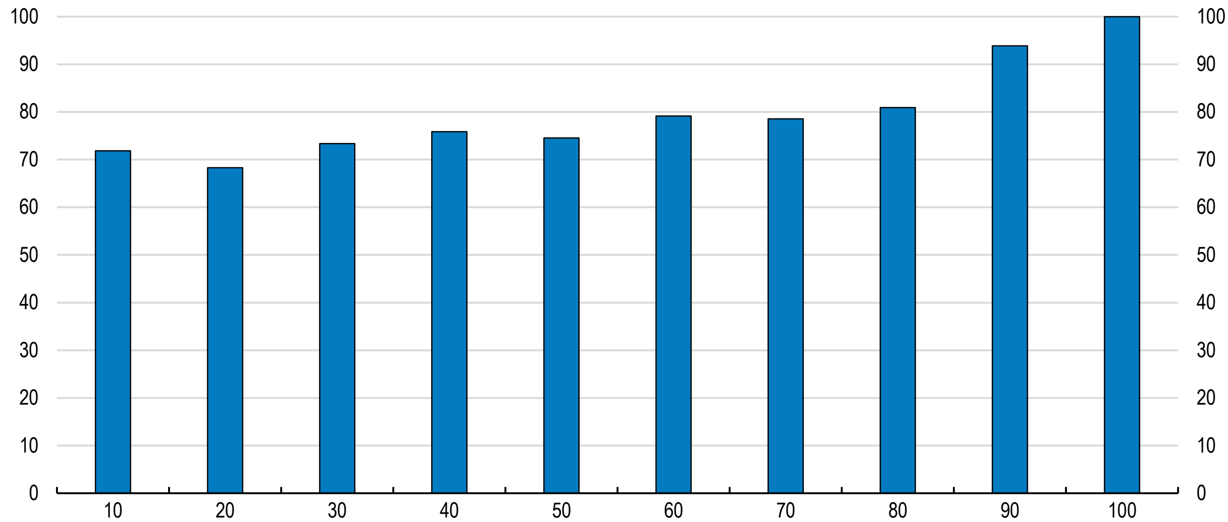
Firm-level evidence shows duality between domestic and international firms

Starting from the mid-1990s, the Romanian economy underwent major structural transformations from heavy industries to manufacturing and services. Romania has attracted large FDI flows since the EU accession, which were directed to large multinational companies and boosted highly-productive sectors such as the ICT sector. Multinational enterprises mainly contribute to the ICT sector, as they account for 73% of total revenue in the sector. In contrast, the vast majority of local firms are small, domestically-oriented and unproductive. In addition, the size of the shadow economy is large, estimated to be roughly between 26-30% of GDP, which limits growth and productivity performance (Medina and Schneider, 2018).

Most of Romanian firms are small and their productivity is low on average. Out of 501 974 total companies operating in Romania, 99.7% were SMEs (0-250 persons employed) in 2018, which is similar to the EU average, according to Eurostat's Structural Business Statistics. However, the shares of small firms (10-49) and medium sized firms (50-249) in Romania are almost 1.5 times and twice as high as the EU average. Their productivity is considerably lower than that of large firms (Figure 2.1).

Figure 2.1. Larger firms are more productive

Median labour productivity by size distribution, index (highest decile) =100, 2015



Note: The figure shows the median labour productivity of firms in different deciles of the firm size distribution in Romania. The X-axis shows the firm size distribution and the Y-axis the median labour productivity relative to that of the highest decile.
Source: Authors' calculation using the 6th Vintage of the CompNet database, full sample.

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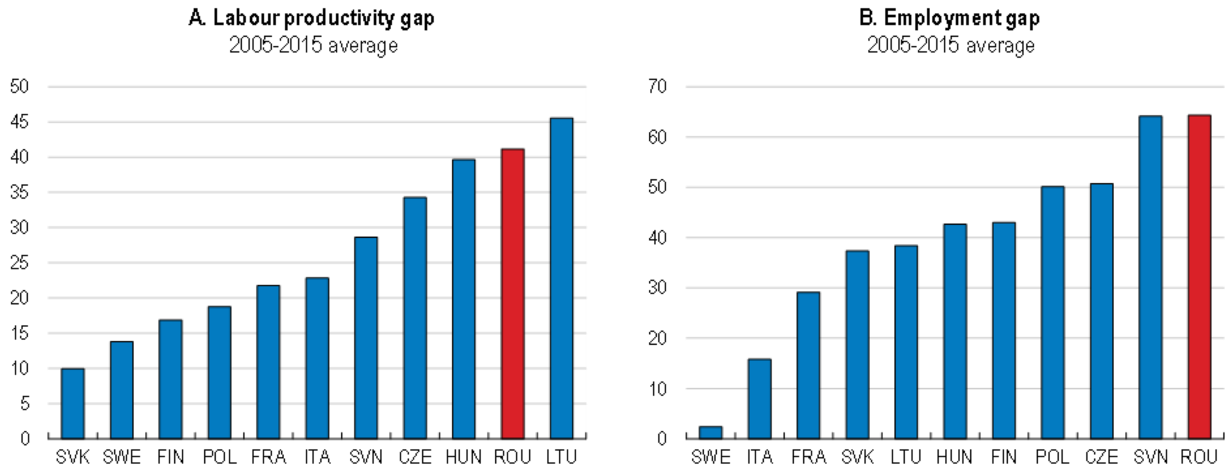
The Romanian economy portrays a dualistic feature between domestically-oriented and exporting firms. Romania's economy is open, as the trade-to-GDP ratio has risen to 85% in 2019, up from 48.5% in 2000, with around 85% of exports going to the rest of the EU (see Chapter 1). However, the share of exporting firms remains low in Romania. For instance, the share of exporting firms with at least 20 employees in the manufacturing sector stands at 31.8%, much lower than in peer countries such as Slovenia (84.8%), Slovakia (81.0%), Estonia (74.7%), Poland (61.2%), and Hungary (48.1%) (Berthou et al., 2015).

In contrast, exporters are substantially larger and more productive (Figure 2.2). A large share of employment (53%) and value added (69%) is generated by large exporting firms (Berthou et al., 2015). Between 2005 and 2015, exporters were 40% more productive than non-exporters in Romania, a higher gap than many other EU and peer countries (i.e., Poland, Slovenia). They were also 60% larger and are 10% more capital intensive compared to purely domestic firms over the same period, which in turn reflects a better allocation of resources, contributing to raising aggregate productivity (National Bank of Romania, 2016).

Despite EU market integration, benefits in terms of technological and knowledge spill-overs have been limited. Romania's domestically-oriented firms are still smaller, less integrated in global value chains, less capital intensive and tend to specialise in low value-added activities (Altomonte and Pennings, 2009). These characteristics limit their capacity to absorb technology diffusion, making them difficult to make the most of the openness of the Romanian economy and the presence of many multinational enterprises in Romania.

Figure 2.2. Exporters are larger, more productive, and capital intensive than domestic firms



Note: In Panel A, labour productivity gap in % is calculated as log differences in labour productivity of exporters and non-exporters in the same industry between 2005 and 2015. In Panel B, employment gap in % is calculated as log differences in the number of workers of exporters and non-exporters in the same industry between 2005 and 2015. Industry-level values are transferred to the country-level by taking simple un-weighted average over industries. Industries defined at NACE 2-digit level.
Source: Authors' calculation using the 6th Vintage of the CompNet database, 20E Sample, Trade module.

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A significant share of domestic firms is still state-owned

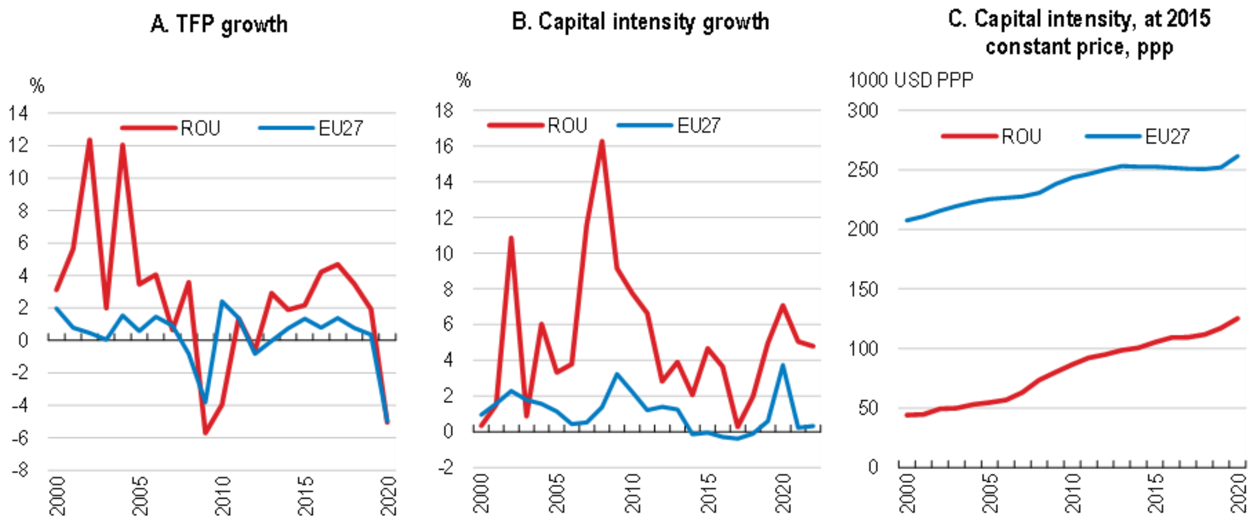
The prevalence of state-owned enterprises (SOEs) continues to be important in the Romanian economy. At the end of 2018, there were 225 central-government-owned SOEs (down from 247 in 2013) and a total of 1 231 local-government-owned SOEs in Romania, the majority operating in the energy and transport sector (European Commission, 2015; World Bank, 2020). In terms of the employment share and equity valuation, Romania's SOE sector is higher than in some of its OECD peer countries, most notably the Baltic countries, but lower than in Poland and Slovenia for instance (IMF, 2019a).

The vast majority of SOEs are heavily indebted with poor profitability, although some SOEs are highly profitable (World Bank, 2020). The companies generating the largest profits are all in the energy sector, while companies in the transport sector are generating the largest losses and receive the largest share of subsidies. In addition, Romania's SOE-dominated transport sector seem to deliver poor output quality, ranking bottom of other emerging economies (Böwer, 2017). The prevalence of so many SOEs reduces aggregate productivity as it can distort the allocation of productive resources across firms (Hsieh and Klenow, 2009; Bartelsman, Haltiwanger and Scarpetta, 2013). It can deter market entry and expansion of young firms, diffusion of technology and, thereby, long-run aggregate productivity and welfare (IMF, 2019a).

Productivity growth slowed down in the 2010s

Romania's growth performance has been underpinned by strong factor accumulation and productivity growth (Figure 2.3, Panel A, Panel B). Both capital intensity and total factor productivity have grown stronger than in other EU countries. However, both capital intensity and productivity have slowed over the past decade. As the process of convergence has progressed, one can anticipate a slowdown in factor accumulation. However, capital intensity in the Romanian economy remains far below the frontier (21% of the EU average in 2000, reaching to 48% in 2020: Figure 2.3, Panel C). It is essential to restore the momentum to increase capital intensity, which is key to technology diffusion (OECD, 2019a). Structural reforms, improving the business environment and the quality of institutions, would help to restore such a momentum and avoid the risk of falling into the middle-income trap.

Figure 2.3. The convergence process can be accelerated



Note: Capital intensity is defined as net capital stock per person employed. It is measured in 2015 USD PPP in Panel C.
Source: The Secretariat's calculation based on the European Commission AMECO database.

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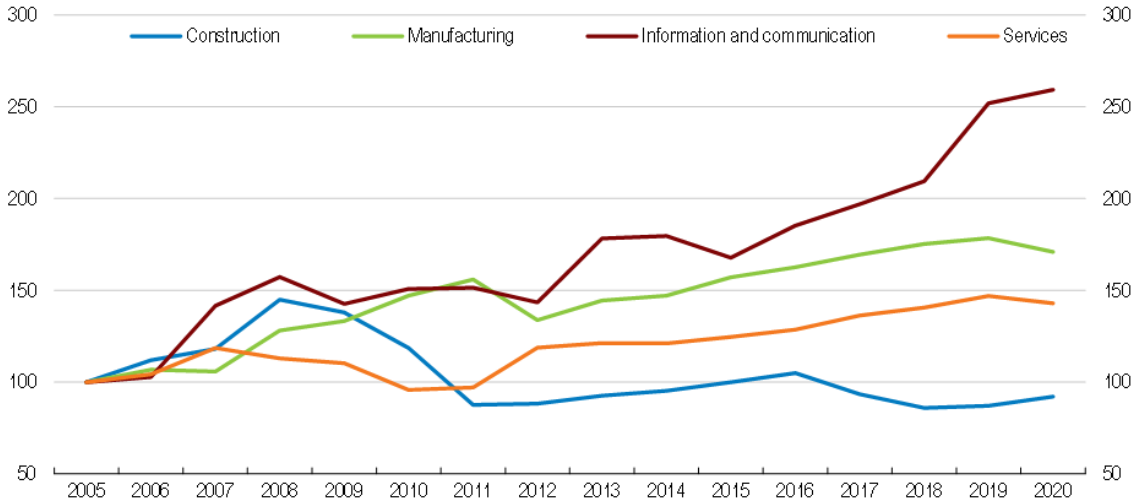
Disparities across sectors and regions are large

Productivity developments have been heterogeneous across sectors (Figure 2.4). It has been particularly strong in the ICT sector, exhibiting positive growth even during the COVID-19 crisis. Both manufacturing and services have grown steadily prior to the COVID-19 crisis, but contracted somewhat in 2020, as these sectors have been adversely hit due to the containment measures. As the economy re-opens after the crisis, productivity growth in these sectors is expected to regain momentum. However, the crisis may have affected productivity developments across sectors disproportionately. Notably, some sectors most affected by physical distancing requirements and associated changes in consumer preferences may be permanently smaller after the crisis (OECD, 2020a). This implies that, unless they adjust employment accordingly, these sectors will face productivity decline while hampering the reallocation of resources, weighing down productivity at the aggregate level.

The rising importance of services in the Romanian economy implies that future overall productivity performance will largely depend on the productivity performance of the services sector. As countries catch up, the share of the service sector contributing to economic growth increases. Services, especially wholesale and retail trade, have been growing in recent years, reflecting strong domestic demand. Services have on average lower productivity growth than manufacturing, related to lower tradability of the services sector and lower levels of automation (Sorbe, Gal and Millot, 2018). This implies that restoring technology diffusion to sustain productivity growth is essential. This bears more importance following the COVID-19 crisis, since the productivity divergence between productive firms and less productive ones risks deepening, due to disparities in the adoption of digital technologies (OECD, 2021a).

Figure 2.4. Labour productivity growth differs across sectors

Index 2005=100



Note: This chart shows the evolution of labour productivity growth computed as real value added per worker (in Euro's) on the aggregate sector level (sectors at 1-digit corresponding to the NACE REV.2 sections).
Source: Eurostat.

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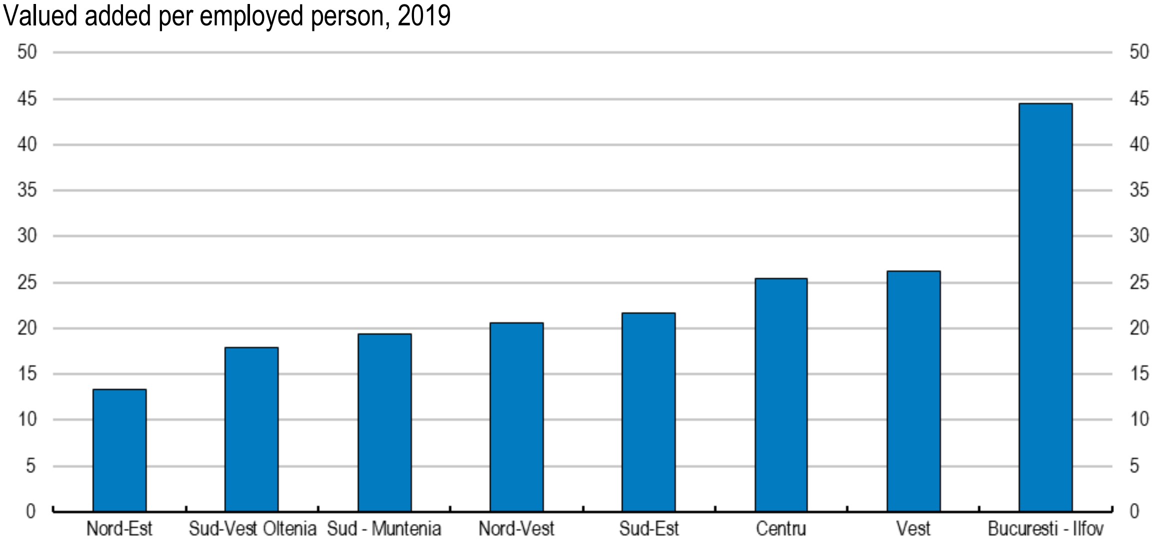
Romania's labour productivity has also been heterogeneous across regions (Figure 2.5). Productivity is high in the *Bucharest-Illfov* region, primarily driven by the knowledge-intensive service sector. The city is hosting the country's top academic institutions and provides a well-developed ICT infrastructure (i.e. high-speed infrastructure), exhibiting the highest research, development and innovation potential in the country. The most dynamic regions, *Nord-Vest* and *Vest,* with a booming ICT sector in cities such as Cluj-Napoca and Timisoara, have outpaced Bucharest in terms of productivity growth. The South West and Eastern part of Romania (*Sud-Vest Oltenia* and *Nord-Est*) are lagging behind in productivity levels. Given shortcomings of the transport infrastructure in many lagging regions, improving connectivity through appropriate transport links between cities and regions is a key priority to reduce regional disparities in productivity.

Figure 2.5. Regional disparity in labour productivity is high

Valued added per employed person, 2019



Source: Eurostat.

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Business dynamism has weakened

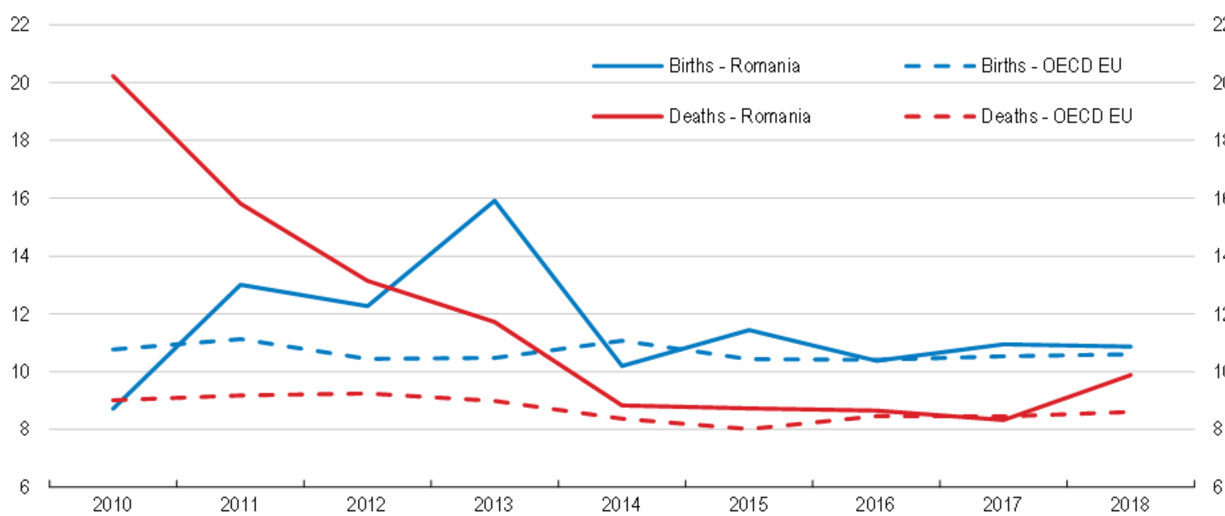
Sizeable productivity differences across sectors, notably in services may be related to the lack of a dynamic business environment, which plays an important role as an engine of productivity growth through the process of creative destruction. It enables new, productive firms to enter the market, grow and replace old, unproductive ones and thereby introduce new ideas and technologies to the market place. Therefore, policies should aim at fostering business dynamism (Bartelsman, Haltiwanger and Scarpetta, 2013; Arnold, Nicoletti and Scarpetta, 2011).

Although the overall firm entry rate is relatively high, the creation of highly innovative firms seems to be low. Firm entry rates in the 2010s were somewhat higher than the EU average (Figure 2.6). However, Romania ranks lower than the lowest-ranked OECD country in the creation of, innovative and tech-intensive start-ups (Figure 2.7), despite the strong performance of Romania's ICT sector and the provision of good digital infrastructure in urban areas. Romania's start-up scene displays high growth potential and has been recently recognised internationally (e.g. Forbes).

In addition, Romania's business dynamism has been declining in the 2010, in particular for firm exit (Figure 2.6). Declining firm exit could be an indication that the selection of the firms at the entry has become increasingly efficient. However, a high survival rate of old firms that are constantly unprofitable and financially distressed suggests that the market selection mechanism is weak. The survival of such firms may further drag down average productivity, since they take up scarce resources at the expense of more productive firms (Adalet McGowan, Andrews and Millot, 2017). A new law was introduced in 2020 (Law no. 55/2020) following the COVID-19 crisis, which has contained a significant rise in insolvency cases, along with other measures such as the moratorium of private loans (see Chapter 1). Going forward, the application of this law should be strictly targeted to those affected by the pandemic in a transitory manner, in order to target those facing short-term difficulties in liquidity due to an unexpected event, distinguished from those truly facing solvency problems.

Figure 2.6. Firm exit has been declining from high levels

As a percentage of existing firms in a given year



Note: OECD EU consists of European countries that are members of the OECD.
Source: Eurostat, Business demography statistics.

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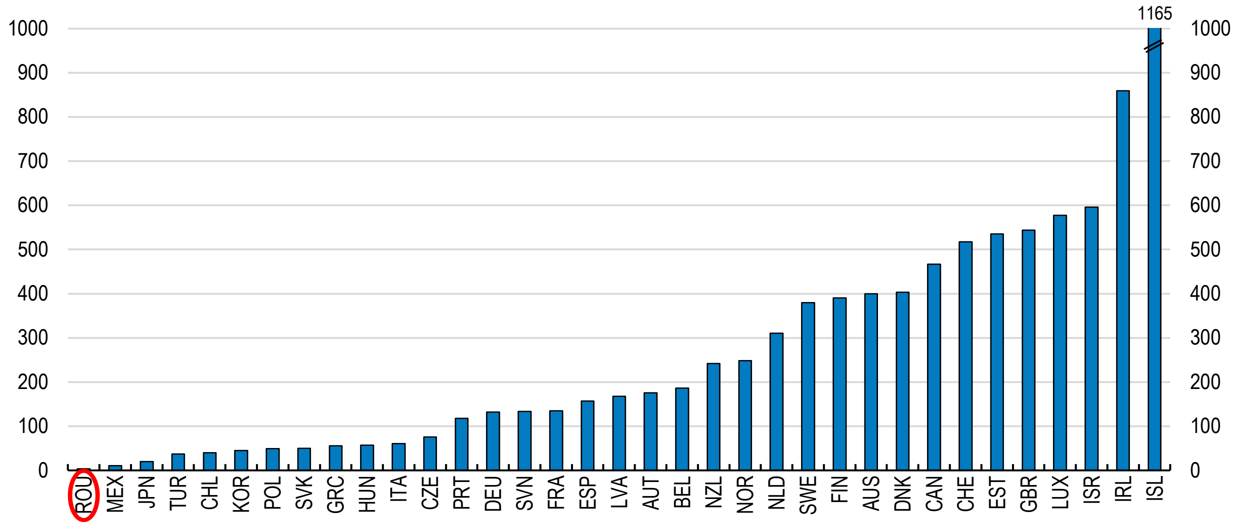
Figure 2.7. High-innovative start-up creation is nascent

Number of start-ups per million inhabitants, 2018



Note: This figure uses data from Crunchbase, a popular online platform that connects venture capitalists with seed stage start-ups. This platform is increasingly used by the venture capital industry as the premier data asset on the tech/start-up world. USA has been excluded from the database due to large sample size.
Source: Crunchbase.

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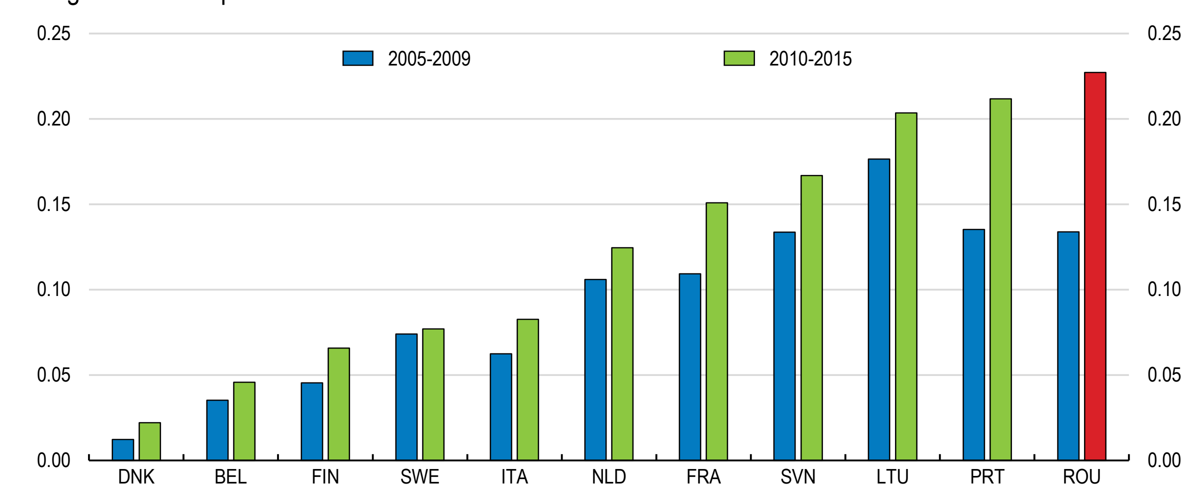
Romania has the highest survival rate of unprofitable firms – defined as firms with negative operating profits for three consecutive years – compared to high-income EU countries and its peers (Figure 2.8). In 2015, 20% of all Romanian firms covered in CompNet (76% of the population of all firms) fell into the category of unprofitable firms. According to the National Bank of Romania, 67 500 companies (31.3% of total 215 900 companies that reported their financial statements to the Ministry of Finance) were loss-making in 2019. Some of them are likely to have made losses continuously over the years. Moreover, 2-3% of firms have reported zero turnover constantly over the past decade, implying a weakness in the exit margin.

Figure 2.8. The share of unprofitable firms is high

Average share of unprofitable firms between 2005-2009 and 2010-2015



Note: Unprofitable firms are defined as firms with negative operating profits for three consecutive years.
Source: Authors' calculation using the 6th vintage of CompNet database, full sample.

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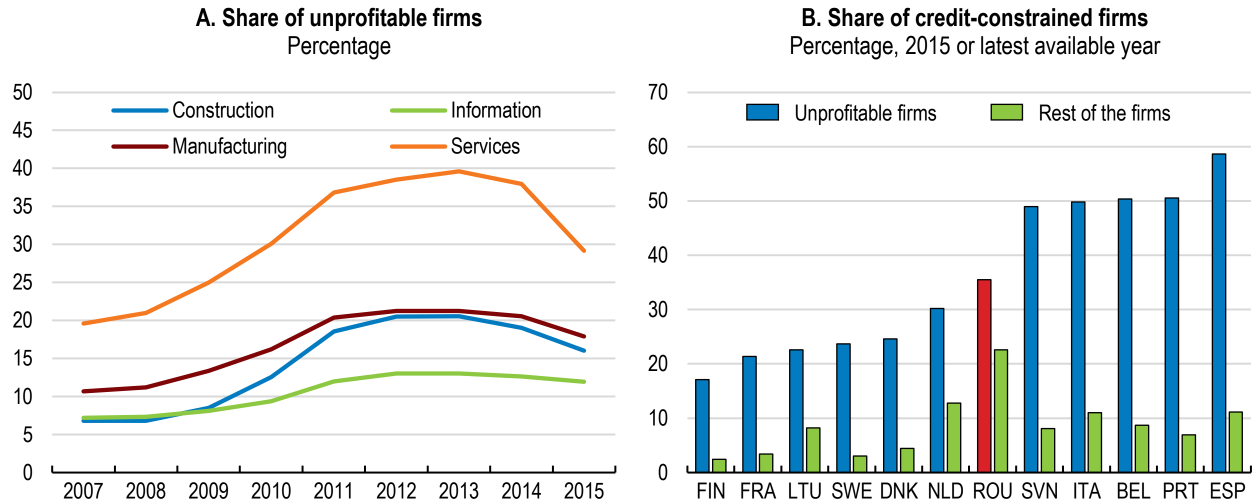
The share of unprofitable firms is substantially higher in the services sector than in the ICT and manufacturing sectors (Figure 2.9, Panel A). The probability of being financially constrained, calculated from their financial position matched with survey data, is higher among unprofitable firms in Romania (Figure 2.9, Panel B). In Romania, the percentage of those firms not classified as 'unprofitable' but still facing financial constraints is higher than in other countries. This suggests that access to finance may be a broader issue.

Figure 2.9. Service sector displays high share of unprofitable firms



Note: Unprofitable firms are defined as firms with negative operating profits for three consecutive years. In Panel B, data refer to 2014 for France, Italy, and the Netherlands. The credit constraint indicator in CompNet is constructed in three steps. First, firms' responses in the SAFE dataset about binding credit constraints is linked with the financial characteristics in the Orbis dataset. Once firms are ranked according to the SAFE score, the next step is to set a time-varying and country-specific threshold value of the SAFE score. After matching responses, several indicators of the financial position of the firm on its probability to be credit constrained is estimated using a probit model. The third step is to use the coefficients of the estimated probit regression to compute a predicted constrained score for the firms in the CompNet dataset, depending on the value of their financial position indicators.
Source: Authors' calculation using the 6th vintage of CompNet database, full sample.

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Access to finance is uneven

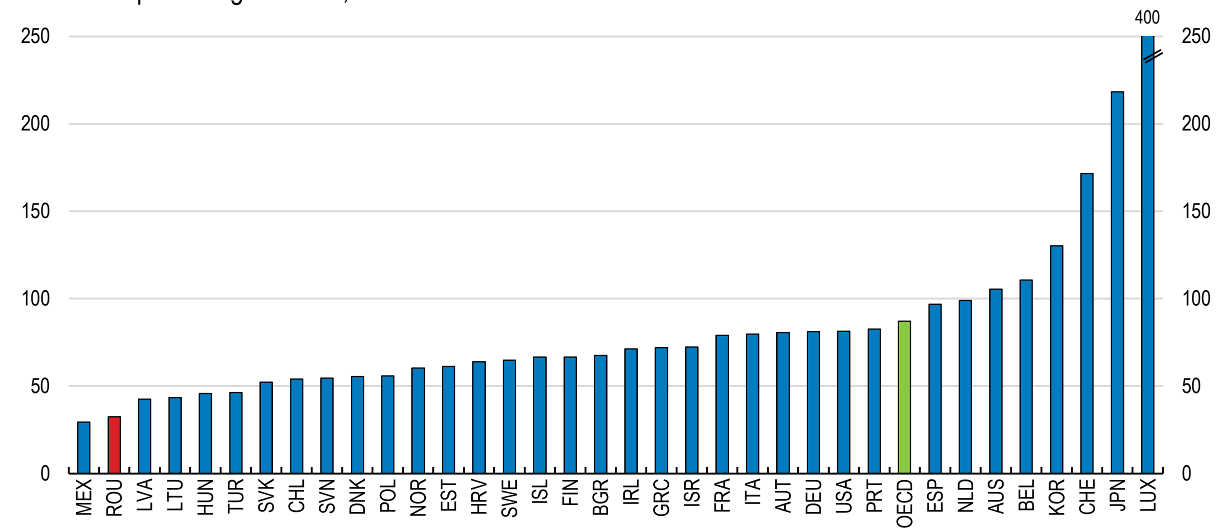
Overall, access to finance remains limited. This mainly relates to low financial intermediation (Figure 2.10), affecting particularly SMEs in rural areas. The financial sector is dominated by banks, which accounted for 76.1% of financial assets in 2020. Following the COVID-19 crisis, the credit standards were tightened in particular for SMEs and have been eased at different paces between large firms and SMEs (National Bank of Romania, 2021). The credit standards were expected to be easier for large firms in the latter half of 2021. Market-based financing remains underdeveloped despite considerable reform efforts from the Financial Supervisory Authority to increase transparency and ease market access (OECD, 2021b). Finally, private equity, an important pillar in the early-stage start-up ecosystem, represented notably by business angels and venture capital funds, is still nascent.

At a first glance, access to finance does not seem to be a major impediment to the business sector. Large and foreign-owned companies are not credit-constrained because they are able to borrow directly from abroad. SMEs in general do not report financing difficulties, in particular as they resort less to bank financing than larger corporations and rely more internal finance (National Bank of Romania, 2020).

However, SMEs in rural areas and early stage high-tech start-ups seem to have difficulties in obtaining external finance, driven by several demand and supply side factors. On the demand side, it has been reported by international and domestic banks that SMEs may rely more on internal finance because they lack the financial and managerial knowledge to successfully attract finance other than debt and that start-ups lack stable revenue and collateral.

Figure 2.10. Access to finance is hindered by underdeveloped financial intermediation

Assets as a percentage of GDP, 2016



Source: World Bank, Global Financial Development database.

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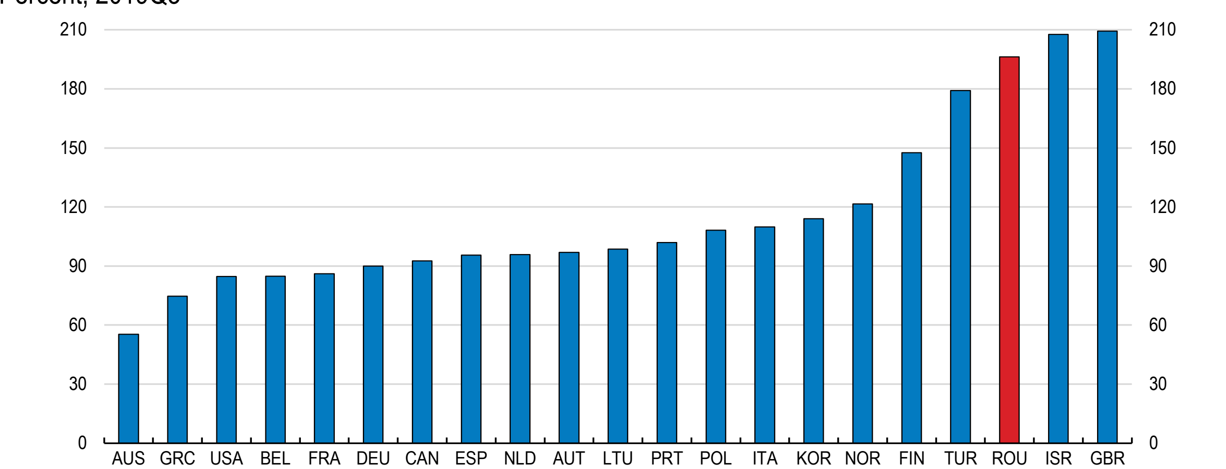
Supply-side constraints to financing are low debt recovery rates, related to inefficiencies in the insolvency regime (see below) and the weak balance sheets of Romanian firms (Figure 2.11). Companies with capitalisation below the regulatory threshold (shareholders' equity should be 50% or more of the difference between total assets and liabilities) account for around 20% of firms in 2019 as reported by the National Bank of Romania. A recent study by the European Investment Bank (Pal et al., 2019) finds that Romania had the second highest share of firms with negative equity within the EU, especially in the microenterprise segment. Moreover, a large share of liabilities consist of intercompany arrears and trade credit. In 2019, 18.4% of total liabilities and equity are trade debt, while loans from banks and non-bank financial institutions were a secondary source (National Bank of Romania, 2020).

Figure 2.11. Debt-to-equity ratios are elevated

Percent, 2019Q3



Source: IMF Financial Soundness Indicators.

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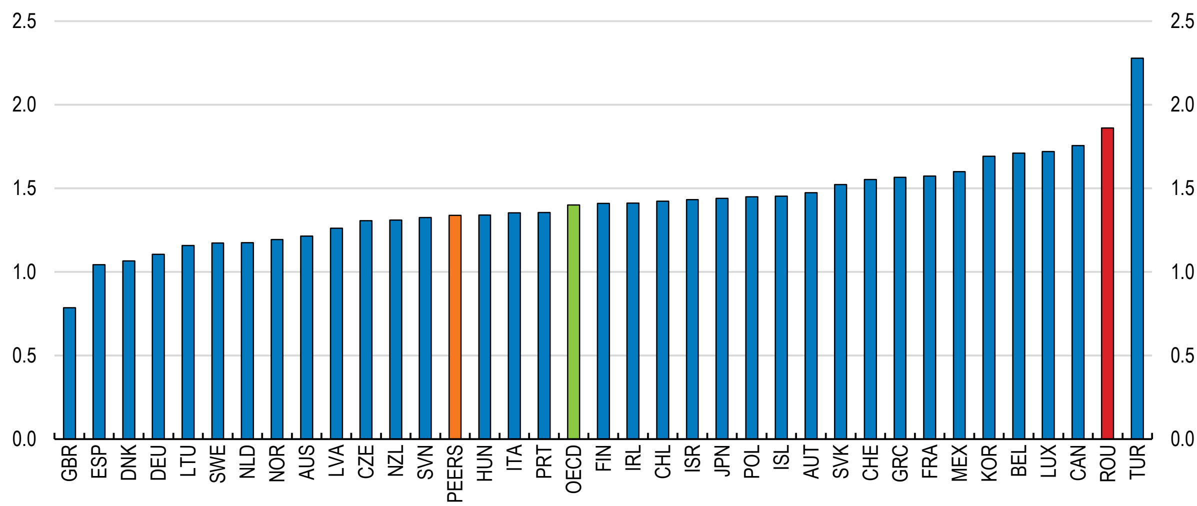
Reducing complex regulatory barriers and state involvement to facilitate competition

Regulatory barriers to competition are high, corporate taxation is low

According to the OECD Product Market Regulation Indicators – measuring the *de jure* competition-restrictiveness of product market regulations across a wide range of countries – Romania tops the list of countries with restrictive product market regulations (Figure 2.12). This hampers prospective firms from entering and growing unimpeded in the market, weighing down market discipline and innovation (OECD, 2015a). Restrictive product market regulation also raises business costs (OECD, 2015a), which can result in higher mark-ups.

Figure 2.12. Product market regulation needs to be improved

2018, index scale 0-6 from least to most restrictive



Note: PEERS comprises the Czech Republic, Hungary, Lithuania, Latvia, Slovakia, Slovenia, and Poland.
Source: OECD (2018), Product Market Regulation Database.

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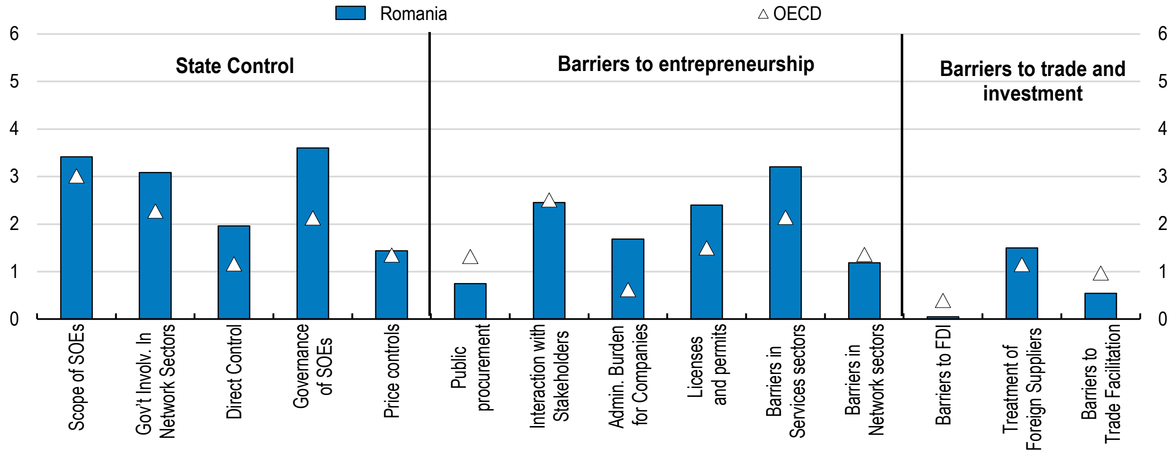
OECD estimates suggest that GDP per capita could increase by 4% in the long run, if Romania were to align its product market regulation to the OECD average (see Chapter 1). The largest benefits would accrue from two pillars, namely reducing state control and improving the governance of state-owned enterprises, as well as reducing barriers to entrepreneurship, especially for professional services, which seem to be particularly high (Figure 2.13). By contrast, Romania's regulatory framework is particularly competition friendly with regard to trade and investment. Barriers to FDI, for example, are substantially below the OECD average (Figure 2.13). In addition, EU citizens have the same propriety rights as Romanian nationals.

Figure 2.13. State control and barriers to entrepreneurship are high

2018, index scale 0-6 from least to most restrictive



Source: OECD (2018), Product Market Regulation Database.

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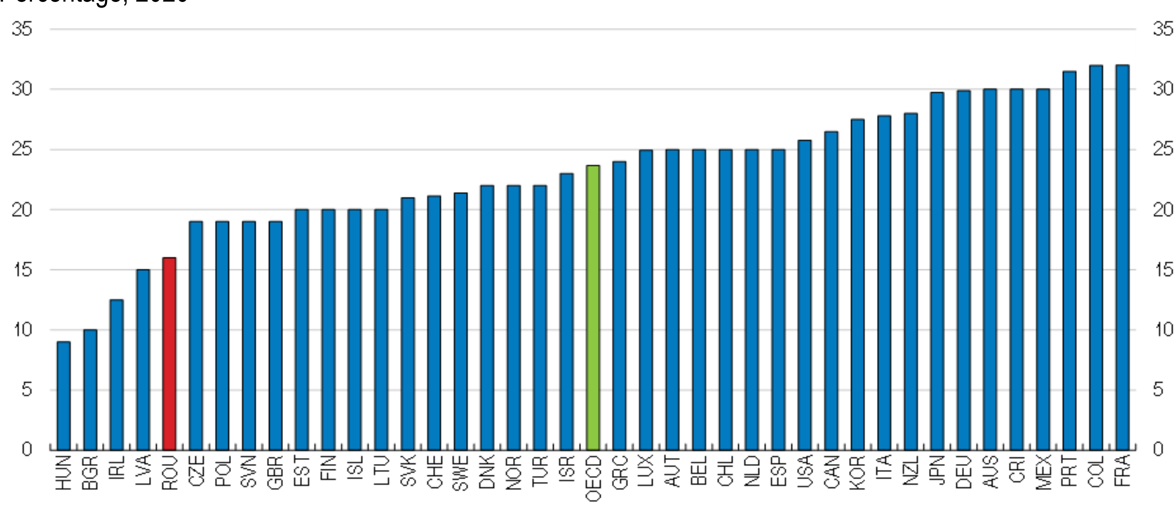
Aside from low barriers to trade, the statutory corporate tax rate in Romania is low by international standards (Figure 2.14). Romania recently introduced a series of measures and exemptions to support SMEs, start-ups and R&D investment. In 2018, the government reduced the special corporate tax rate applying to all microenterprises with one or more employees from 2% to 1% and turnover below EUR 1 million. Until 2017, this was capped at EUR 100 000. A tax rate of 3% applies to microenterprises without employees, provided their turnover is also below the EUR 1 million threshold. Procedures to pay taxes are close to the EU average and have been reduced over the past years (PwC and World Bank, 2018). The authorities plan to revise the taxation of microenterprises, as it is too generous. This plan should be pursued as size-contingent policies, if they are too generous, increase incentives to under-report turnover and profits and reduce firms' incentives to grow and increase their productivity and profitability.

Figure 2.14. The corporate tax rate is well below the OECD average

Percentage, 2020



Note: The corporate income tax rate shows the basic combined central and sub-central (statutory) corporate income tax rate given by the central government rate (less deductions for sub-national taxes) plus the sub-central rate.
Source: OECD Corporate Tax Statistics database.

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While the statutory corporate income tax rate in Romania is business friendly, the proliferation of successively amended special taxes has compounded uncertainty in recent years. The government issued the emergency ordinance in 2018 (GEO No.114/2018), without the consultation of relevant stakeholders and impact assessment. The ordinance contained sizable and distortionary sectoral measures and tax increases, for instance on banks, energy and telecommunications, which triggered a strong response from the affected parties and a negative market reaction. Sectoral turnover tax rates increased from 0.1% to 2% for energy and from 0.4% to 3% for telecoms. While the subsequent revisions repealed the tax on banks assets (see Chapter 1), the turnover tax for energy and telecommunications still remains in place, which may have distorted the market and potentially violate EU competition rules (IMF, 2019b).

Reducing administrative burden and increasing competition in professional services

Efficient business regulation supports firm creation and competition. Economies that have a more efficient business registration process tend to have a higher rate of firm entry and greater new business density (Égert, 2016). For example, Portugal increased the number of entrepreneurs by 17% by introducing one-stop shops in 2005 (Branstetter et al., 2014).

Romania has made some progress over the past years in terms of reducing administrative burden, notably, through the establishment of the National Trade Registry (see below). As they stand currently, however, red tape and complex regulatory procedures for entrepreneurs remain significant in Romania, limiting the incentives to compete and increasing the cost for businesses (Figure 2.13), which can be improved significantly if the planned reforms in the National Recovery and Resilience Plan are effectively implemented (see below).

Romania has already made some progress in reducing administrative barriers by introducing the National Trade Registry to serve as a one-stop shop for starting a business and transferring procedures for registering businesses on an on-line platform since 2012 (European Commission, 2017a). The use of on-line services has increased over time and accelerated significantly during the COVID-19 pandemic, where all services were transferred on-line. According to the National Trade Register Office, approximately 35% of new companies used the online registration platform in 2020, which has increased to 37% in the first quarter of 2021. Corporate tax registration takes place simultaneously with company registration at the trade registry. However, new companies choosing to register for VAT must also undergo a separate procedure with the National Fiscal Administration Agency, which issues the VAT certificate (World Bank, 2017a).

While business registration has been significantly simplified and is increasingly performed electronically, administrative procedures following registration and through business operations remain cumbersome. Licensing obligations – such as environmental or fire safety permits and licences – that can add up to business registration, are currently not integrated into a streamlined procedure. This means that businesses have to obtain licences from multiple public institutions, often having to file paper applications. There is limited exchange of information within the public administration and business is asked to provide the same information to different public authorities. It is difficult to find clear and accessible information on the administrative steps that business and investors have to undertake. Moreover, while Romanian legislation provides for “silence is consent”, which could make the application process more predictable, the policy is not applied systematically, thus leaving business waiting for a decision that is often delivered beyond the statutory required period (OECD, 2022).

The government could improve the business environment by developing and promoting a wider and more consistent use of digital business procedures. This step would require streamlining and simplifying administrative procedures, effectively implementing “silence is consent” policies and enhancing electronic one-stop-shops for all business licensing matters and progressively moving to a single point of contact that effectively serves as the unique interface for all procedures from the registration of a business throughout the life of the business. The burden of dealing with multiple institutions should shift from business to a government co-ordinating body that could co-ordinate back-office procedures. The government could also provide incentives by actively promoting the take-up of online business services. For example, it could offer online registration at substantially lower fees than paper-based registration, while abolishing unnecessary fees altogether. Another important tool is public information campaigns to emphasise the benefits of online registration and overcome any conscious and unconscious bias towards electronic certificates.

The National Recovery and Resilience Plan (NRRP; the Government of Romania, 2021) envisages a number of reforms and investments to improve administrative procedures. These include the introduction of tacit approval, once-only principle asking applicants to provide the same information only once, and the elimination of dual controls and unnecessary renewals for licences and permits. The digitalised platforms that will be set up as part of investments in the NRRP aim to further simplify and reduce the procedures to start and close a business, set up a new one-stop shop for all required licences, and integrate legislative changes on the efficiency and transparency of controls over the activity of businesses (for further details, see the Government of Romania, 2021). As these measures would significantly improve the quality of regulatory procedures, they need to be implemented effectively.

Obtaining construction permits and electricity access is particularly burdensome in Romania and has been frequently mentioned as a major challenge by business representatives. Developers have to consult numerous laws, regulations and websites to identify the documentation required for a building permit application as well as the construction standards they must follow (World Bank, 2020; World Bank, 2017a). The main bottleneck in obtaining electricity connection is the large number of clearances needed from various agencies before the establishment of the connection can start. Romania has a long process for getting an electricity connection, compared to the rest of the EU (World Bank, 2020).

The government should, therefore, urgently reduce the number of regulations needed for construction and electricity connection permits and establish a single focal point for a permit application – a one-stop shop that could coordinate with all the agencies (World Bank, 2017a). Simplification of some of these procedures could be part of an overall business environment reform that would streamline business procedures. Such reform would also reduce difference across the country in terms of speed and ease of processing applications. Expanding electronic platforms throughout the permitting process could also be envisaged to increase transparency and reduce opportunities for corruption.

Despite past reforms by the Romanian Competition Council to reduce entry and price regulations in professional services, access to certain professions and services remains highly restricted by a cumbersome regulatory framework (Figure 2.13). This is the case for accountants, notaries, architects, and estate agents, who are granted a high number of tasks with exclusive rights. Burdensome accreditation requirements apply to lawyers and engineers (World Bank, 2020). Price controls applied to lawyers, engineers, and architects, have also distortive effects on the market. Romania should, therefore, reassess the application of minimum and maximum prices and consider a reform of professional licences to align with OECD best practices (OECD, 2022).

Improving the governance of SOEs

Addressing the underperformance of SOEs requires a strong corporate governance framework. Well-designed governance structures are also needed to address the frequent challenge of undue politically motivated interference in SOEs' activities. The OECD guidelines on SOE governance (OECD, 2015b) provide an international benchmark of best practices.

Corporate governance rules specific to SOEs in Romania were systematically introduced for the first time in 2011 through the government emergency ordinance (GEO) 109/2011 (European Commission, 2015). This represented a major step in the implementation of the better corporate governance practices, and aimed at depoliticising and professionalising the management of SOEs (Romanian Fiscal Council, 2017). Through improvements in corporate governance and increased liberalisation efforts, Romania has been successful in enhancing the performance of some SOEs, especially in the energy sector, which shows the highest profit among all SOEs. However, the government has reversed the course with Law no. 111/2016, implemented in 2018, by significantly reducing the number of SOEs subject to the reform made in 2011. The significant deterioration in profitability and payment arrears in the SOE sector likely reflects this change (Romanian Fiscal Council, 2021). The National Recovery and Resilience Plan aims at improving the governance of SOEs, in particular, by eliminating all the exceptions made by the above mentioned Law no.111/2016, which should be pursued.

Many SOEs, especially in the transport sector, continue to be managed by line ministries or local governments and display low performance (European Commission, 2015). In both cases, the ownership rights (defined as the power to appoint board members, the power to communicate financial and non-financial objectives to the SOEs, and the right to vote the state's share at the annual shareholder meetings) are exercised by the relevant tutelary public authority – either the competent line ministry or the competent local authority –, while the Oversight Unit within the Ministry of Finance monitors the performance of the SOEs. Each line ministry has a department supervising the SOEs under its responsibility.

Such an ownership structure is not an ideal setup for avoiding political interference in the day-to-day management nor to avoid conflicts of interest between the state's roles as enterprise owner and regulator. Moreover, the frequent replacement of management and board members due to changes in ministries, as well as opaque selection procedures for managers and board members, continue to hamper efficient organisational functioning (European Commission, 2015), including the implementation of infrastructure projects (see below). It creates room for favouritism, especially in the absence of a strong regulatory and accountability framework (OECD, 2019c). In terms of transparency, SOEs are legally required to submit financial and economic indicators to the Oversight Unit, which publishes annual reports on the activities of SOEs on their website. In practice, however, there are SOEs that do not fulfil this obligation, as only 123 out of 146 SOEs that have this obligation sent their reports to the Ministry of Finance. As a similar pattern was observed in the previous years, it is not clear to what extent the sanction provisions foreseen in legislation have been binding.

Enforcement of internationally accepted good practices needs to be prioritised in order to depoliticise and professionalise the management of the SOEs, and improve transparency, accountability, and performance. Changing the governance model from towards a more centralised (or at least centrally coordinated) ownership model could help to improve corporate governance; as this has been done in the last 10-15 years in a number of Western European countries and emerging economies (OECD, 2018). Such a framework would allow to monitor and evaluate SOE performance more easily since it would bring stronger accountability with one body evaluating the performance of SOEs, as opposed to being spread over several different ministries.

The National Recovery and Resilience Plan envisages measures to improve both the governance model of SOEs and transparency. It aims to operationalise the Taskforce at the Centre of the Government for Corporate Governance Policy Coordination and Monitoring by the end of 2022, which will be responsible for ensuring competitive selection procedures for the appointment of administration board members among SOEs, while reducing interim/temporary management board appointments by 50% in SOEs at the central level. The Taskforce will also be responsible for monitoring, evaluating and publishing the performance indicators and enforcing sanctions for SOEs non-compliant with key performance indicators. These measures are expected to improve the performance of SOEs substantially and need to be implemented effectively.

Privatisation efforts have slowed down in recent years. The only major privatisation in the last few years was the sale of the largest chemical company Oltchim, while non-viable assets remained in the ownership of the state (World Bank, 2020). Small and unprofitable SOEs continue to operate without economic or public policy rationale. It is, therefore, important to reassess the economic rationale of these SOEs on a regular basis and consider resuming privatisation efforts, which should be backed up by legislation for investment screening and transparent procedures in order to fend off the risk of corruption.

Moreover, compliance with the performance targets should be closely monitored. Non-compliance should be followed by sanctions of varying severity, ranging from additional reporting requirements to administrative measures imposed on SOE boards. Performance benchmarking of SOEs with private and foreign companies can further inform the monitoring process towards more efficient resource allocation. Among OECD countries, Korea applies a particularly rigorous SOE monitoring system, including customer satisfaction surveys and index-based evaluations, which are seen as key factors for the performance of Korea's SOEs (Park et al., 2016).

Private-sector expertise, international experience, and independent board members are often absent in Romania. For example, Estonia requires board members to come equally from the private and public sectors to secure more private-sector expertise (OECD, 2013) and a number of North European countries have gone beyond this to appoint boards that consist largely or entirely of independent directors. Board members should be evaluated on an annual basis, as is the case in Sweden and the Czech Republic (Regeringskansliet, 2016).

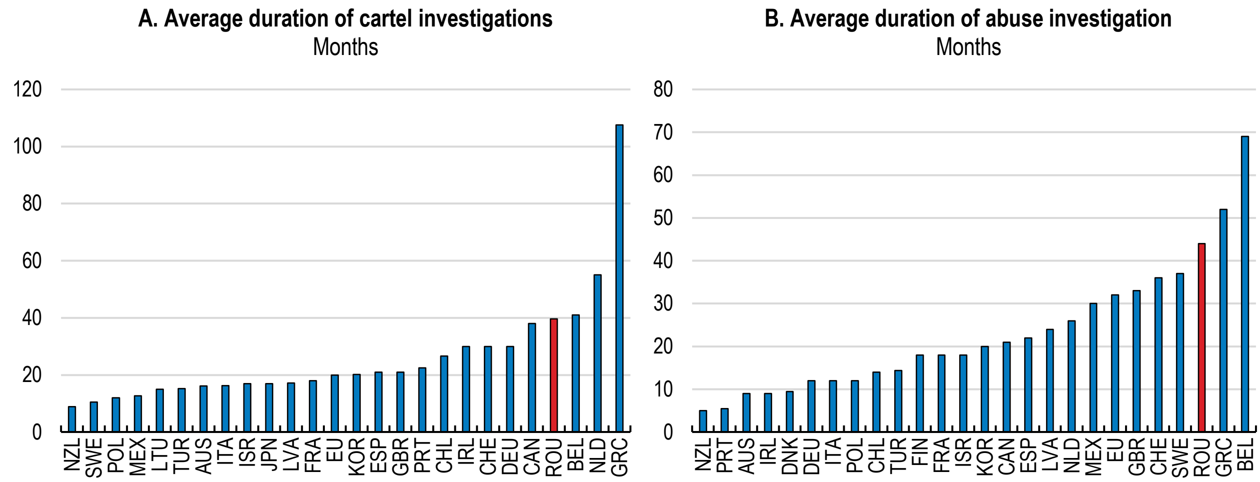
Competition policy enforcement is strong but duration of investigation remains high

The Romanian Competition Council (RCC) has successfully remained independent, despite political pressure over the past few years. It is involved in all competition fields: antitrust enforcement, merger control, advocacy and sectorial inquiries. With 234 competition inspectors and little turnover, the RCC seems also to be well resourced, above many advanced OECD countries (France: 199; Italy: 126) and its peer countries (Poland: 215), according to annual reports by competition agencies to the OECD on recent developments in 2018. They have a number of tools available, among others, the whistle-blower platform – an online tool that enables any person to signal potential anticompetitive deeds, which has been highly successful (Global Competition Review, 2018). The RCC is also reinforcing its cooperation with foreign competition authorities, showing its ability to manage international cases.

The competition authority is considered to be fairly effective and is regarded as an active enforcer (Global Competition Review, 2019). The RCC imposed in total EUR 90 million in fines in 2018 – four times more than in 2017, which itself marked a six-fold increase compared to 2016. Moreover, the RCC challenged three of the 59 mergers that were notified in 2018, higher than in many OECD countries.

Despite strong policy enforcement of the RCC, the average duration of cartel and abuse investigations is still high, although it has improved in the past few years (Figure 2.15). The allocation of cases among staff remains unclear. A more effective prioritisation policy of cases could help to free up time for high impact cases that are generally more complex and time consuming. The RCC spends around 5% of its budget on advocacy, which is low compared to other major competition authorities (Global Competition Review, 2018). Hence, spending on anti-cartel programmes and the continued promotion of leniency procedures leading to partial or total immunity should be increased. The implementation of the European Competition Network Plus Directive on the better functioning of national competition authorities represents a crucial opportunity to further enhance competition enforcement in Romania, which should be fully seized.

Figure 2.15. Duration of investigations remains elevated



Note: The Global Competition editorial team measures and compares antitrust enforcement programmes around the world, combining data supplied by the agencies with their own reporting and the feedback of lawyers, economists and local journalists who interact with competition authorities.
Source: The Global Competition Review 2018.

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Adapting access to finance to companies needs

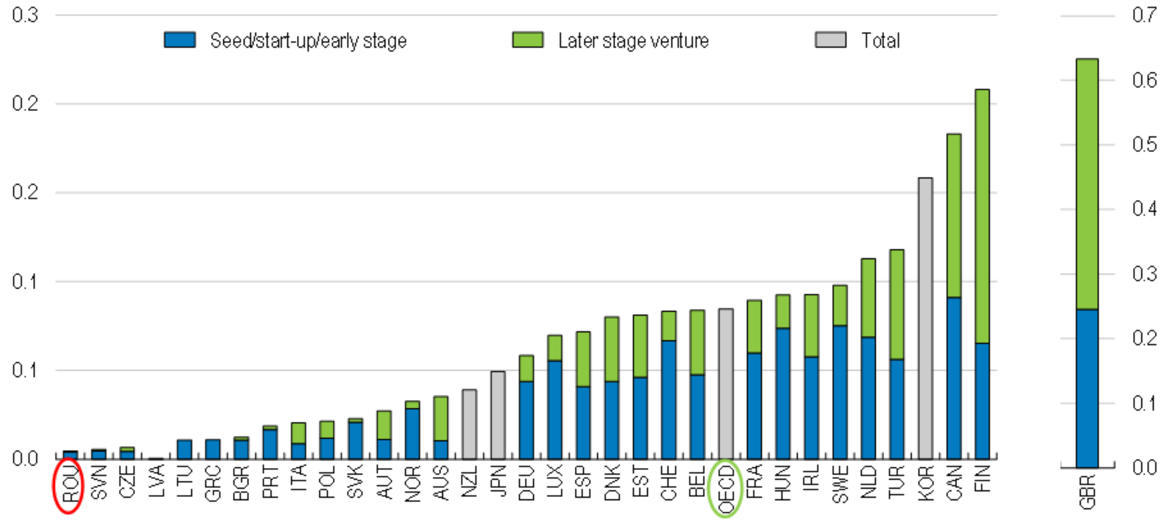
Difficulties in accessing finance are extensively recognised as one of the major obstacles for starting and growing a new business, investing in innovative projects, improving productivity, and financing their growth (Heil, 2018). In Romania, a national government strategy for the promotion of entrepreneurship and direct public support programmes are in place. The 'Start-up Nations' programme is among such support programmes and provides grants (amounting to 0.13% of GDP in 2018). The programme aims to finance business plans by young firms in a wide range of sectors (from information technology to accommodation), and its beneficiaries are selected by the defined criteria such as job creation. The programme has been suspended since 2020, and the authorities intend to introduce a new programme 'Star-Tech Innovation'.

The strategy of the 'Start-up Nations' programme was not entirely clear. For instance, it was not clear if the programme aimed to support start-ups or if this was instead aimed at promoting specific industries. The new 'Star-Tech Innovation' programme is planned to target innovative start-ups. In this case, the programme should address specific market failure such as information asymmetry typically faced by highly innovative start-ups as they are involved in innovation processes with uncertain outcomes. Such a programme should be subject to continuous evaluation in order to ensure that it is strictly targeted to those with high growth potential, Moreover, start-ups do not only require funding, but 'smart money' – mentoring, advice, and network, which can be better supported by fully rolling out the other existing programmes to promote entrepreneurship and/or by strengthening the relation with private investors through specific funding schemes (see below).

The lack of innovative high-tech start-ups (Figure 2.7) can be linked to the lack of business incubation and acceleration provision in Romania (Figure 2.16). The authorities can consider setting up a public capital fund to co-finance private investors as is commonly found in OECD countries (OECD, 2015c). Such a scheme makes the most of the expertise of private investors with less risk of crowding them out from the market. Alternatively, if they find there are no relevant private funds in the market, such a public fund can finance entrepreneurs directly. There is a successful example in Chile, which has established a public venture capital fund pursuing a long-term vision (Box 2.1).

Figure 2.16. Early stage start-up funding needs to be promoted

% of GDP, 2020 or latest year available



Note: 2019 data for Australia, Japan and the United States.
Source: OECD (2021), Venture capital investments (database).

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Box 2.1. Example of public VC fund: Start-Up (SUP) Chile

Taking exit through acquisition as a measure of success, almost all of the top 10 successful start-up accelerators around the world are private. The exception is Start-Up Chile (SUC) which was launched in 2010 by the Chilean government. SUC is currently regarded as one of the most successful government-led start-up accelerator programmes in the world, with an overall survival rate of 54.5%. In contrast to many government-led funds, it is open to start-ups from other countries. Companies from 85 countries have participated since 2010. Another crucial factor for its success is that SUC's goals were long-term oriented, hence not tied to valuations and sales in the short-term but to create a dynamic entrepreneurial ecosystem. Another important aspect was its private-public structure making it less susceptible to changes in the government or policies. Interestingly, it includes a special programme for female-founders. There are three distinct programmes of SUC:

S Factory is a pre-acceleration program for start-ups in early concept stage for female founders from all around the world. Selected start-ups receive around USD 14 000 equity free and 4 months acceleration (i.e. seed investment, connections, mentorship, educational components) that culminate in a public pitch event. After the 4 months, successful start-ups may apply for the seed programme. There are two application rounds per year, selecting 20-30 high potential female founded start-ups in each round. Instead of establishing a gender quota for the accelerator, SUC decided that a supported programme for less experienced female entrepreneurs would have a stronger impact on changing the low female-founded start-up ratio.

Seed is an acceleration program for start-ups with a functional product and early validation. Selected companies receive around USD 30 000 equity free and 6 months acceleration. There are two rounds per year, selecting 80-100 companies in each round.

Scale is the final programme funding top performing start-ups. Selected companies must have passed through the Start-Up Chile seed program initially. They receive around USD 86 000 equity free. There are two rounds per year of 20-30 companies in each round.

Source: https://www.startupchile.org/; (Lassébie et al., 2019).

Microcredit fills a market gap by providing finance to disadvantaged individuals in less accessible areas aiming to start a business. The microcredit sector in Romania is diverse and fragmented, consisting of more commercially oriented micro-finance institutions. The Romanian Microcredit Facility, established 15 years ago, extends loans to microfinance institutions at attractive terms, rather than directly lending to borrowers, and microfinance institutions in turn lend to borrowers (the "on-lender" approach). This approach is effective as long as microfinance institutions cannot raise funds at reasonable costs. A recent assessment by Pop and Buys (2015) notes that the provision of microcredit is highly concentrated within more developed regions where in theory private institutions are able to raise funds in better conditions. The Romanian Microcredit Facility should be assessed in its role and activity and restructured accordingly if necessary.

As part of the National Recovery and Resilience Plan (NRRP), the National Development Bank will be set up and operational as of 2025. According to the NRRP, the Bank will pursue a wide range of objectives from facilitating access to finance for SMEs to funding infrastructure projects and improving the absorption of EU funds. However, at this stage it is not clear what mandates will be attributed to the Bank. If its mandate is to support SMEs generally, it needs to be tailored to their financing needs, which can be done either through the "on-lender" approach or through public guarantee schemes. In both cases, its mandates would need to be articulated with the existing programmes such as the Romanian Microcredit Facility and IMM Invest (introduced as an emergency measure against the COVID-19 crisis, see Chapter 1). If it is mandated to support strategically important areas, strong accountability will be required to explain how investment projects are selected and how the outcomes of its support to investment projects are assessed, thus justifying public support.

Improving judicial efficiency and insolvency regimes to enhance business dynamism

Long duration of bankruptcy cases and unpredictability of case outcomes affect judicial efficiency

A well-functioning judicial system, including a well-designed insolvency regime, is crucial to the allocation of resources and business activities: it enhances the economy's ability to dispose non-viable firms and facilitate the restructuring of viable ones. It also ensures contract enforcement and facilitates debt resolution, especially in the Romanian context, where many firms have a weak balance sheet structure (high leverage and low equity base). Empirical evidence shows that slow court resolution diminishes the efficiency of credit markets (Fabbri, 2010; Jappelli, Pagano and Bianco, 2005). Other dimensions of judicial efficiency, such as the low predictability of case outcomes, weak incentives for judges (Miceli and Coşgel, 1994), inefficiencies in the allocation of court resources (Palumbo et al., 2013) and weak insolvency regimes can also affect case resolution.

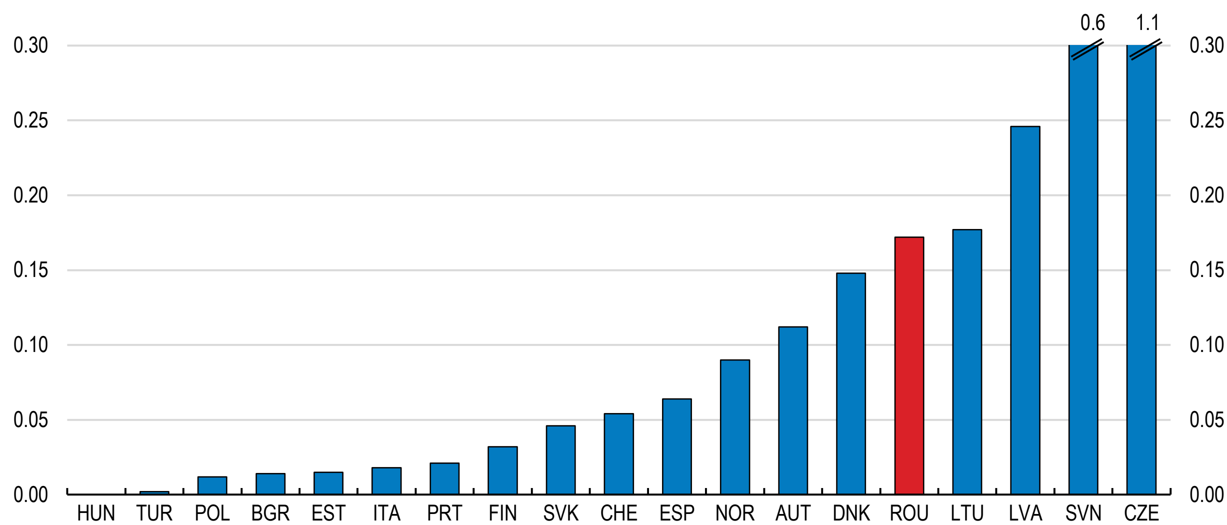
At first glance, Romania shows a below average length to resolve civil and commercial cases before the first instance courts in 2018 (European Commission, 2020). Case resolution, however, differs depending on the type of cases and takes time particularly for bankruptcy cases (including the enforcement process after court sentence), taking 418 days in first instance courts, about 3.5 times as long as civil cases, according to indicators from the Ministry of Justice. The latter indicators also show that the duration of bankruptcy cases has increased between 2016 and 2018, while the resolution trend for civil matters and business cases has remained stable or reduced slightly. Slow resolution of bankruptcy cases is also an issue identified by the European Commission for the Efficiency of Justice (Figure 2.17).

The average duration of insolvency proceedings is long (3.3 years), compared to peer countries (2.2 years) and the OECD average (1.8 years). While the cost of insolvency proceedings is close to the OECD average, the recovery rate is very low and stands at 34.4%, compared to the OECD average of 67.3%, but also below the peer average (55.8%), indicating inefficiencies in the Romanian corporate insolvency regime and its effectiveness in facilitating the exit of non-viable firms (Figure 2.6).

The resolution rate of bankruptcy cases differs across courts (Figure 2.18). Some courts have a higher resolution rate, even if the stock of judges' cases is higher. For instance, Bucharest has a higher resolution rate than Covasna or Giurgiu, even though in Bucharest each judge had an average of almost 800 insolvency cases. It seems to indicate that some courts are more efficient than others, although information on the complexity of cases is lacking.

Figure 2.17. Case resolution for bankruptcy is slow

Number of pending cases per 100 inhabitants, as of December 31, 2018



Source: European Commission for the Efficiency of Justice (CEPEJ).

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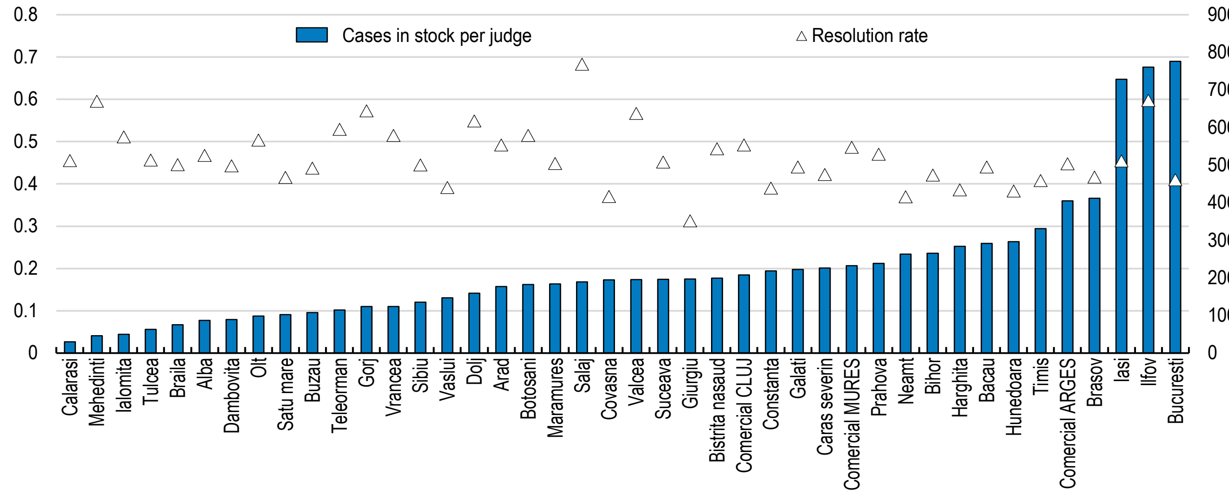
Litigation is frequent in Romania as it had among the highest litigation rate in first instance courts across Europe in 2018 (Figure 2.19). Businesses have repeatedly expressed concerns over the unpredictability of case outcomes, which may have an impact on litigation. For instance, plaintiffs who have weak cases and good information about the likely negative outcome would be more reluctant in taking their cases to court, as they might expect to lose the case. However, if the court outcome is unpredictable, they might decide to bring their cases forward anyway, as there may be some chance of obtaining a favourable outcome.

Figure 2.18. The resolution rate differs between courts

2017



Source: Ministry of Justice.

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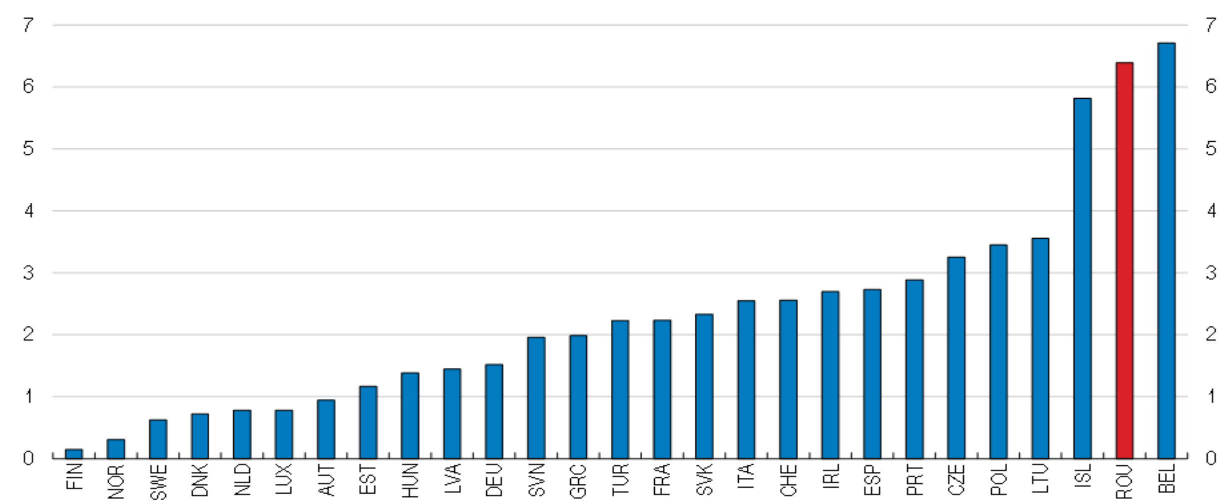
Figure 2.19. The litigation rate is high

First instance courts, per 100 inhabitants, 2018



Source: CEPEJ.

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Making the corporate insolvency regime more efficient

The corporate insolvency law (Law 85/2014) includes modern provisions based on international best practices (World Bank/IMF, 2018), but implementation remains a challenge. The insolvency proceeding ends up with reorganisation or liquidation. In Romania, reorganisations are rare as only 1.2% of companies ended up in reorganisation in 2013, according to the Romanian Association of Banks. Companies enter insolvency proceedings at a late stage, when they are clearly in distress making reorganisation difficult. Small family-type SMEs are even more reluctant to enter into insolvency proceedings. The reasons are manifold, but generally the fear of stigma and bankruptcy is high, as 56% of entrepreneurs report such fear in comparison with 43% in the EU (European Commission, 2013). The fear of stigma and bankruptcy prevails in spite of the possibility of a fresh start directly after bankruptcy (i.e. immediate discharge from debt repayment obligation). The situation can be improved by addressing some specific issues in the insolvency regime, for instance, by introducing early warning tools and developing out-of-court settlement schemes.

Generally, insolvency regimes should encourage debtors to take appropriate actions early on without barriers to initiate insolvency proceedings (Adalet McGowan and Andrews, 2016). In Romania, insolvency proceedings can be initiated by both the creditor and the debtor. A new law in 2020 removed the restriction that the debtor cannot initiate the insolvency proceedings if 50% of tax claims are outstanding to public creditors, which is a welcome development. While firms, in particular SMEs, often cannot perceive worrying signs related to their business at early stages, early intervention is facilitated by early warning tools as found in more than half of the OECD countries (Adalet McGowan and Andrews, 2018). Romania should introduce early warning tools by transposing EU Directives on the Restructuring and Second Chance as soon as possible.

Insolvency proceedings are lengthy. Once the debtor or creditor initiates the insolvency proceedings, the observation period starts. A judge who is specialised in insolvency cases notifies the relevant parties (i.e. the debtor, creditors and the National Office of the Trade). The judge will also nominate a judicial administrator who is in charge of producing a preliminary table of creditor's claims, including their value and priority. All measures taken by the judicial administrator can be challenged in court by creditors and debtors, including the table of creditors. Once challenged, it will again go to the judge, extending the observation period and resulting in long delays, which is restricted to the time limit of 1 year. Moreover, court hearings are scheduled with an approximately 4 month interval, adding to the delays in insolvency cases, which should be shortened to ensure a faster resolution.

Romania includes reorganisation tools regarded as best practices. For instance, debtors can obtain a stay on assets during the restructuring period and continue firm operation. Moreover, unanimous vote by all creditors to agree on the restructuring plan is not required (i.e. possibility of a cram down on dissenting creditors). While priority rules are in place for creditors (i.e. secured vs. unsecured), dissenting creditors within the same priority group are treated equally, which is a best practice (Adalet McGowan and Andrews, 2016). Nonetheless, recent amendments in the insolvency regime in 2018 through emergency ordinance are a concern, since they provide tax creditors a super-priority rank to claim their assets over other creditors. This superpriority creates little incentive for the tax authorities to participate in debt restructuring, often prolonging insolvency proceedings significantly, and prevents other creditors from claiming the value of investments in case of liquidation, which is also found in OECD countries (for example in Spain; OECD, 2021c). This is one of the main challenges of the restructuring process that insolvency practitioners and other stakeholders report in Romania as well. The government should revise these amendments. The deterioration of assets, due to delays in insolvency proceedings, results often in the liquidation of businesses and bankruptcy of entrepreneurs, in which case the tax authorities cannot claim their rights anyway, making all the parties worse off.

Courts are involved at different stages of both liquidation and restructuring proceedings, such as launching the insolvency procedure, the appointment of the insolvency practitioner, the confirmation and declaration of the restructuring plan and the pre-insolvency mechanisms. While court involvement is important in guaranteeing the rights of different parties involved, a high degree of court involvement may prolong the exit of weak firms, particularly when the judicial system is not efficient (Adalet McGowan and Andrews, 2016). The government should reduce the court involvement in cases where it is not absolutely necessary, for instance in the pre-insolvency regime. Italy has pre-insolvency regimes in place (*Piano Attestato di risanamento*), which allows the restructuring of the company with a third party expert without court involvement (Deloitte, 2017).

Two in-court pre-insolvency regimes are currently in place to restructure debt, if the debtor has financial difficulties: preventive arrangement (*concordat preventive*) and the ad-hoc mandate. However, these pre-insolvency regimes are not effective and rarely used: between 2009 and 2018, only 89 pre-insolvency procedures have been initiated, out of which only seven were successful. Special fast track insolvency proceedings for SMEs, such as simplified or pre-packaged in-court proceedings are currently lacking in Romania. SMEs may warrant a different treatment from other firms in a debt restructuring strategy as complex, lengthy, rigid procedures and required expertise, may entail additional costs (Adalet McGowan and Andrews, 2018).

Businesses have repeatedly expressed the need for out-of-court mechanisms. Such mechanisms can incentivise debtors to signal their financial difficulties at an early stage, facilitating a speedy and successful restructuring, and reducing the fear of stigma and bankruptcy. Estimates suggest that about 65% of all companies going through an out-of-court procedure in Europe are restructured successfully (European Commission, 2017b). Romania should consider introducing out-of-court mechanisms which have been successfully implemented in a number of countries, such as Austria, Slovenia and Portugal (Bergthaler et al., 2015). A number of countries have introduced simplified procedures for SMEs in their general insolvency regimes, such as Portugal, Germany, Greece, and Italy (Bergthaler et al., 2015).

Making case outcomes more predictable

Frequent changes of the law contributed to unpredictability of case outcomes. Romania has made significant progress in implementing judicial reforms. However, frequent political interference and legislative changes are a concern (Box 2.2). Notably, hundreds of Government Emergency Ordinances (GEOs) have been issued in recent years, raising concerns about their excessive use, lack of transparency and insufficient respect of the rule of law (Council of Europe, 2019). It is imperative to reduce the unpredictability of case outcomes by limiting the use of emergency decrees. Emergency decrees should only be used exceptionally. A proper assessment should be made before implementing new laws in consultation with major stakeholders, to avoid frequent changes and amendments in the law which increase the unpredictability of case outcomes.

Unpredictability of case outcomes may also be related to inconsistency in the judges' decision-making. This can be improved, for instance, by revising the evaluation system of judges. In Romania, judges are evaluated periodically by the Court President and two judges appointed by the Superior Council of Magistracy. Judges are evaluated both on quantitative and qualitative criteria, such as the resolution and duration of cases and the quality of legal documents drafted. The evaluation of judges can take into account the consistency of case-law, which however needs to be balanced against the risk of affecting the independence of judges. Instead, the consistency of case-law can also be ensured at the institutional level. In this respect, the Superior Council of Magistracy, the supervisory body of the judiciary, is encouraged to identify and resolve divergent interpretations of lower courts.

In order to improve the quality of judicial decisions, legal assistance to judges by other professionals can be strengthened. For instance, court fees seem to be complex and judges in Romania report spending unnecessary time reviewing complaints supposedly due to errors in calculating court fees (World Bank, 2017b). Court staff could be in charge of revising these complaints so that judges could devote more time to solving cases. High court congestion can be reduced by reviewing complex rules and by reducing judges' duties other than solving cases.

Box 2.2. Overview of the reform process in the Romanian court system

After the communist period, a new Constitution was established in 1991, leading to a reorganisation of the judiciary under the Law on the Organization of the Judiciary (Law no. 92/1992). However, judiciary reforms in the post-transition period were slow, civil society weak and judges still politically connected (IMF, 2017). Fundamental reforms to strengthen civil society and improve judicial independence were performed in 2003 under external influence (i.e. NATO membership and EU accession). The Judicial System Reform Strategy of 2003 entailed, most importantly the institutionalisation of the Superior Council of the Magistracy (CSM) in order to increase independence of justice, by reducing the involvement of the Executive in the appointment and promotion of judges (Coman and Dallara, 2012). The reform process continued in 2015, including changes to strengthen the independence of judges, to increase the efficiency and accountability of the judiciary, and to separate the careers of judges and prosecutors (Council of Europe, 2018).

In spite of these positive developments, there has been room for political interferences in the judiciary and some achievements have been reversed (IMF, 2017). In 2017, different reforms on the judicial system were initiated, raising concerns about the consequences for the independence of magistrates. These include amendments to changes in the statute of judges and prosecutors, on judicial organisation, on the CSM, and legislative proposals to amend the Criminal Code and the Criminal Procedure Code. These changes were implemented in spite of serious concerns with respect to the implications for the independence of the judiciary (GRECO, 2018; Council of Europe, 2019). Subsequently, these amendments have been or planned to be repealed (see Chapter 1).

Enhancing digitalisation to increase court system efficiency

A relevant policy question is how to improve a judicial system and making it more effective with limited resources, a common concern among countries worldwide. There is no obvious way of doing so, and different policy options, such as increasing spending in the judiciary, the number of judges, increasing salaries, and restructuring the judicial map, resulted in different outcomes. In Romania, the amount of resources in itself does not seem to be a problem, as the number of judges per inhabitant is higher than the EU average (24.6 per 100000 inhabitant versus 21.7) and the court budget as a percentage of GDP is larger (0.27% versus 0.22%). This implies that how to better use resources is likely important than the sheer amount of resources to improve the effectiveness of the justice system in Romania.

Empirical evidence so far does not allow to conclude that increasing the overall budget of the judiciary leads to an improvement in the judicial system unless it is an underfunded system (Cross and Donelson, 2010; Voigt and El-Bialy, 2016). There is no conclusive evidence that an increasing number of judges leads to an increase in resolved cases. Studies from Israeli and Bulgarian courts show that an increase in the number of judges resulted in a decrease in the productivity of incumbent judges (Beenstock and Haitovsky, 2004; Dimitrova-Grajzl et al., 2016). There is some evidence, however, that court output might rise with an increase in judicial staff as in the case of Portugal, for instance (Martins Borowczyk, 2010).

In recent years, a common trend among some European countries has been to reduce the number of courts. France reduced the number of courts in 2008. Courts with low activity (less than 500 new cases per year) were dissolved but each county was still provided with one labour court and one civil court to guarantee access to justice. The total number of judges was kept constant since judges from removed courts were transferred to other courts. At the national level, no effects could be found on the duration of solving cases (Espinosa, Desrieux and Wan, 2017). In 2017, more than 90% of the total expenditure on courts was for wages and salaries of judges and court staff. Romania has the second highest share of salaries in total spending, while few resources remain for training, building infrastructure and digitalisation of the judiciary (European Commission, 2020).

Continuous training is mandatory in Romania and specialised training for bankruptcy cases is available. However, 78% of all judges receive training in judicial ethics (i.e. integrity, knowledge of law) rather than judge craft (i.e. judicial skills in dealing with complex cases, management, etc.), the highest share across EU countries (European Commission, 2020). Almost no training is devoted to IT skills. While perception of bribery is considerably higher among judges in Romania compared to peer countries and EU average (European Network of Councils for the Judiciary, 2017), a better balance between training on judge craft and judicial ethics should be envisaged.

Digitalisation can speed up the resolution of court cases by improving the workload of judges. In 2016, Romania devoted less than 1% of the overall court budget for computerisation (i.e. computers, software etc.), which is lower than peer countries (Poland: 3.1%; Lithuania: 7.7%; Hungary: 1.8%) (CEPEJ, 2018), but has been increasing over the past years to reach 1.5% in 2021. Romania should increase spending to digitalise its court system. Further investments in ICT infrastructure are crucial since evidence suggests that countries devoting a larger share of the budget to ICT have shorter trial length (Palumbo et al., 2013).

Romanian courts have implemented the ECRIS application, covering the workflow of court cases and the STATIS, an IT application facilitating the court management. STATIS generates reports regarding court activity. The reports consider indicators on the age of the cases in stock, the number of pending cases, the number of cases solved, and the average duration of cases. New updates of ECRIS software are under progress to ensure that cases are randomly assigned to judges. However, a proper assessment of the functioning of the judicial system requires further data on courts' activity.

Data collection could be further improved by incorporating crucial statistics on case complexity at a disaggregated level. A significant challenge for judges is to identify which cases should be prioritised, which cases entering the system have a high degree of complexity and therefore have a higher likelihood of being pending for years and how to address these types of cases (i.e. providing temporary support for judges such as judicial assistants). A well-designed IT tool should take into account such prioritisation, which the new updates of ECRIS software aim to do. It would allow Court Presidents to monitor the progress of cases and to manage them efficiently. It should also be applied nationwide to all the courts, which is also supposed to be ensured by the new updates of ECRIS software.

Closing transport infrastructure gaps to promote productivity and reduce regional disparities

Transport infrastructure gaps are large

Infrastructure contributes to productivity and economic activity in many ways. Infrastructure can raise the productivity of private and public sector inputs and the rate of return of private investment, attract foreign direct investment, increase the volume of international trade, and generate positive externalities (such as agglomeration effects; OECD, 2015d). Infrastructure is also central to meet key environmental challenges (OECD, 2019b).

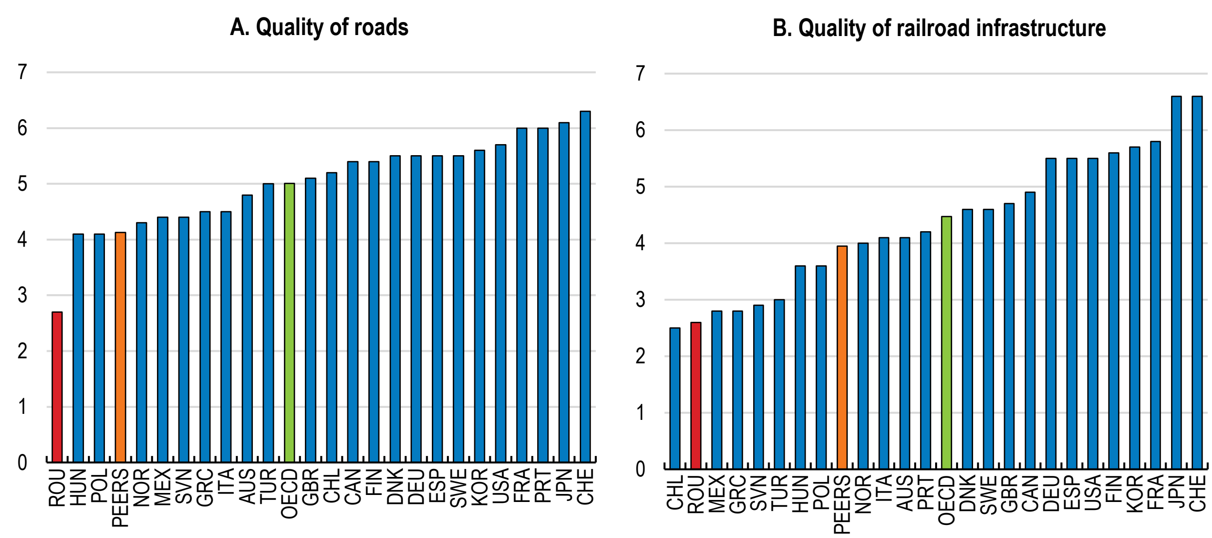
Romania's transport infrastructure is underdeveloped, with road and rail quality being close to the lowest-ranked OECD country (Figure 2.20). Infrastructure development is slower in Romania compared to peer countries that have similar institutional arrangements, namely a centralised model. Such a model ensures strong coordination among stakeholders, which is considered to be efficient (OECD, 2020b). Therefore, the problems in infrastructure development in Romania likely resides in the implementation of specific investment projects (see below).

The low absorption rate of the EU Structural Funds in conjunction with substantial time and cost overruns contributes to the low quantity and quality of transport infrastructure. So far, Romania has absorbed 63% of the European Structural and Investment Funds allocated to the country over the programming period 2014-20 , with the reimbursements by the EU made until 2023 (see Chapter 1). Over the next programming period 2021-27, a substantial amount of funds is allocated to Romania (up to EUR 30.3 billion, or 13.9% of 2020 GDP from the three funds under the Cohesion Policy). In addition, also a substantial amount of grants will be made to Romania over the next 5 years through the Recovery and Resilience Fund (up to EUR 14.2 billion, or 6.5% of 2020 GDP), which focuses on such priority areas as the environment and digitalisation.

Romania should speed up the absorption of EU Structural Funds, which can help to finance and develop core transport infrastructure projects. For road, the most important transport infrastructure projects using EU Funds, which are currently in progress, include: Lugoj-Deva Motorway; Sibiu-Pitesti Motorway; Bucharest road ring; Sighisoara-Simeria Railway; and Brasov-Sighisoara Railway. These projects contribute to the completion of the Trans-European Transport Network (TEN-T). During the next Multiannual Financial Framework 2021-27, investment projects in the transport sector will focus on the continuation of the investments started during 2014-2020, with the main objective of completing the corridors of the TEN-T network that transit Romania, namely the Rhine-Danube corridor and the Orient-East-Med corridor, by finalising the missing sections.

Figure 2.20. The quality of road and rail infrastructure is low

Global Competitiveness Index, scale from 1 to 7 (best), 2018



Note: This is a self-assessed measure asked to business executives. For infrastructure, the following question is asked: "In your country, how is the quality (extensiveness and condition) of road (railway) infrastructure [1 = extremely poor—among the worst in the world; 7 = extremely good—among the best in the world]. CEE consists of the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia, and the Slovak Republic.
Source: World Economic Forum, Global Competitiveness Index (2018).

StatLink https://stat.link/l8f6t7

Road

Despite road transport being the principal modality of moving freight in Romania and subject to large EU Structural Funds investments, the state of the road infrastructure remains precarious and is one of the least developed in Europe (European Commission, 2019a). Fewer kilometres of motorway have been constructed than in other CEE countries since joining the EU in 2007. OECD CEE countries have built motorways faster, as the motorway density (motorway kilometres / 1000 km2) in Hungary and the Czech Republic is more than three times as high as that in Romania (Milatovic and Szczurek, 2020).

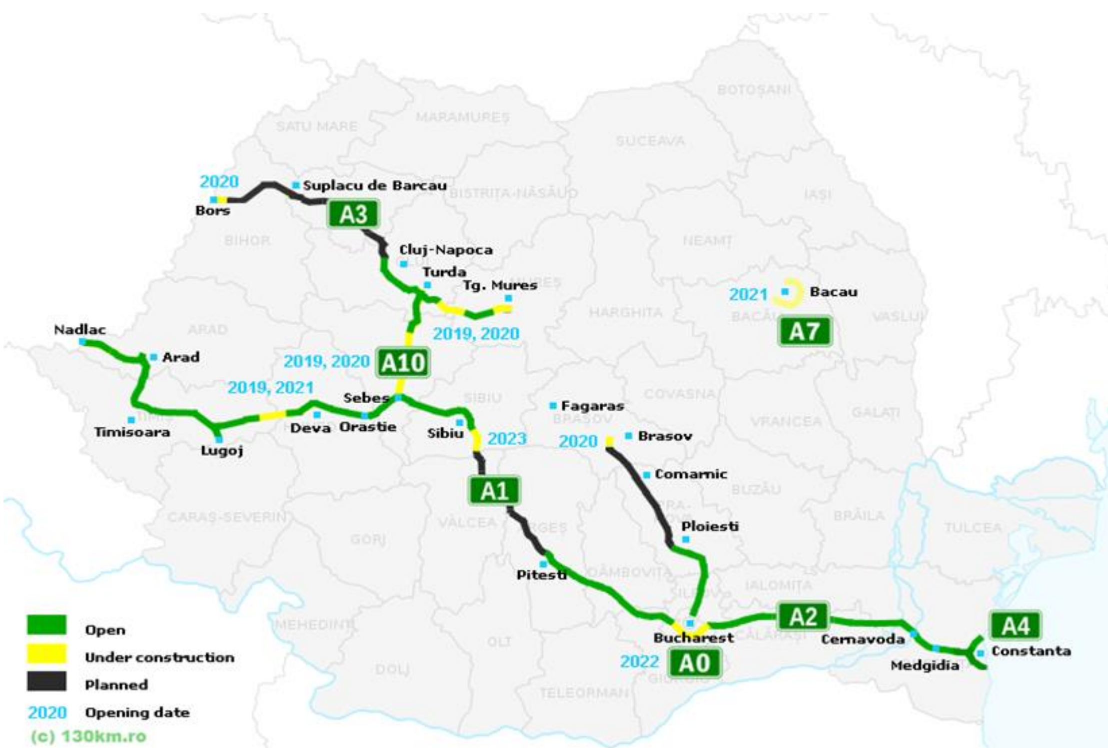
The most developed motorway, the Pan-European Corridor 4 – ranging from Arad to Constanta – is not finished yet despite available investments from EU funds (Figure 2.21). The Western province of Banat, with its rich city of Timisoara, is the only Romanian region fully connected to the Western European motorway network. Connections between rural regions to motorways are still insufficient, especially Moldova (the poorest region in Romania) (Figure 2.21). Worse yet, the motorway network built around Bucharest is not connected to any other motorway network.

Poor and inefficient infrastructure leads to very low transit freight transportation. Indeed, Romania has not yet taken advantage of its status as a transit country for the southern regions of Eastern Europe. Compared to other EU countries and peer countries, Romania operates small volumes of international traffic, including incoming, outgoing and transit international freight transport (OECD, 2016).

In addition, approximately 90% of the national road network is made up of roads with only one traffic lane for each direction and with very low effective speed (average 66 km/h). This has an impact on both freight delivery time and safety. These roads do not ensure the possibility of overtaking local agrarian vehicles and thus reduce safety for heavy freight transport vehicles, which are the major users of the national road network. Romania is the poorest performer in road safety in the EU. Romania recorded 95 road accident fatalities per million inhabitants, almost twice as high as the EU average of 49 (European Commission, 2019b). A new road safety strategy is envisaged to be implemented as part of the reforms in the National Recovery and Resilience Plan.

Figure 2.21. Motorway conditions are poor and fragmented

2021



Note: This graph displays the fragmentation of Romania's motorway.
Source: Romanian Motorway Info, http://www.130km.ro/index_en.html.

Rail

Rail freight volume and passenger have declined over the years and is lower than most of the regional peers, including Slovenia, Slovakia, Poland, Hungary and the Czech Republic (Milatovic and Szczurek, 2020). International railway transport is negligible in Romania, compared to OECD countries, confirming the weak attraction of Romania's infrastructure for international traffic. This is likely related to the low quality of railway infrastructure (Figure 2.20).

While the country performs well in terms of railroad density, the efficiency and developmental state of train services are very low due to systematic underinvestment and poor maintenance. This leads to a reduced quality of the services provided, one of them being a reduced speed for commercial freight trains (approximately 28.3 km/h) (OECD, 2016). Moreover, only 37% of the rail network is double track, while the EU28 average is 59%. This affects the delivery time of rail freight transport, which is significantly slower than road freight transport in Romania and explains the preference expressed by the business sector for road transportation. Addressing these performance differences would support modal shift towards rail, helping to reduce the carbon intensity of the economy, as stated in the National Recovery and Resilience Plan.

Ports

The Port of Constanţa is the main Romanian sea port, playing a significant role as the transit node for the landlocked countries in Central and South-Eastern Europe. The volume of goods handled here represents more than 95% of the commodities handled in all maritime ports in Romania. Approximately 60% of the goods imported and exported by Romania in 2015 were transported by sea, followed by road and inland waterways according to Eurostat. However, a major obstacle is the transportation of goods to the destination because connections to national roads and rail networks from other ports at the Danube and inland waterways are slow and inefficient. Romania has 30 inland river ports and most of these ports have a poor infrastructure and inefficient connections with other transport modalities, limiting the volume of traffic (OECD, 2016). A development strategy for ports and inland waterway navigation is under development with EU funding and a more integrated approach for investments in the sector is envisaged for the next 2021-27 programming period.

Enhancing infrastructure governance and tapping EU Funds to close the gaps

OECD countries' experience shows that shortcomings in a country's infrastructure governance jeopardise infrastructure projects' timeframe, budget and service delivery targets (OECD, 2017). Effective infrastructure governance hinges on a clear regulatory and institutional framework and robust co-ordination across different levels of government (OECD, 2017). Sound governance also increases investment efficiency and productivity, while deterring corruption. By improving the infrastructure governance, Romania can speed up the absorption of EU funds, which would be timely as the allocation of grants from the European Union over the coming years is significantly increased (see Chapter 1).

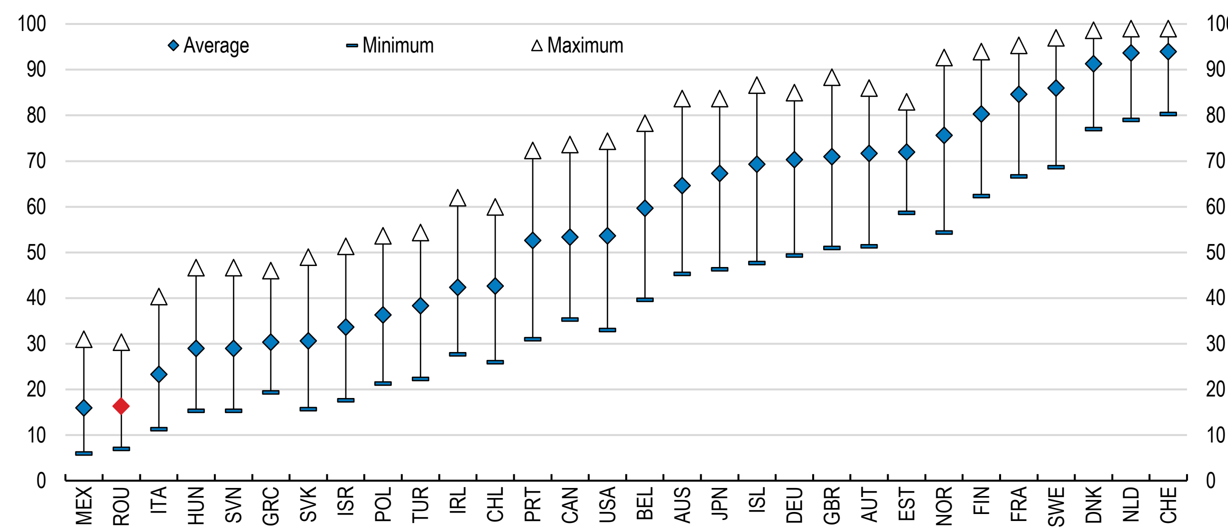
According to a recent study, Romania has weak infrastructure governance, close to the lowest-ranked OECD country (Figure 2.22). The result is largely driven by inefficiency in planning practices and, to a lesser extent, in public procurement. Moving governance quality from relatively low to relatively high standards implies a 0.2 percentage point increase in productivity growth per year on average across OECD countries (Demmou and Franco, 2020). This value is even higher for Romania. Moving from the current infrastructure governance to best practices, Romania could increase productivity growth by 2.3 percentage points in the first year. The positive impact would then fade over time, as Romania will move to higher productivity levels.

Romania has made some progress in improving public infrastructure governance. For instance, the government introduced the General Transport Master Plan in 2016. The Plan defines the objectives of national transport infrastructure and is instrumental for planning major projects and actions. The Plan, with its Implementation Strategy, defines project priorities, their schedules and funding sources. The above mentioned investment projects have been identified as priorities in the Plan. By extending the Plan, the authorities will introduce the Investment Plan 2021-30, focusing political, institutional and financial efforts on a clear set of priorities to the creation of a national transport network.

Such an overarching infrastructure strategy is key to ensure effective public investment (OECD, 2020b). A recent OECD study (OECD, 2019d), illustrating good practices in five OECD countries, emphasises the importance of rigorous assessment taking account not only of cash-flow projections but also broader economic and social costs and benefits, which should be defined by an overarching strategy. Such a strategy should duly consider the impact to the environment, which would prioritise rail over road infrastructure, all else equal. The selection of some rail investment projects in the National Recovery and Resilience Plan was based also on the environmental concern, which is a good example. At the same time, major road infrastructure projects for completing the TEN-T Network should not be undermined as the economic return from road investment projects is high, given the low level of development in road infrastructure.

Figure 2.22. Infrastructure governance needs to be improved

Ranging from 0 to 100 with higher values reflecting better governance, 2016



Note: The figure shows cross-country level of infrastructure governance according to the summary index provided by the Hertie Business School. The indicator is estimated from a Bayesian Factor Analysis model; the red rhombus shows the average estimate, while the black square and the black triangles the upper and the lower bound respectively.
Source: Hertie School of Governance.

StatLink https://stat.link/fxbtme

Romania has many good aspects in terms of institutional arrangements in the use of EU funds. The country has a centralised model, which helps to ensure strong cooperation among actors such as line ministries, managing authorities and the paying authority (OECD, 2020b). The Ministry of Investment and European Projects (MIEP) is in charge of decisions made over programming and the implementation of funded projects in a centralised way. Such an institutional arrangement allows for reducing administrative burdens including duplication and for ensuring synergies and complementarities of investment projects in different programmes. For instance, the Partnership Agreement and Operational Programmes for EU Funds were drawn up in cooperation with a wide range of stakeholders, including managing authorities and beneficiaries (those implementing investment projects).

The absorption of EU Funds has been held back due mainly to obstacles to prepare and implement specific investment projects. As a result, project proposals were sometime rejected by the EU authorities, which assessed them according to such criteria as objectives, feasibility and cost-effectiveness. Also, investment project cycles (from feasibility studies on projects to reimbursements by the EU) are very long. This can be measured in terms of the peak in expenditure toward the end of the two Multiannual Financial Framework periods (2007-13 and 2014-20). As of October 2021, the absorption rate of EU funds stands at 63%, which is expected to approach 100% toward 2023, pushed up also by a high contracting rate (145% of the total EU allocation). There are much more investment projects committed within the framework of EU structural funds than can be reimbursed by the European Commission ("over-contracting"), which helps to raise the absorption rate. However, it can also be considered as an indication of the weakness in project design and implementation (i.e. reflecting that many projects will not qualify for EU funding due to these weaknesses).

Infrastructure projects require careful planning and forward looking cost-benefit analysis. This can minimise the risk of shortfalls in returns as well as unexpected opportunity costs and contingent liabilities due to cancellations and delays and allow sustainable performance throughout the investment cycle. For instance, if the techniques identified in a feasibility study turn out inadequate for specific geological areas, the project is required to change the techniques, or even the supplier, with financial corrections. If the projects are not finalised as planned, they may not be reimbursed from the EU. All these problems can cause claims by private companies as they can incur losses in such cases. For large infrastructure projects, project designing is often made by public entities, either directly by the line ministry or by state-owned enterprises for road and rail.

The issue of preparing and prioritising specific investment projects bears even more importance with the implementation of the National Recovery and Resilience Plan (NRRP, see Chapter 1). The management structure for the implementation of this Plan is similar to the one for the traditional EU funds, i.e. it is centralised in the MEIP. There is coordination in terms of infrastructure investments between the traditional EU funds and the NRRP. For instance, part of investments to complete the TEN-T network (see above) will be implemented within the framework of the NRRP. There are investment projects that remain to be designed specifically by public entities. In this case, they also need to take into account specific requirements, such as the environmental standards, which highlights the necessity to strengthen administrative capacity.

Strengthening administrative capacity requires skilled employees in the public sector. Romania could determine what attracts and retains skilled employees, and use this to inform employment policies, including compensation and non-financial incentives (i.e. learning programmes). A dedicated unit within the MEIP is in charge of the administrative capacity and training of the employees in the identified specific expertise, such as state aid, risk management, internal audit, public procurement, financial management and control, EU and national legislation and management skills. These are related to project management. As project planning is often made directly by the public administration in Romania, the development of related expertise should be all the more important. The MIEP and other line ministries have also introduced some specific measures to improve the quality of project designing. These include technical assistance, including that with Joint Assistance to Support Projects in European Regions (JASPERS) for major projects, which should be assessed and developed further. The public authorities have drawn on expertise from external bodies, such as the European Investment Bank, which can be further developed.

Framework conditions affect investment operation and processes. These include regulatory legislation and practices, such as those related to public procurement. In Romania, stakeholders criticise frequent changes to national-level procedures and documentations by the government as "changing the rules during the game". Such changes had strong implications for the management of the funding and frequently triggered other unforeseen problems (Surubaru, 2017). The proceedings in public procurement are often rigid and inefficient in the sense that they do not take into account the specificities of each project as well as potential beneficiaries, depending on which the procedure should be customised. As a result, it often ends up with awarding the bidder proposing the lowest cost without taking account of quality aspects, which can cause implementation problems.

Above all, policy uncertainty affects the quality of governance and undermines infrastructure planning. In cases, projects are politically motivated with top-down decision making, with leadership in public entities rotating very frequently, delaying some investment projects. At the same time, such political pressures can cut down preparation periods in investment projects, yielding inadequately prepared infrastructure projects. The governance for public infrastructure needs to be depoliticised. This can be done, for instance, by effectively ensuring the implementation of the investment projects prioritised according to the objectives in an overarching strategy (such as the General Transport Master Plan). Ensuring transparency in the project selection procedure, by associating relevant stakeholders and providing sufficient information to the public, would help to avoid political interference.

Public-private partnerships (PPPs) are another way to finance investment projects and overcome the infrastructure gap. A new legal framework on PPPs entered into force in Romania in 2018 (GEO No. 39/2018) that allows Romania to implement large-scale PPP infrastructure projects. Romania aimed to finish the construction of the strategically important Ploiesti-Brasov motorway through PPPs, but the project has not been accomplished and is now under another feasibility study. PPP procurement is highly complex: the optimal delivery mode depends on the nature of the assets involved, the risk assessed, the services provided, and the design of the procurement system. To be efficient, PPPs require market risk to be shared appropriately between the government and the private partner(s). Consequently, contract design plays a critical role (International Transport Forum, 2018). The authorities have been working to improve the legal and institutional framework as well as administrative capacity, while obtaining technical assistance from external bodies, and such efforts should be extended.

Table 2.1. Policy recommendations to strengthen the business environment

MAIN FINDINGS	RECOMMENDATIONS (key in bold)
Strengthening competition to reinvigorate productivity growth	
The licence and permit system imposes burden on businesses.	**Simplify the licence and permit system, enhancing the use of online services.**
Entry barriers in professional services remain high.	Reduce the number of restrictions in some professional services such as lawyers and engineers.
The financial performance of many SOEs is poor. The implementation of good corporate governance rules has been suspended for the vast majority of SOEs. The dispersed ownership of SOEs between line ministries and local governments makes them vulnerable to political interference and conflict of interest.	Restore the reform on the corporate governance rules aimed at depoliticising and professionalising the management of SOEs along the lines of the OECD guidelines on SOE governance. Fully operationalise the centralised unit responsible for the appointment of board members and for monitoring the performance of SOEs. Consider resuming privatisation efforts, backed up by legislation for investment screening and transparent procedures.
Highly-innovative start-up creation is low.	Tailor the 'Star-Tech Innovation' programme to meet the financing needs of highly-innovative start-ups and evaluate it continuously. Alternatively set up a public venture capital fund to support highly-innovative start-ups.
Microfinance schemes are fragmented and do not address financing needs of SMEs in rural areas. The National Development Bank will be set up to support the recovery in the aftermath of the COVID-19 crisis, but its mandate has not been clearly defined yet.	Clearly specify the mandates of the new National Development Bank to address financing difficulties for SMEs. Require stronger accountability if the Bank targets support to strategically important areas.
Improving the judicial efficiency and insolvency regime to enhance business dynamism	
Legislative instability deteriorates the business climate.	**Reduce further the use of emergency decrees and conduct a proper impact assessment before implementing new laws.**
Weak data capacity reduces the efficiency of the judicial system.	Enhance data collection to allow a proper assessment of the functioning of the court system.
Businesses enter insolvency proceedings late due to high stigma and fear of bankruptcy, preventing successful restructuring of businesses.	**Strengthen the insolvency regime to facilitate debt restructuring, notably by introducing out-of-court mechanisms.** Introduce early warning tools by transposing the related EU Directive.
Recent amendments in the insolvency regime impose high barriers to successful restructuring of distressed firms.	Revise the new amendment that gives tax creditors a super-priority rank to claim their assets over other creditors.
Courts involvement in different stages of the insolvency procedure is high.	Reduce court involvement in insolvency proceedings, except where it is absolutely necessary.
Closing transport infrastructure gaps to promote productivity and reduce regional disparities	
Poor quality of transport infrastructure, especially road and rail, exacerbates regional disparities and limits global value chain integration.	Speed up the absorption of EU Funds, in particular, on the rail infrastructure to facilitate the green transition.
The absorption of EU funds has been slow, as reflected in very long investment cycles. While prioritisation principles and criteria for public investment are defined in the law, policy continuity is an issue.	Ensure that investment projects are effectively implemented according to the long-term infrastructure strategy, while avoiding frequent changes in the legislation and in the management in state-owned enterprises.
The quality of project preparation is generally low.	Enhance the capacity of project designing within public entities, notably by drawing more on external expertise.

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3 Improving labour market conditions for stronger and inclusive growth

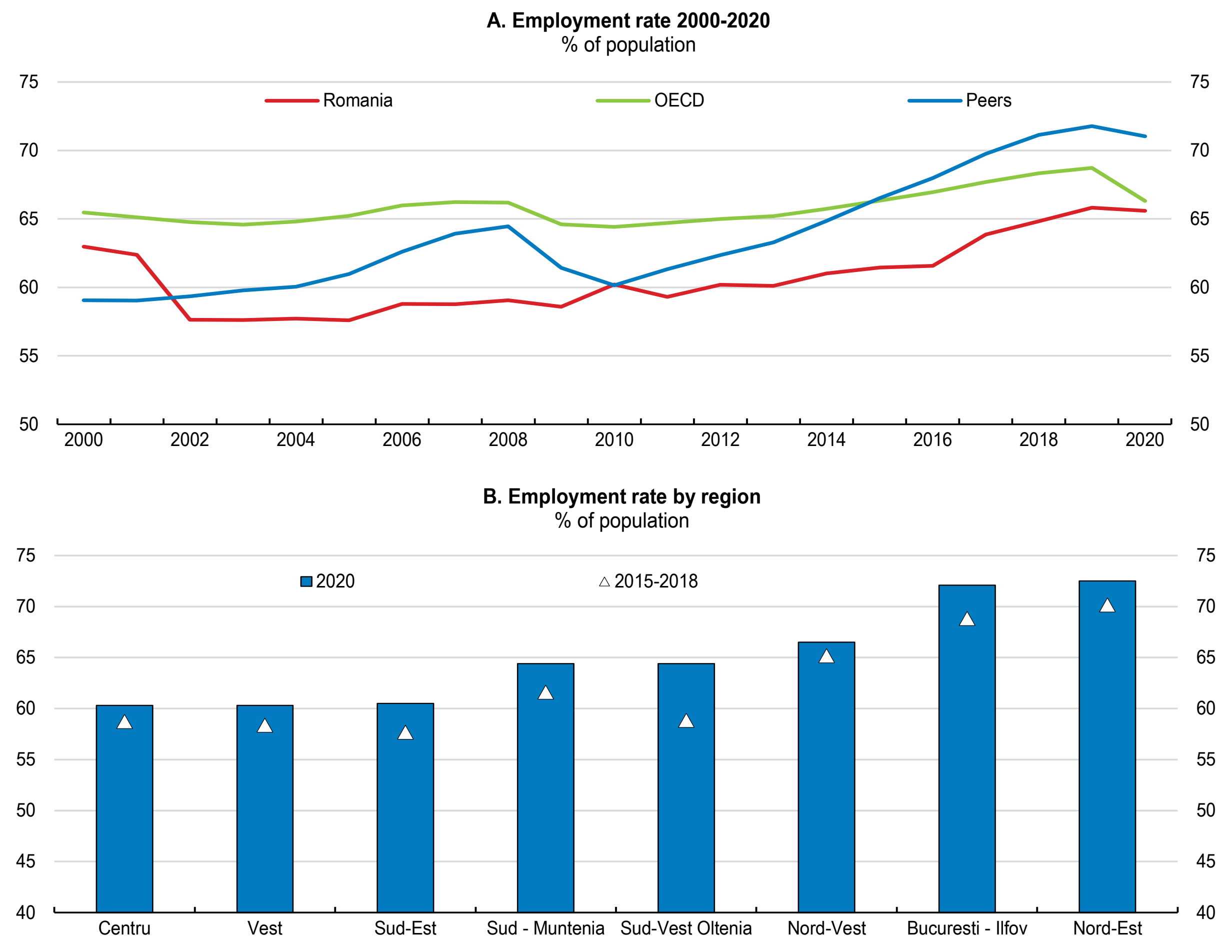
Caroline Klein, OECD

Pierre Lesuisse, OECD

A large share of Romania's population is detached from the formal labour market and does not have the skills needed to adapt to the fast changing environment. This results in large income and regional inequalities, with some groups – low educated, women, youth, and Roma – remaining at risk of poverty and social exclusion, especially in rural areas. The COVID-19 crisis has aggravated barriers to the labour market integration of vulnerable individuals. At the same time, skill mismatch on the labour market undermines Romania's capacity to grow and to adapt to technological progress. Improving matching to support the recovery and making it more inclusive requires a vast range of measures. First, barriers to participation should be addressed, especially for disadvantaged groups, through more effective active labour market policies. Second, youth unemployment should be tackled by addressing the high level of early school leaving and strengthening employers' involvement in training. Finally, offering reskilling options to Romanian workers is urgently needed and requires developing adult education. Doing so will involve increasing financial incentives for workers to train and improving guidance services, especially for the low skilled and in small firms.

After being hit hard by the global financial crisis, Romania's convergence process has resumed, with above OECD average economic performance. The COVID-19 crisis put a halt to this impressive performance. The recovery from the initial shock has been rapid, but crucially hinges on the containment of the pandemic (Chapter 1). Labour market conditions have been resilient so far, sustaining living standards. After increasing by 7 percentage points between 2009 and 2019, the employment rate stabilised close to the OECD average in 2020 (Figure 3.1, Panel A), meeting the 70% national target for the 20-64 age cohort. Unemployment reached a record low level in 2019 and increased only moderately during the pandemic. The convergence of wages accelerated, with average net earnings rising five times faster than in the EU over the past 5 years, partly reflecting a higher qualification level of workers and a higher sophistication of jobs. One fifth of jobs remains in the agriculture sector, where subsistence farming still prevails, but the share keeps declining at a fast pace.

Figure 3.1. Labour market performance is uneven



Note: Peers consists of Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia.
Source: OECD Labour Force Statistiques; Eurostat.

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However, human capital challenges are holding back Romania's convergence process. Before the pandemic, labour shortages have intensified on the back of high emigration. Tensions on the labour market will likely return as the recovery gains speed, especially in strategic sectors, such as ICT or construction, where investment needs are large. At the same time, a large share of the Romanian population, especially among youth and women, occupies low-productivity jobs or is not working. High inactivity rates, informality and in-work poverty generate substantial income and well-being inequalities. The COVID-19 pandemic has exacerbated barriers for individuals with low employability to integrate into the labour market. Regional disparities and the rural/urban gap are large and have increased over the past few years (Figure 3.1, Panel B). In addition, like for OECD countries, Romania's capacity to adjust to global megatrends, especially to harness the potential of digital transformation and to address demographic challenges will depend on its capacity to mobilise its labour resources and to endow Romanian workers with appropriate skills to adapt to a fast changing environment. In response to these challenges, the government recently issued the new national Employment Strategy for 2021-2027 that includes four main objectives: (i) sustainable integration in the labour market of the labour force; (ii) increasing the economic potential of young people: (iii) modernising and strengthening labour market institutions and (iv) strengthening the adults vocational training system.

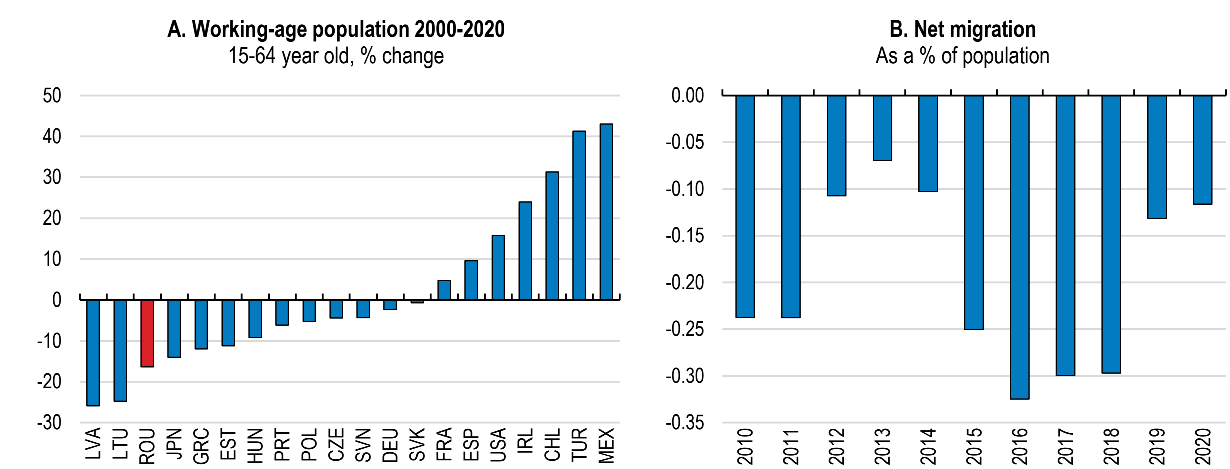
Against this background, this chapter discusses potential structural policies to improve labour market conditions in Romania for stronger and more inclusive growth. It first presents current and future challenges of the Romanian labour market. It then discusses policies to stimulate participation in the formal labour market and to tackle high youth unemployment. Finally, it investigates avenues to improve the adaptive capacity of the Romanian population to technological change.

Mismatch in the labour market undermines inclusive growth

The labour force has declined due to emigration and ageing

Romania is ageing and depopulating at a much faster pace than many OECD Central Eastern European (CEE) countries. Reaching 19.4 million in 2019, its population has been persistently decreasing since 1991, losing 3.8 million people, and is projected to decline further to around 15 million by 2070 (Figure 3.2, Panel A). While being amongst the highest in Eastern Europe, the fertility rate, at 1.8 children per women in 2018, remains below the replacement level. Around half of the Romanian population is in working age, above the OECD average, but the old-age dependency ratio – measured as the ratio of dependents above age 64 to the working age population – is projected to increase fast and to exceed 53% in 2050.

Figure 3.2. The working age population has declined on the back of high emigration



Source: United Nations Population Statistics; Eurostat.

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Emigration played an important role in past population loses and, despite robust economic performance, has intensified before the pandemic. The Romanian diaspora is the fifth largest group of emigrants living in OECD countries. Around 3.5 million Romanians went abroad between 2007 and 2015 and 17% of people born in Romania were living in the OECD in 2015 (OECD, 2019a). While emigration has decelerated significantly in 2019, 1.05 % of the population left the country, around twice as much as in OECD CEE countries. Emigrants are relatively young and skilled, one fourth of them having a tertiary education level (against 15% for the resident population).

The main reasons for leaving Romania are the better job prospects and higher remuneration in the destination countries (OECD, 2019a). Other pull factors include better working conditions, public services and quality of public governance (European Commission, 2019). In 2020, a large number of Romanians living abroad returned due to the restrictions imposed in their host countries. Future migration flows remain uncertain and will hinge on the relative economic prospects in Romania compared to destination countries. Romania has a unique opportunity to retain former emigrants and reintegrate them in the labour force. Policy measures that contribute to improving job quality, rule of law, and effectiveness of public services, especially education and health, could help (Chapter 1).

Immigration had increased fast prior to the pandemic, but without compensating the acceleration of emigration (Figure 3.2, Panel B). Between 2013 and 2019, foreign-born population increased from around 183 000 to 612 000 people, but it still accounts for only 3.7% of the total population, below the OECD average (13%). Immigration flows reached 1% of the population in 2019, higher than the CEE OECD average. Labour immigration from non-EU countries has accelerated. Work permits accounted for more than 50% of long-term residence permits delivered to third country nationals in 2019 (around 14 000 permits, from 4700 in 2018, OECD, 2020a).

A large share of the population is detached from the formal labour market

Participation in the labour market is low

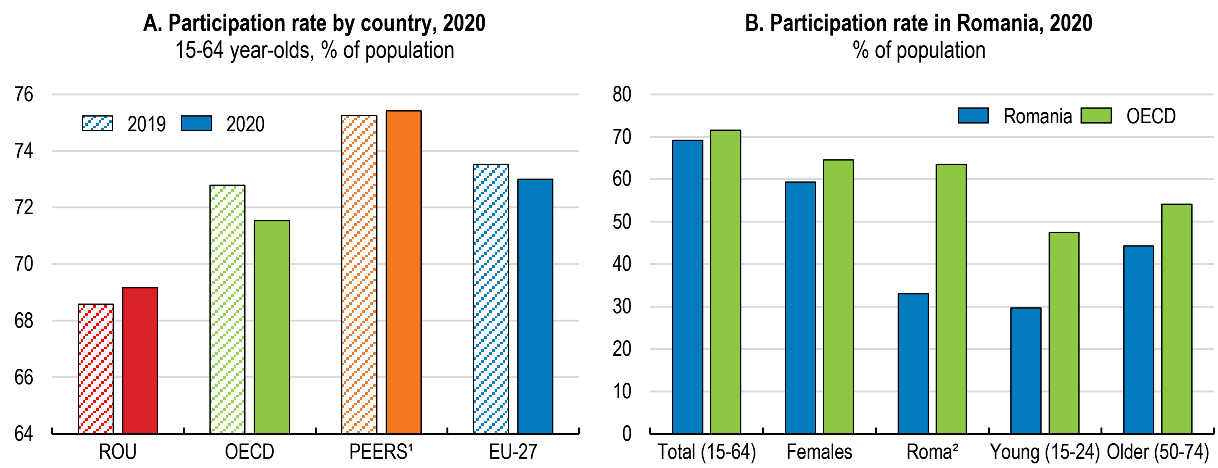
A large share of the working age population is inactive or engages in low productivity jobs, especially in rural areas, where formal job opportunities are scarce. Despite having increased, including in 2020, the labour market participation rate remains relatively low by OECD standards, especially for women, young, old age and Roma people (Figure 3.3). More than half of the inactive population in working age is above 50 or low educated. The gender participation gap is among the highest compared with OECD countries: only 59% of women work or look for a job, 19 percentage points less than men. It is particularly pronounced in the Roma population, as the women participation rate is 3.5 times weaker than for men. Labour market participation of Roma in Romania is below levels seen in other CEE countries (FRA, 2016). The gender participation gap is also significant for older people. While the participation rate of older men is close to the national average (62%), it reached only 37% for women aged between 55 and 64 in 2019.

Informal employment remains widespread

Informal employment is widespread, estimated at between 14.5% and 30% of total employment depending on the methodology used (ILO, 2018a; Williams et al., 2017). The share of undeclared work is much higher than for the average OECD country or most of the OECD CEE countries. Two main groups can be identified among those in informal employment: those for whom informal employment constitutes a survival strategy (e.g. subsistence farming and family workers), and those who evade taxes and social security contributions (i.e. non-registered firms, employees without labour contracts or receiving envelope payments) (Parlevliet and Xenogiani, 2008). In Romania, like for inactivity, informality is prevalent in rural areas, with around 70% of the estimated informal employment in the agriculture sector (ILO, 2018a). Undeclared work is also prevalent in home services (housekeeping, child or elderly care) and in the construction sector. However, the increasing number of registered employees in the construction sector suggests the informality rate in this sector has entered a downward path since 2019.

Informality is often associated with low paid jobs, the absence of training and career perspectives. It contributes to poor health outcomes and old-age poverty, as informal workers do not have access to social security insurance and to the pension system. Informal workers are also likely to be more affected by the COVID-19 pandemic, as they were not covered by support measures directed to workers.

Figure 3.3. Labour market participation is low



1. PEERS comprises Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia, and Slovak Republic.
2. Data for Roma refer to 2016, the OECD average for Roma is the average of Czech Republic, Greece, Spain, Hungary, Portugal, and Slovak Republic.
Source*:* OECD, Labour Force Statistics; Eurostat. Labour Force Statistics; and European Union Agency for Fundamental Rights (2017), EU-MIDIS II: Second European Union Minorities and Discrimination Survey.

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Informal jobs in the agriculture sector still account for a large share of employment

A large proportion of workers in the agriculture sector, that accounts for 20% of total employment in 2018, almost three times more than in OECD CEE countries, own a small farm and live from subsistence farming. The average farm size in Romania is more than ten times smaller than in peer countries, undermining economies of scale and investment in productivity-enhancing technologies. For instance, in 2013, more than 95% of utilised agricultural area did not have access to irrigation and was fully dependent on rain-fed production (World Bank, 2018a). Employment in the agriculture sector, especially subsistence farming, is decreasing relatively fast and will continue to do so in the coming years. Poor working conditions and high level of in-work poverty have entailed emigration from rural to urban areas, but internal labour mobility remains among the lowest in the European Union. Addressing barriers for rural population to access better jobs, including by facilitating access to training, would reduce poverty significantly (Chapter 1) and free up labour resources in more productive sectors.

Youth integration in the labour market is difficult

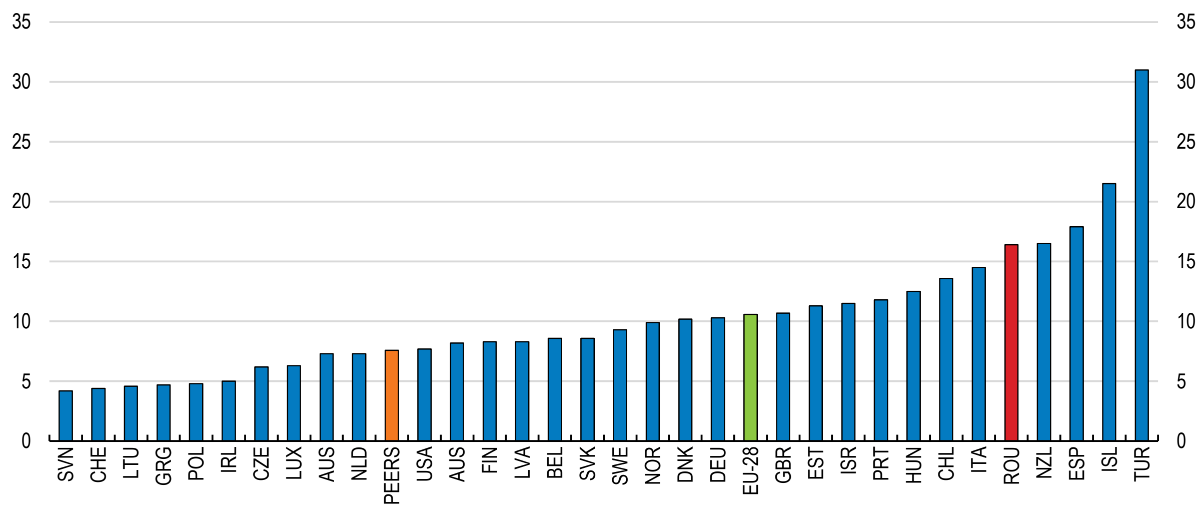
Despite being on a declining trend since 2015, the share of youth (aged from 15 to 24 years) neither in employment nor in education and training (NEET) stands at around 15% since 2019, well above the average rate in the OECD CEE countries (9%). Women and Roma are over-represented among NEETs: around 18% of young women and 63% of young Roma are detached from the labour market and the education system (FRA - European Union Agency for Fundamental Rights, 2016). Besides, the youth unemployment rate has declined relatively slowly since the global financial crisis, reaching 17% in 2019, four times higher than the national average. Furthermore, a third of young jobseekers are looking for a job for more than one year, a much larger share than in OECD and OECD CEE countries (15% and 21% respectively). Contrasting with many OECD countries, youth unemployment has increased less than total unemployment during the pandemic. The youth unemployment rate increased by 0.5 percentage point to

17.3% between 2019 and 2020. At the same time, while labour market participation increased in Romania over that period, it has remained relatively stable for young people.

The lack of qualification is an important barrier to youth employment. A large number of students leave the education system without attaining upper secondary education, which is recognised as the minimum level of attainment needed in a knowledge economy (Kitchen et al., 2017). Early school leaving rate has declined over the past decade, but remains the fifth highest in the OECD (Figure 3.4). Pupils from families with low socio-economic status, living in rural areas, and/or Roma are more exposed to the risk of leaving school without qualification. In particular, less than one third of Roma pupils attained upper secondary education in 2016. The pandemic had a limited impact on the share of early school leavers in 2020. Nevertheless, by accentuating poverty issues in disadvantaged households and disrupting learning, especially during school closures, the COVID-19 crisis risks aggravating school dropouts in the medium run (OECD, 2020b).

Figure 3.4. A large number of youth leave the education system without a qualification

Rate of Early Leavers from Education and Training in % of the total population aged 18 to 24, 2018 or latest



Note: Early leavers refers to persons aged 18 to 24 who have finished no more than a lower secondary education and are not involved in further education or training. PEERS comprises Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia, and Slovak Republic.
Source: OECD, Education database.

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Skills shortages pose risks to the recovery

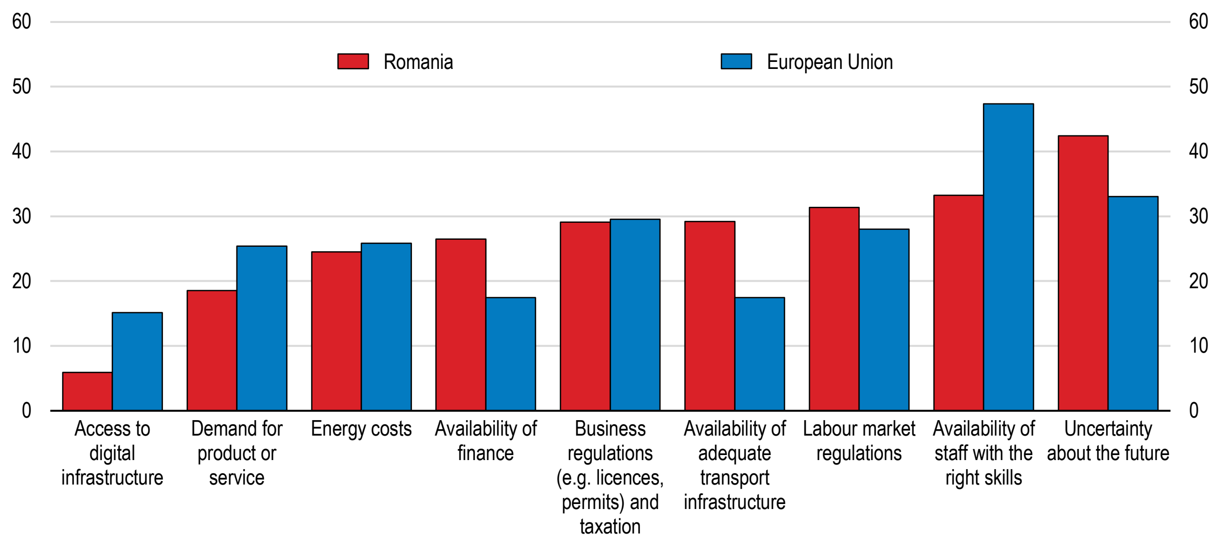
Before the COVID-19 crisis, despite the relatively high level of untapped resources, labour shortages intensified, hampering business growth and investment (Figure 3.5). Shortages were particularly large in labour intensive sectors, including construction, health, education, and Information and Communication Technology (ICT) (World Bank, 2020, CDR, 2019). The pandemic temporarily eased tensions on the labour market with the decline of activity. In some sectors, labour demand has remained strong though (e.g. construction, IT), reflecting the asymmetric impact of the pandemic across the economy. Overall the COVID-19 crisis induced a moderate decline in employment, partly explained by job retention measures (see Chapter 1), the increase in public investment, and the relatively low share of jobs at risk from containment measures (e.g. accommodation and food services, and wholesale and retail trade, (OECD, 2020c).

The impact of the COVID-19 crisis on the composition of the labour market remains uncertain, but some pre-existing trends will likely persist. Recruitment of ICT specialists is projected to intensify as the recovery gains momentum, the vibrant ICT sector continues to develop and digitalisation of the economy progresses. Business representatives estimate total shortages could reach 1.1 million workers by 2021 in a no policy change scenario (CDR, 2018).

Labour shortages in the construction sector have undermined highly needed infrastructure and residential investments over the past five years. They are expected to increase in the coming years, as EU-funded infrastructure projects will require additional recruitments (European Commission, 2018a). Rehabilitation and expansion of transport, health and education infrastructure as well as public utility networks are of paramount importance for Romania's economic development and will be stimulated by the implementation of the Recovery and Resilience Plan (see Chapter 1 and 2). Fiscal facilities and a specific minimum wage have been introduced in January 2019 to address shortages by improving the attractiveness of the construction sector for workers. Formal employment and remunerations have increased since then in the sector, but a thorough evaluation of the measures would be needed to assess their impact and their cost-effectiveness.

Figure 3.5. Labour shortages have undermined business growth

Percentage of all firms citing a major obstacle, 2019



Note: Firm responses to the question: "Thinking about your investment activities in your country, to what extent is each of the following an obstacle? Is a major obstacle, a minor obstacle or not an obstacle at all?"
Source: European Investment Bank, EIB Investment Survey.

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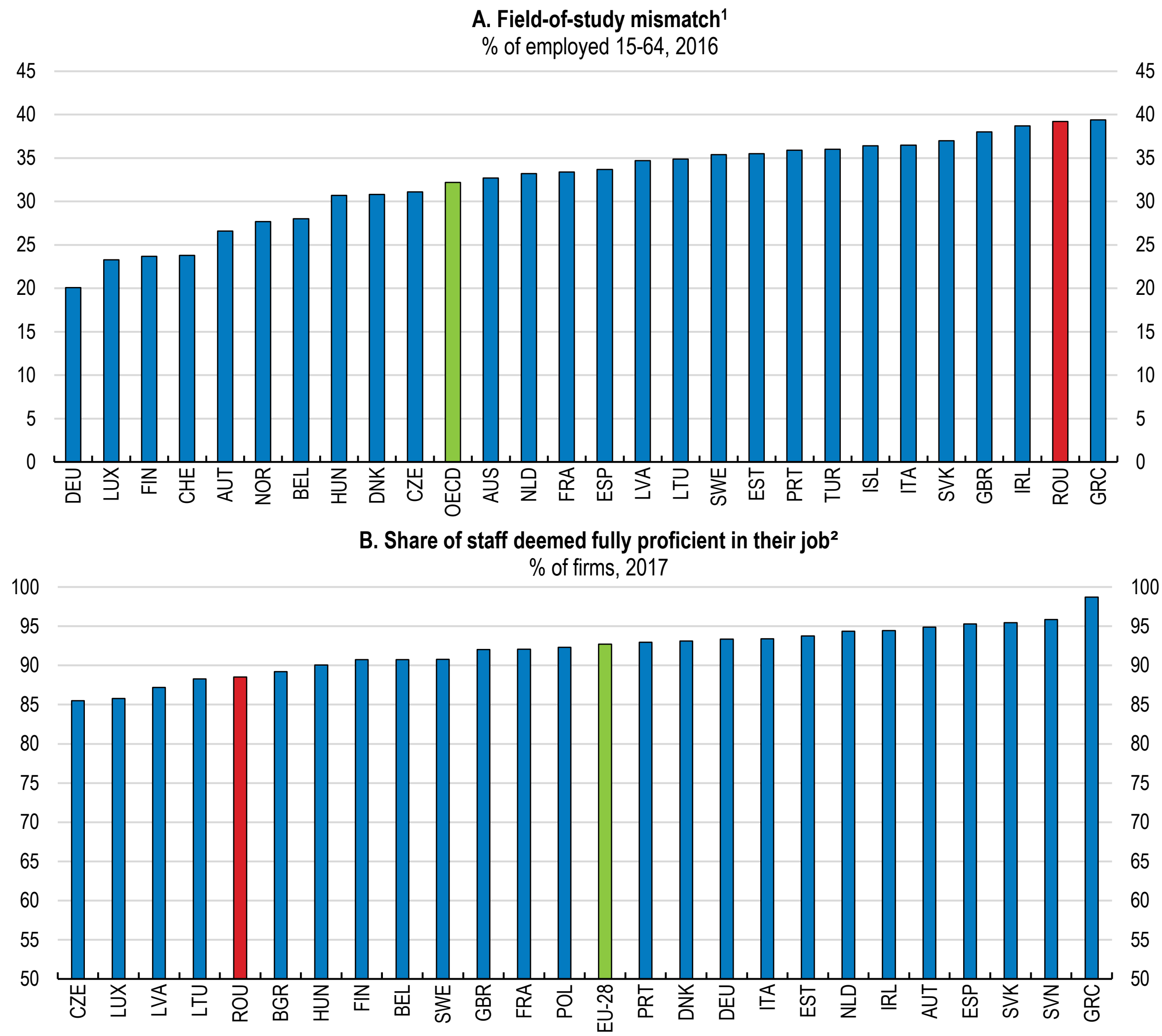
The labour shortages have multiple causes, including high emigration of skilled workers. Mismatch between the labour market needs and available skills plays an important role. While the share of over- or underqualified workers is relatively low by international standards, skills acquired at school do not fit labour market needs (ARACIS, 2016; World Bank, 2017). A relatively high proportion of workers do not work in the field they studied and do not have the right skills to fit the current needs of businesses (Figure 3.6). Around 40% of employers identify an inadequately educated workforce as a major constraint for doing business (World Bank, 2020a). Employers point to the low employability of students and to the lack of key socioemotional skills, including motivation, problem solving, teamwork, and communication (World Bank, 2018a). In tertiary education, according to the Eurostudent survey, only 37% of students assess that the study programme prepares them well for employment, while half do so in OECD CEE countries (DZHW, 2018).

Figure 3.6. Some indicators point to a high level of skills mismatch



1. Field-of-study mismatch arises when workers are employed in a different field from what they have specialised in.
2. Firm responses to the question: "How many of your staff do you think are fully proficient in their job?" A proficient employee is someone who has the skills to do the job to the required level.
Source: OECD Skills for Jobs database; European Investment Bank, Investment survey 2018.

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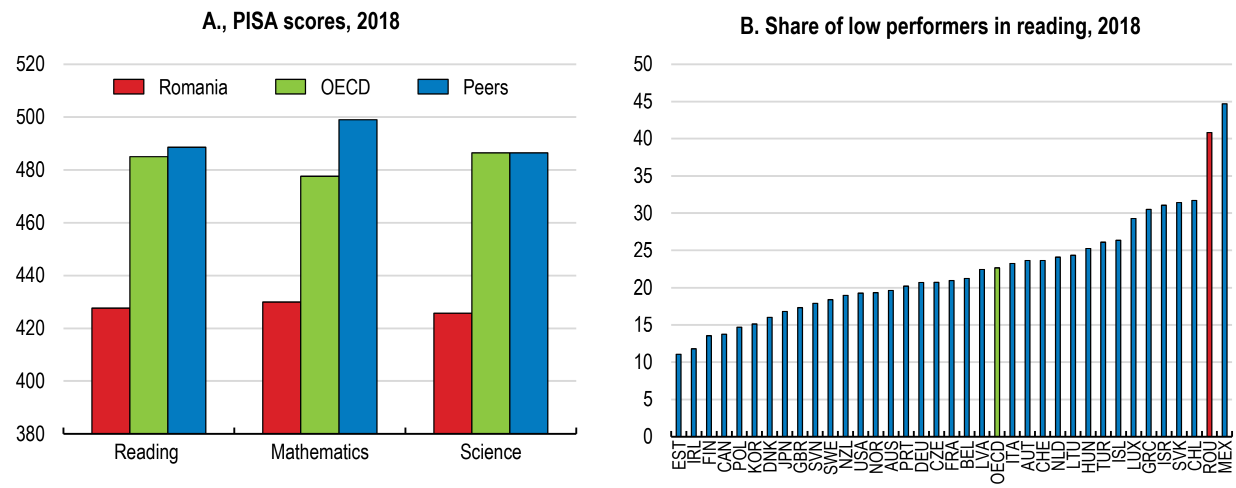
Digitalisation can exacerbate labour market tensions

The skills needed to adapt to a digital world are missing

The COVID-19 crisis has accelerated the digitalisation of the economy and accentuated the need for workers to adapt to a fast changing environment. The ability of countries to provide workers with competences to use new technologies will determine to what extent they can reap the benefits of the digital transformation. Furthermore, upgrading skills - especially technical and managerial skills - supports the diffusion of digital technologies and their positive impact on productivity (Sorbe et al., 2019). Digital skills will be increasingly important, but generic and cognitive skills are also key, as working in a digitalised environment requires cognitive, interpersonal, managerial and organisational skills (OECD, 2019c; OECD, 2016a; Grundke et al., 2018).

A relatively large share of the Romanian population lacks basic skills. Romania's scores in the PISA survey have stagnated and remain below the OECD average (Figure 3.7, Panel A). The share of low performers in reading, mathematics, and science is quite high (OECD, 2019d). In 2018, more than 40% of the students did not achieve baseline proficiency in reading, almost twice the OECD average (Figure 3.7, Panel B). The "Educated Romania" project, which sets the objectives of reforms in the education system, aims at reducing the share of low performers to 20%, below the OECD average.

Figure 3.7. Educational outcomes remain below OECD standards



Note: Peers consist of Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia.
Source: OECD (2019), PISA 2018 Results (Volume I).

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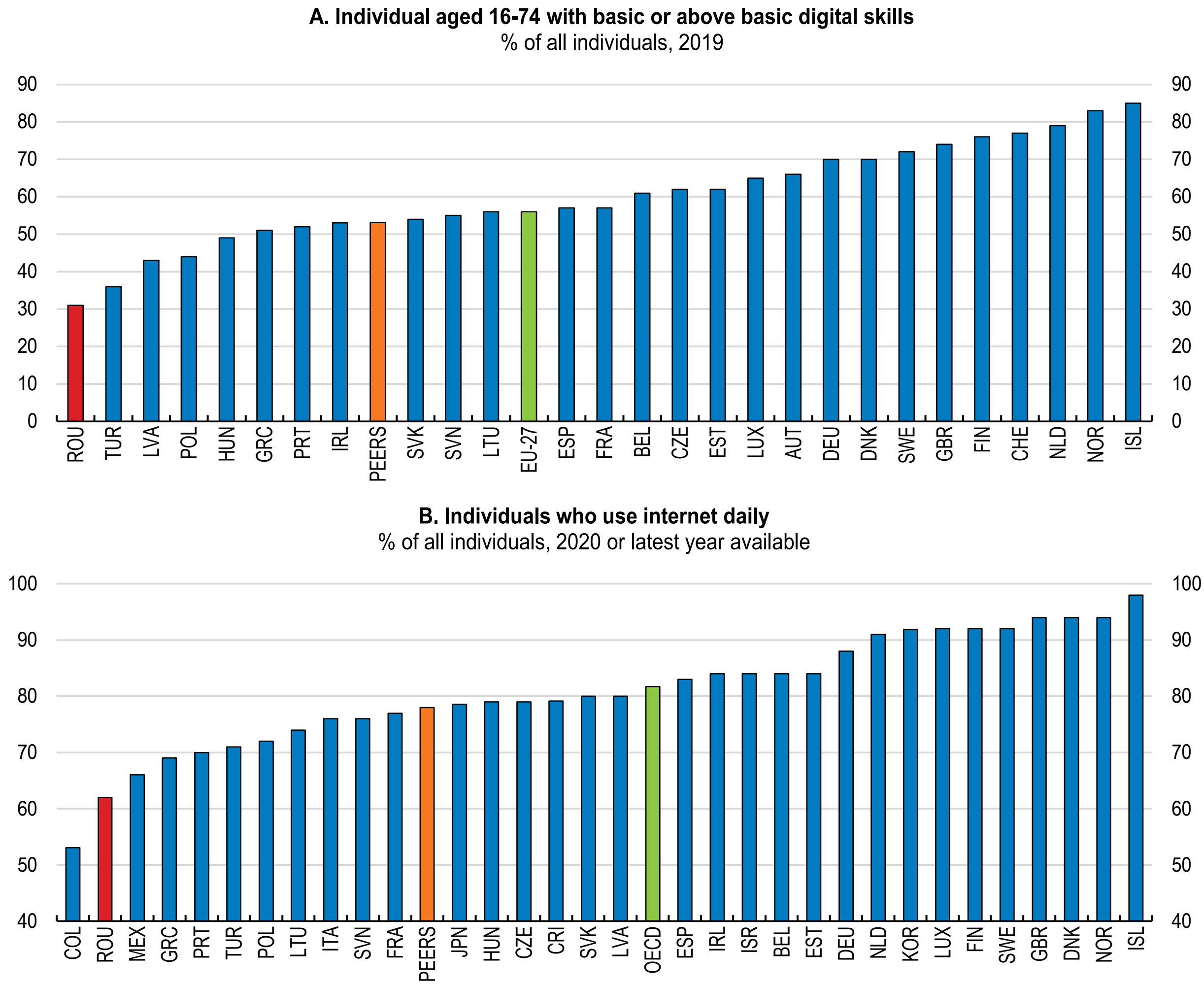
While the IT infrastructure is of good quality on average (see Chapter 2), Romania lags behind its OECD peers in terms of exposure to digital technologies. High-tech hubs (Bucharest, Cluj-Napoca, and Timisoara) coexist with areas with low IT penetration. A large number of Romanians do not have basic digital skills nor use digital tools (Figure 3.8), in particular in rural areas and among the old age and the poorest people. Access to ICT training is limited. For instance, in 2019, only 6% of firms provided training to their personnel to develop or upgrade their ICT skills (vs. 23% in the EU and 19% in OECD CEE countries according to Eurostat data). This share did not increase in 2020, despite the development of teleworking and the increasing demand for online services due to the physical distancing measures.

Regional inequality in skills provision is large and some regions are stuck in a low skills trap. Both the supply of and demand for skills is relatively low in some regions, which can create a vicious cycle or low investments in skills and poor quality jobs (OECD, 2018b). Workers will have low incentives to upgrade their skills, knowing they will not be able to find jobs in the local economy that use them, and employers may be reluctant to move to more skill-intensive production and services, knowing that they are unlikely to find the workers with the skills needed to fill these positions. This calls for adapting policy actions to the local context and take into account regional specificities.

Digitalisation will affect a large number of jobs

While it can help to tackle shortages in labour intensive industries and create quality and productive jobs, digitalisation might exacerbate already high inequalities in the labour market (OECD, 2019e). Technologies can replace workers for routine tasks, mostly performed by low and medium-skilled workers who are already more exposed to unemployment risks. Nedelkoska and Quintini (2018) estimate that 14% of jobs in OECD countries are highly automatable, and that another 32% may undergo significant changes due to automation. Overall, the risk of automation declines with the level of skills and education, except for some low-skilled professions (e.g. for personal care). Digitalisation can also exacerbate regional inequalities as some regions concentrate high-tech firms, high paid jobs and high-skilled population.

Figure 3.8. A large share of the population lacks digital skills



Note: PEERS comprises Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia, and Slovak Republic.
Source: OECD, ICT database; and Eurostat.

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The share of jobs at risk of automation is higher in OECD Eastern European countries than in the OECD on average (Nedelkoska and Quintini, 2018). Romania has a relative high share of routine jobs in the manufacturing, ICT and agriculture sectors (World Bank, 2020b). According to McKinsey (2018), 54% of workplace activities could be automated by 2030 in Romania. PwC (2019) estimates that around 600 000 jobs will be affected by the digital transformation, with 325 000 jobs creations and 275 000 workers needing reskilling.

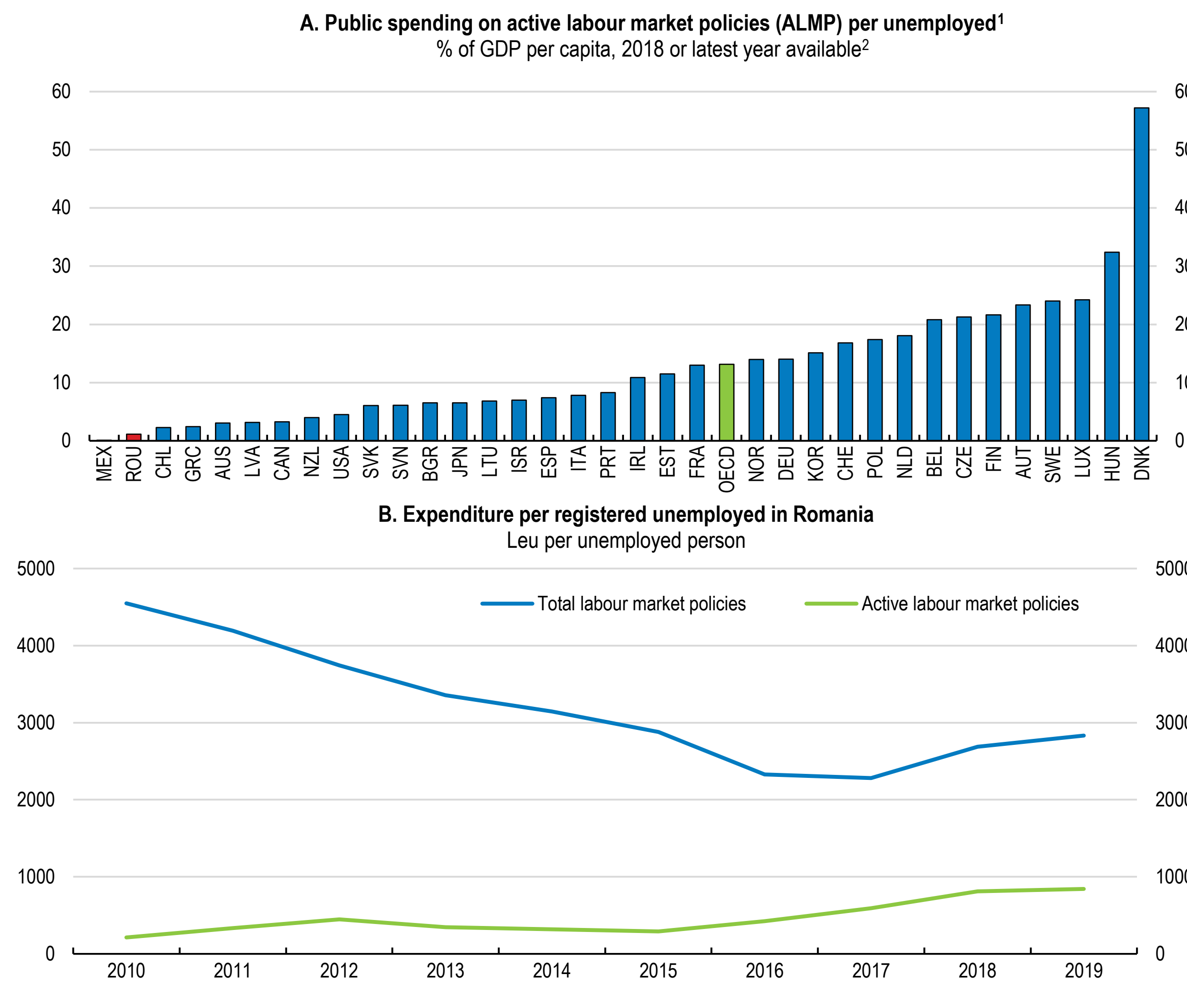
Fostering participation in the formal labour market

Raising participation in the formal labour market is key to increase living standards together with reducing gender and ethnic inequalities. Employment is the main route out of poverty and mobilising untapped labour resources can raise Romania's growth potential. According to recent OECD estimates, increasing the average participation rate to the OECD average and closing half of the gender gap would boost GDP per capita respectively by around 8% and 6% after 10 years. Doing so requires tackling multiple barriers to participation, while increasing the employability of inactive people. Improving active labour market policies can help, since too few inactive people are within the reach of public employment services (PES). Specific barriers to female and Roma employment needs to be addressed. Finally, more needs to be done to improve working conditions and eliminate undeclared work.

Improving the effectiveness of active labour market policies

Active labour market policies are key to mobilise the workforce detached from the labour market and to address the multiple barriers jobless people face to (re-)enter employment. They can also play a central role in the relocation of displaced workers from sectors affected by the pandemic to those with better prospects. However, business representatives in Romania consider labour market policies could do better to help jobseekers reskill or find a new job (WEF, 2019). Before the pandemic, spending on active labour market policies (ALMPs) has been very low and a large share of jobseekers was not participating in activation measures (Figure 3.9 and Figure 3.10). In 2018, only one in eight long-term unemployed was registered with PES (European Commission, 2019). In 2020, spending on active labour market policies increased by 11%, less than the total number of registered unemployed.

Figure 3.9. Spending on active labour market policies has been low



1. Active labour market policies include expenditure on the PES or other administration, training, employment incentives, supported employment, direct job creation and start-up incentives.
2. 2019 for Romania, 2017 for the Czech Republic and 2018 for the other countries.
Source: OECD Labour Statistics; European Commission, Labour Market Policy database; and OECD Economic Outlook database.

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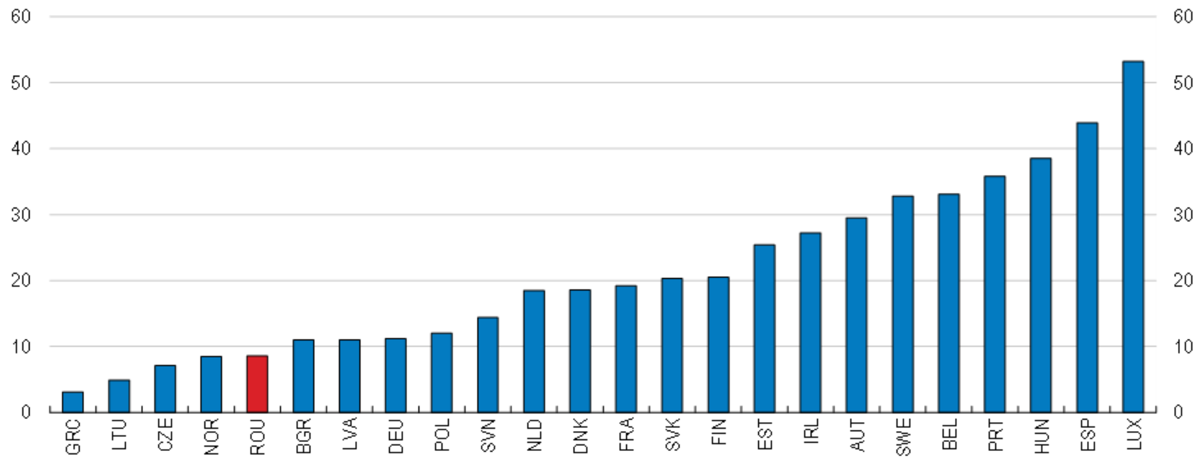
Figure 3.10. Participation in active labour market policies needs strengthening

Participation in active labour market policies of registered unemployed, as % of registered unemployed, 2019 or latest year available



Source: European Commission, Labour Market Policy database.

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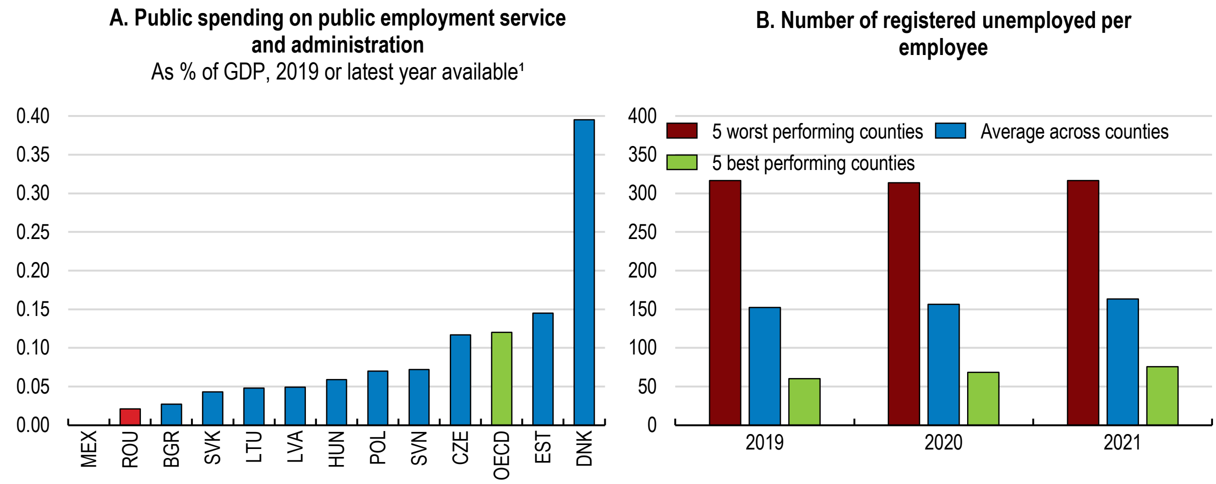
The understanding of job opportunities and ALMPs is limited among jobless people (CDR, 2018), contributing to low participation in activation programmes. This calls for developing reach-out mechanisms to engage with those detached from the labour market in job search or training. This requires increasing financial and technical resources allocated to PES from very low level (Figure 3.11), while reducing bureaucracy that has been identified as another important barrier to participation (CDR, 2018). The workload of PES staff has increased with a growing number of jobseekers and of vacant positions in the National Agency for Employment (ANOFM) due to recruitment difficulties. The number of employees in ANOFM has declined by 8% since 2016, while it was already low by international standards (European Commission, 2018b) and is unequally distributed across countries (Figure 3.11).

Measures to develop profiling tools and target PES support on the more vulnerable jobseekers that would generate large efficiency gains have been delayed. Profiling tools are in place, but PES do not provide personalised services based on the specific profile of job seekers nor on labour market analyses. Developing IT tools to support the establishment of a client-oriented PES and reduce red tape is thus priority, as it can free up resources and thus support caseworkers in coping with increasing number of clients (OECD, 2020d). An integrated information and management system to improve the links between job training, job placement and labour market information and online local jobs portals are considered as good practices and should be developed. Automation of procedures, such as registering jobseekers and processing unemployment insurance benefits, *via* exchange of data across administrations, like in Estonia, could contribute to saving scarce staff resources.

Strengthening cooperation between public administrations could help enhance the reach of ALMPs. Programmes to integrate employment services with social, education, and health services, in 139 marginalised communities, have started in 2019 (POCU project) and should serve as pilots for an implementation at the national level. Expanding the coverage of social assistance benefits from current low level can also increase participation in ALMPs, as the allocation of benefits is conditioned to registering with PES. Implementing the Social Inclusion Income (VMI) reform, voted in 2016, that aims at streamlining the social assistance system and increasing its coverage and adequacy, is thus priority (see Chapter 1).

Figure 3.11. Public employment services have been underfunded



1. 2019 data for EU countries, 2018 for the other countries.
Source: European Commission, Labour Market Policy database; and Ministry of Labour and Social Protection.

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The efficiency of active labour market policies could improve as well. Employment incentives accounted for 85% of spending on ALMPs before the pandemic, by far exceeding levels seen in CEE OECD countries (32%). While international studies find them to be among the most effective tools to improve the employability of jobseekers, they also suffer from a high deadweight cost, i.e. many employers receive subsidies to recruit someone they would have hired anyway and can have substitution and displacement effects (Cahuc, Carcillo and Zylberberg, 2014). The risk of large deadweight losses is high in Romania since subsidies are poorly targeted and cover a large number of jobseekers, including graduates of educational institutions and unemployed over the age of 45. In addition, they are relatively generous, reaching RON 2250 per month (close to the minimum wage of RON 2300) during 12 months. To improve cost efficiency of the measure and reduce the deadweight loss, employment subsidies should target jobseekers with the lowest employability, especially low-productivity workers and long-term unemployed.

Up-skilling and re-skilling measures can improve jobseekers' employability, but little emphasis has been put on training, information and guidance services in Romania (Vasilescu, 2018). Only 14% of spending on ALMPs measures was dedicated to training before the pandemic, well below the EU average. Consideration should be given to develop courses turned toward strong practical component. In addition, more should be done to analyse the effectiveness of vocational training measures directed to jobseekers. An evaluation framework for labour market programmes is still missing. Government plans to improve data collection through a centralised IT system should be accelerated and systematic impact assessments should be carried out to focus funding on those interventions that are cost-efficient and limit deadweight. The planned implementation of the "ReCONECT" programme that aims at establishing an integrated mechanism for anticipating labour market needs, as well as monitoring and evaluating public policies, including activation measures and professional training, is a step in the right direction.

Providing specific support to the Roma population

Specific policies should be dedicated to the disadvantaged Roma communities, which face multiple barriers to employment (Toderita et al., 2018). Labour market participation of Roma is much weaker than in other OECD CEE countries, especially for women, pointing to the need to strengthen targeted measures. Fostering participation in the labour market would be the best remedies against poverty and social exclusion in these communities. Improving the employability of the Roma population, which is much younger than the non-Roma one, would also contribute to rejuvenating the work-age population, tackling labour shortages, and enlarging the tax base.

Outreach, including hiring of mentors for Roma jobseekers or mediators, should be reinforced as Roma tend to be less well informed about employment opportunities and their rights to benefits (FRA, 2016). In this respect, the above-mentioned project of establishing integrated community services is a step in the right direction. Living in marginalised conditions and poverty affects Roma's employment opportunities in multiple ways, including educational outcomes and the process of school-to-work transition (FRA, 2018). Therefore, addressing poverty as a multidimensional phenomenon is priority and requires combining active labour market policies with social policy instruments, as well as combating stereotypes (see Chapter 1). Authorities should collaborate more with non-governmental associations with a good track record of effective support for Roma and can also outsource some of the services to non-state providers to target the hard-to-place job-seekers from disadvantaged groups (Tergeist and Grubb, 2006; Bednarik et al., 2019).

Supporting social economy enterprises is another avenue to improve the integration of Roma in the labour market (European Commission, 2014a; OECD, 2021a). Those enterprises can be an alternative to public works schemes that do not provide relevant skills and can even lower the probability of finding employment after the programmes have ended (Card et al., 2015). Lock-in effects that prevent enrolees from job search or training activities can lead to a long-term exclusion from the primary labour market. However, in Romania, public policies targeting social enterprises are limited in scope and do not effectively support their development (European Commission, 2019b; OECD/European Union, 2018). Support measures, including free legal or management counselling, reserved contracts in public procurement, are poorly implemented not least due to weak administrative capacity. Other barriers include highly bureaucratic certification procedures and limited access to finance. To address these issues, some inspiration could be taken from experiences in OECD countries (Box 3.1). For instance, in Hungary, resources centres support Roma people in setting up cooperatives with training and consultation sessions. In any case, systematic performance monitoring and impact evaluation should be implemented to determine if these programmes are as efficient and effective as intended. The inclusion of measures to support social enterprises in the national Recovery and Resilience Plan is welcome, but their effective implementation will require a careful monitoring.

Box 3.1. Promoting social enterprises

Policy makers have a crucial role to play to support the development of social enterprises. Creating and managing a social enterprise can prove difficult not least due to the specific skills it requires and greater difficulties to access funding. A compendium of good practices (OECD/EYU, 2017) for policy makers to draw inspiration from the design and implementation of different policy initiatives in the EU identified key avenues for reform:

- Build appropriate legal framework to clearly define the nature, mission and activities of social enterprises and promote it.
- Create support structures to raise visibility, especially among investors, and to play an intermediary role among all relevant stakeholders.
- Engage and consult with the relevant stakeholders for instance by establishing strategic partnerships to facilitate participation in value chains and access to skills and networks.
- Facilitate access to business development services and specialised support structures (hubs, accelerators, incubators) to build social entrepreneurial skills (e.g. training on how to navigate public procurement procedures, developing business plans, accessing financing sources).
- Support risk-sharing mechanisms for finance providers (e.g. guarantee schemes).

- Foster social entrepreneurship skills in the education system, with specific educational programmes and partnerships with research institutions.
- Ensure continuity of support in time and across different government levels (central and local).

Source: OECD/EU (2017), OECD/EU (2013) Policy Brief on Social Entrepreneurship – Entrepreneurial Activities in Europe.

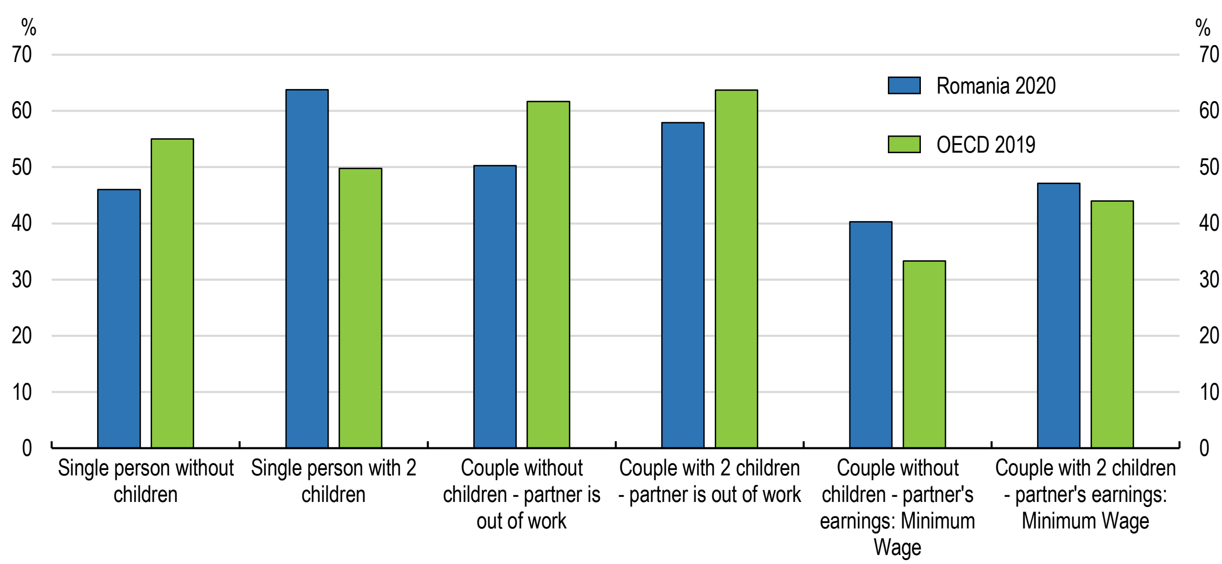
Removing barriers to participation of women

Raising the participation of women in the formal labour market could significantly increase Romania's labour supply. Halving the gender gap in participation would increase the labour force by around 6.5%. The labour market participation of women was 19 percentage points lower than for men before the pandemic, one of the largest gap when compared with OECD countries (see Figure 3.3). The gap had increased over the last decade and continued doing so in 2020, possibly because women disproportionally bore childcare responsibilities during school closures and are overrepresented in the sectors most affected by the COVID-19 crisis. Differences in participation are much more pronounced in rural areas, where participation of women reached only 67%, reflecting the relative high share of women working in the informal economy. It is also large in Roma communities, where 13% of Roma women are employed, a third less than Roma men (FRA, 2016).

Financial gains of taking up a job for single parents and second earners are relatively low when compared to the OECD average (Figure 3.12). The effective tax rate on entering employment has increased over the past two years. The withdrawal of benefits for households with children is particularly costly when non-working partners move into work (Kalyva et al., 2018). A labour market insertion incentive given to parental leave recipients, to help them re-enter the labour force, has increased in 2021, but its impact needs to be carefully assessed.

Figure 3.12. The effective tax rate on entering employment is high for lone parents and second earners

Participation tax rates at the minimum wage, by family composition



Note: This indicator measures the proportion of earnings that are lost to either higher taxes or lower benefit entitlements when a jobless person takes up employment at the minimum wage level. Estimates for 2020 do not include the increase in the labour market insertion incentive implemented in 2021.
Source: OECD tax-benefit models and policy database (http://oe.cd/taxBEN).

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Care responsibilities can negatively affect participation in the labour market (OECD, 2017a). In Romania, women are disproportionately the principal caregivers for children, elderly or disabled relatives, with women spending twice as much of their time on unpaid care work than men, a level close to the average of high-income countries (ILO, 2018b). Around 34% of women declare caring responsibilities, while only 2% men do so. While the impact of motherhood on the employment gender gap is relatively low compared with CEE peers, it is much more pronounced for low-educated women. Women also bore most of the epidemic-related childcare burden triggered by school closures (UN, 2020). The paid leave for parents introduced in 2020 to mitigate the impact of the COVID-19 crisis on families with children has likely helped to maintain female employment during the lockdown though.

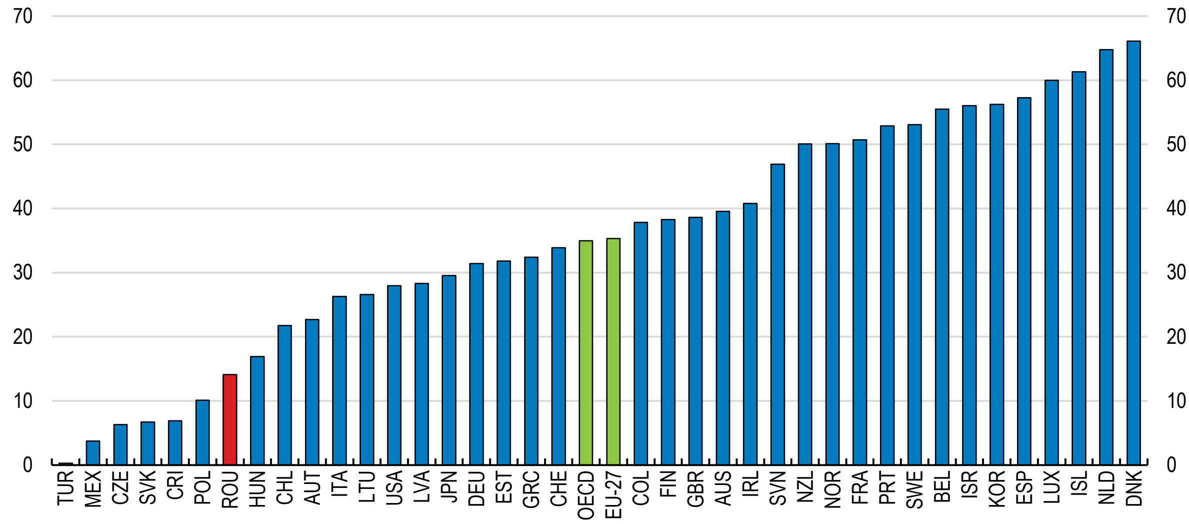
Expanding childcare and early childhood education facilities is important to improving the labour market participation of young mothers. Participation in early childhood education is much lower in Romania than on average in the OECD (Figure 3.13). At the same time, early education is considered as an increasingly important part of the education system, as it has positive effects on future learning outcomes, especially for children with a disadvantaged background. The “Educated Romania” project includes notably objectives of increasing participation in preschool education of children up to 3 years old to 30% and the establishment of national curriculum at all levels of early education. Incentives for enrolling children aged between 3 and 5 in early education have been reinforced. Since 2020, low-income families can receive RON 100 per month (around EUR 20) for each child enrolled at the kindergarten.

However, more needs to be done to support participation of children below 3. Shortages of childcare facilities, especially in rural areas, still need to be addressed. More than 90% of the nursery places are located in urban areas (OECD, 2020f). In Bucharest, there were only around 4000 places in crèches for a population of 50 000 children aged below 3 in 2018 (World Bank, 2019). Informal employment in the childcare sector is widespread, but is mainly used by high-income families (Polese & al., 2018). The national Recovery and Resilience Plans foresees the establishment of 110 new nurseries and 412 of complementary services, servicing up to 4 500 children from 0 to 6 years-old and 20 000 children from disadvantaged backgrounds respectively, as well as the creation of a framework programme for the continuous training of professionals in early childhood education (European Commission, 2021).

Developing healthcare for elderly people, rehabilitation, palliative or home-care services would also help labour market participation of women. While Romania is ageing fast and demand for long-term care is increasing, the coverage of long-term care provision remains low, reaching less than 1% of the old-age population. Despite a strong increase in the number of public homes for the elderly since the early 2000s, less than 0.5% of people over 65 lived in a residential care in 2016 (Vladescu et al., 2016). In 2017, there were 11 beds in residential long-term care facilities per 1000 population aged 65 years old and over, four times less than in the average OECD country. The financial decentralisation of social services led to uneven development, a lack of transparency and unpredictable financing (Spasova et al., 2018, WHO, 2020).

Figure 3.13. Early childhood education enrolment remains low

Percent of children enrolled in early childhood education and care services, 2019 or latest available



Note: Data refer to 2019 for EU countries, to 2011 for the United States, and to 2017 for the other countries. For EU countries, enrolment includes children 0-3 while for the other countries, it refers to 0-2 year olds. Data generally include children enrolled in early childhood education services (ISCED 2011 level 0) and other registered ECEC services (ECEC services outside the scope of ISCED 0, because they are not in adherence with all ISCED-2011 criteria). Data for Denmark, Finland, New Zealand, the Slovak Republic, Slovenia, and Spain cover early childhood education and care (ISCED 0) only.
Source: OECD Family Database; and Eurostat.

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Non-residential services are also underdeveloped and there is an insufficient number of workers in the field (OECD, 2020e). In 2018, the government employed 7000 people, as personal assistants for older people, equivalent to less than 0.2% of the total population older than 65 years (WHO, 2020). A national strategy to support caregivers and develop care services is needed, starting by establishing stable financing mechanisms. The national Recovery and Resilience Plan includes the provision of vouchers that should contribute to the formalisation of 60 000 workers in the home care sector. While this is a step in the right direction, this measure will mainly benefit wealthy households that can afford hiring domestic workers. Investment in a network of 71 day-service centres and in mobile teams of care providers is planned. Improving access to quality long-term care will require a more ambitious reform of the system, including the development of integrated services and quality monitoring, as well as the provision of stable financing.

The length of paid leave available to mothers exceeds the OECD average (108.7 weeks vs. 53.9 weeks in the OECD). The parental leave can reach 24 months and is paid 85% of the monthly salary with a cap (Popescu, 2021). While high-wage earners tend to return earlier that the maximum period allowed, financial gains to do so are limited for medium or low-wage earners. Financial incentives to return to work before the end of the parental leave have increased though. The insertion incentive is RON 1500 (around EUR 300) if parents return to work before the child is 6 months old and RON 650 (around EUR 130) per month otherwise. It is provided until the child is two years old (or three years in the case of children with a disability). The decline in uptake of this benefit during the crisis suggests the pandemic discouraged the labour market participation of parents on leave (Popescu, 2021). In addition, paid leave reserved to fathers is relatively short (5.3 vs. 8.1 weeks in the OECD). Increasing the “daddy quota” – the minimum share of available parental leave reserved to fathers on a ‘use it or lose it’ basis - to the average OECD level would accelerate the return of mothers to the labour market and have a positive impact on children and parents well-being (OECD, 2017b). In 2022, Romania will implement the EU Directive that extends the minimum period of parental leave that cannot be transferred from one parent to the other and sets the minimum duration of paternity leave to 10 days.

Tackling undeclared work

Designing policies and institutions to address the problem of widespread labour informality is a mandatory condition to improve job quality and free-up resources for productive and formal employment. Undeclared work that materialises through the absence of a work contract, hidden self-employment, and wage envelopes, highjacks resources and is associated with poor working conditions and career prospects as well as the absence of training (OECD, 2018c; Parlevliet and Xenogiani, 2008). Informal workers tend to be more exposed to health risks, as firms in the informal sector invest relatively less in workplace safety and operate outside of the purview of government regulation (Forastieri, 1999). Safety at the workplace needs to improve in Romania. At 5.3 per 1000 employees, the incidence of fatal accidents at the workplace was the second highest in the EU in 2018. The incidence of non-fatal accidents is extremely low in international comparison, suggesting underreporting issues. The COVID-19 pandemic strengthened the need to ensure health and safety at workplace with adequate preventive measures. In the longer term, it will be important to adapt the work environment to an ageing workforce.

The persistence of informal employment in Romania is due to a large number of interlinked factors (Parlevliet and Xenogiani, 2008). First, poverty, which is among the main reasons pushing people into informality, is still high in Romania, especially in rural areas where job opportunities are scarce and subsistence farming remains the only option. Emigration is an additional determinant, as temporary migrants return to Romania for short periods of time and tend to engage in informal work. Bureaucracy increases the cost of formalisation. Finally, a number of societal factors such as the culture of non-compliance and the lack of trust in public institutions, especially in their capacity to manage public resources and deliver quality public services, play an important role. Improving the quality of public services provided, in particular social security, and communicating effectively on the benefits of formal work are necessary actions to tackle voluntary informal work.

Substantial efforts have been made to tackle informality, notably by revising the labour market regulation, reforming the tax system, and carrying out national awareness campaigns. The impact of these measures is unclear as evaluations are missing. Simplified procedures for business and workers' registration have reduced the cost of formalisation. The decline in the tax wedge over the past decade likely helped to encourage formal employment. At the same time, the relatively high level of labour income taxation can encourage false self-employment.

Efforts to detect and punish undeclared work should continue. Strong labour law enforcement is a necessary condition to eliminate undeclared work. The Romanian Labour Inspectorate is well staffed by OECD norms, which is appropriate given the size of informality. It provides online and onsite advice publishes an information letter, issues verbal warning to promote compliance with the law. This can improve the protection of workers without excessively burdening enterprises. Sanctions imposed by the Labour Inspectorate amount to 20 000 lei, amounting to 30% of the annual average gross wage in 2019. Because it is one of the most important factor determining effective deterrence (Weil, 2008), the level of fines should be set to a level that is proportionate to the seriousness of the violation and effectively discourages law infringement. For instance, it should be higher in case of recidivism, revised on a regular basis, and indexed at least on inflation. To facilitate the formalisation of work, the transition to formality could be encouraged by reducing the fines if the employer employs the worker on a formal contract, the fine being reduced with the length of the contract offered like done for instance in Greece (Williams, 2021).

Joint control action of the labour inspectorate and the fiscal administration are possible under a collaboration protocol. Nevertheless, coordination between law enforcement agencies could be improved. For instance, the labour inspectorate cannot intervene in all suspected cases of false self-employment and has no obligation nor protocol to alert the tax administration (Heyes and Hastings, 2017). A risk assessment system based on more information sharing, including by merging the data on contractual agreements (REVIVAL), company registry and taxes should be developed. Expanding joint actions should also be envisaged. In Lithuania, for instance, after a first screening exercise based on employees tax declarations, interviews or inspections of firms suspected of undeclared work were planned and shared between law enforcement agencies (OECD, 2018d).

Social dialogue should also play a key role in ensuring effective labour law enforcement and a safer work environment (OECD, 2019j). In particular, trade unions can support workers in their complaints against non-compliance and provide information on job hazards. In Romania, the trade union density is relatively large (around 23% in 2019), but on a fast declining trend. Social partners have limited power as they play only a consultative role in forming the economic and social policies and are not involved in most collective negotiations. In 2015, more than 90% of the collective agreements did not involve trade unions (Eurofound, 2019).

Like in many OECD countries, collective bargaining has weakened significantly in Romania over the past decade following a social dialogue reform in 2011 (Chivu et al., 2013). The number of employees covered by collective agreements has declined sharply, from 98% in 2011 to around 45% in 2019. This is partly due to relatively strict representativeness criteria and high fragmentation of employers' organisations and trade unions. This is worrisome as collective bargaining plays important roles, not least in ensuring improvement of working conditions and access to training (OECD, 2019j, OECD, 2018c, Keogh, 2009;).

A legislative project aiming at strengthening the social dialogue by revising representativeness criteria for trade unions and the role of employees in the collective bargaining process has been debated in Parliament, but no agreement has been found due to strong opposition from the employers' confederation. It is important to resume the negotiations. Another option to strengthen the social dialogue would be to establish work councils that can initiate a collective labour dispute and have bargaining prerogatives in firms that do not have trade union representatives. The national Recovery and Resilience Plan and the Operational Programme "Education and Employment" 2021-2027 include support interventions directed at social partners to strengthen their capacity to cooperate and engage in social dialogue, but given the diversification of the forms of work and the fragmentation of the labour market restoring social dialogue will be challenging.

Bringing youth in

Labour market outcomes of young people have improved before the pandemic, though not as much as those of the rest of the population. The unemployment rate of those aged 15 to 24 fell from 24% in 2011 to 17% in 2019, above the OECD average of 12% though. The progress before the pandemic clearly reflects the favourable economic conditions and high emigration flows, while the positive impact of labour market policies is less evident. The gap between youth and total unemployment rates has widened dramatically over the past few years, with the youth unemployment rate reaching four times the national average in 2019. The school-to-job transition is difficult for low-skilled youth. A high number of young Romanian leaves the school system without acquiring competencies to adapt the labour market and its fast changing needs. Rapid growth of labour costs disconnected from economic fundamentals before the crisis might also have priced out unexperienced low skilled workers from the labour market.

Youth unemployment has increased moderately since the start of the COVID-19 crisis (from 16.8% in 2019 to 17.3% in 2020). Nevertheless, the pandemic risks leaving long-lasting scars on careers of youth people, not least by complicating access to education and training. Policies can contribute to mitigating these adverse effects, as illustrated by the experience of OECD countries (OECD, 2021c). An ambitious and comprehensive policy package is needed so that no young person is left behind (OECD, 2021d).

Preventing and addressing school dropout

Reducing high dropout rates in upper secondary education and providing a minimum education level to every citizen is a precondition to improve current and future labour market performance. Individuals with low basic skills are more likely to be persistently detached from the labour market and not to have access to training in their adult lives. The National Strategy to Reduce Early School Leaving (2015-2020) aimed at reducing the share of school leavers to 11.3% by 2020 from 19% in 2015. Reaching the target is challenging as early school leavers' face multiple difficulties, including poverty and social exclusion, which have been aggravated by the COVID-19 crisis. In 2020, 15.6% of young people were early leavers from education. The national Recovery and Resilience Plan rightly identifies the reduction of school dropout as a key priority.

During the pandemic, school closures have disproportionally affected disadvantaged pupils who did not have access to remote learning. The World Bank estimates that illiteracy could increase by 10 percentage points in the aftermath of the crisis (World Bank, 2020b). Policies to provide remote learning and support teachers and pupils included the provision of ICT equipment, guidelines to teachers, TV broadcasts and online learning platforms. To compensate for learning losses due to the disruptions of face-to-face learning, a programme "School after school" was in place for around 6 months in 2021 in primary and secondary schools. The objective is to offer face-to-face remedial courses to 168 000 vulnerable children. Remedial instruction is crucial to help those children who have missed school to get back on track and reduce long-term learning losses. Evaluations to assess the learning gaps on a regular basis, like done in France for instance, would be a first necessary step. Targeted measures to address gaps identified in these evaluations should then be implemented. Programmes should be prolonged according to the needs and coordinate with other on-going initiatives to tackle school dropout.

The government strategy to reduce early school leaving encompasses a large range of measures, such as the development of early warning mechanisms to identify at-risk students, community mediation to reach out to families in risk groups, and remedial school with individualised intervention plans. Envisaged measures also include mentoring of teachers and school principals and the provision of training and learning tools to address educational special needs, both at the national and schools levels. Social programmes currently offer cash and in-kind benefits for disadvantaged students, including means-tested scholarships, hot meals, subsidies to acquire IT equipment and reimbursement of transportation costs. Other projects are targeted at vulnerable groups or disadvantaged schools, such as "the Romanian Upper Secondary Project" to improve passing rates in the baccalaureate of underperforming high schools and "Inclusive schools: Making a difference for Roma children" (INSCHOOL) launched in 2019. The on-going mapping of disadvantaged schools will contribute to improving the allocation of resources in the school network.

However, government initiatives have been limited in scope and scale so far. Second chance programmes have been extended but their distribution is uneven and below demand (OECD, 2020g). To address implementation issues, guidelines were provided to schools, but the impact remains to be seen. Students at-risk of failing are concentrated in disadvantaged schools in rural areas, which have inadequate resources and do not attract experienced teachers (see Chapter 1). The capitation formula that determines around 92% of school funding does not to take into account the socio-economic vulnerabilities of schools (World Bank, 2018b, Chapter 1). Since 2021, the formula allocates more resources to schools located in rural areas. A revision of school funding mechanisms is envisaged under the "Educated Romania" project, aiming at reducing large inequalities.

Romania could also define Priority Educational Intervention Areas as done in Portugal and France and allocate extra human resources or funding on a long-term and predictable basis. Other options include hiring youth coaches that advise and accompany young people at risk of dropping out from school or being marginalised like done in Austria, Norway or Uruguay (OECD, 2018e). Establishing a national network of youth mediators like done in Bulgaria should also be envisaged.

Romania also participates in the Youth Guarantee programme launched in 2013 by the European Commission and reinforced in 2020, a political commitment undertaken by all EU Member States to give all young people under 30 a good quality offer of employment, continued education, an apprenticeship or a traineeship within four months of either leaving formal education or becoming unemployed. This programme had only limited impact, as it reached only 14% of the NEETs and was not adapted to their needs (Toderita et al., 2019). Lack of consultation with main stakeholders and weak coordination at the local level were identified as the main obstacles to effective implementation. Reinforcing the cooperation between various actors involved in youth policies, including public employment services and educational authorities, like done in many OECD countries, including Australia, Latvia, Portugal and Norway, would be welcome (OECD, 2021e, OECD, 2016b). For instance, regional "partnership brokers" in Australia contributed to strengthening local connections between schools, businesses, community groups and families (OECD, 2016c, Box 3.2). In addition, as discussed above, improving the integration of vulnerable groups in the labour market will require improving the capacity of public employment services in reaching those detached from the labour market and targeting spending on active labour market policies to more effective programmes.

Box 3.2. The Australian "Partnership Brokers" programme

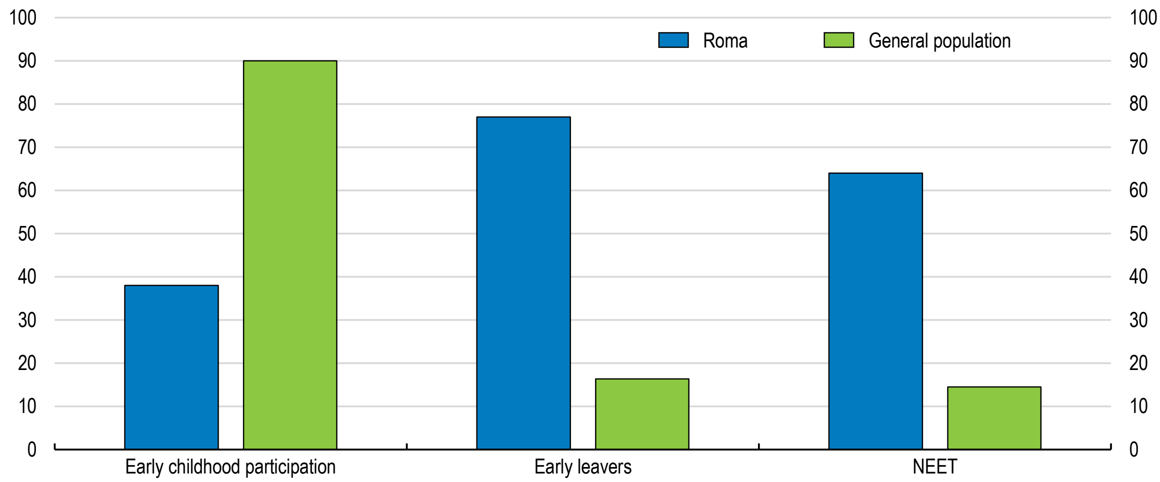
Youth policies are often poorly co-ordinated due to the fragmentation of responsibilities across a range of ministries and implementation located at different government levels (local, regional and national). Effective institutional structures can greatly contribute to institutionalising cooperation across the various actors. The School Business Community Partnership Broker ("Partnership Brokers") programme operated between 2010 and 2014 in 107 Australian regions is an innovative concept for improving the coordination of local policies for at-risk youth. It aimed at facilitating and strengthening local connections between schools, businesses, community groups and families, to promote educational attainment, social participation and successful school-to-work transitions among youth. Main tasks of the partnership brokers were to help disadvantaged young people access and navigate local support systems, to improve the collaboration of various actors involved in delivering youth support services, and to identify and help bridge gaps in service delivery. In practice, they organised locally regular interactions and informal exchanges of information between the various stakeholders. While the cost-effectiveness of the programme is impossible to assess in the absence of a formal evaluation, the initiative is deemed to have made a considerable contribution to linking up the key actors (supporting around 4 000 local partnerships).

Source: OECD (2016b) and OECD (2016c).

Specific measures are needed to address school dropout in the Roma communities. Educational attainment of the Roma population improved drastically: around 60% of the young Roma completed a lower secondary education level, twice as much as the older generation (World Bank, 2018a). However, the large gap with non-Roma persists (Figure 3.14). Roma's early school leaving rate is five time the national average and has increased with the closure of schools during the pandemic. Training and incentivising teachers to improve the quality of education in schools with a high percentage of Roma pupils and scaling up school mediation can help to reduce school dropout (World Bank, 2014). Engaging and communicating with parents on the benefits of school attendance, in particular for girls, is also crucial and give rather good results (FRA, 2016). Participation in early childhood education should also be fostered, not least because it has a positive impact on education performance over life (OECD, 2012). According to Ministry of Education estimates, less than a third of Roma children between 3 and 5 are enrolled in pre-primary education. Support measures, such as the hiring of school mediators, the establishment of kindergartens in some communities, and EU-funded grants in a few disadvantaged schools, are steps in the right direction, but should gain scope and scale.

Figure 3.14. A large number of Roma children are not engaged in education

% of individuals in each group



Note: Early childhood participation refers to children from 4 to compulsory school age; early leavers count for those aged 18-24 with at most lower secondary education and not in education (or training); Neither in Employment nor in Education or Training rate (NEET) refers to the 15 to 24 years (Eurostat).
Source: EU (2016), Second European Union Minorities and Discrimination Survey, Roma – Selected findings, European Union, Agency for Fundamental Rights; EU-SILC (2017) EU-LFS (2017/18); PISA.

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Improving the relevance of vocational education and training

One main cause of high dropout rates is the low quality and the low relevance of vocational education and training (VET) (OECD, 2020g). Competences acquired in vocational schools needs to better adapt to fast changing labour market needs. Outdated teaching methods lead to insufficient technical and job-related skills (World Bank, 2018a). Business leaders have a relative negative opinion about the adequacy of the skillset of VET graduates (WEF, 2019) and VET is still seen as a low status type of education by students and the public. At the upper secondary level, students graduating from vocational schools have higher employment rates than those coming from the general education, but the gain is much lower than on average in the EU. Like in OECD countries, VET has been hit hard by the COVID-19 crisis, as distance-learning tools are less suited for practice-oriented courses and the crisis-triggered reductions in work-based learning opportunities for students (OECD, 2021b). Measures have been taken to continue VET remotely, in partnership with companies, including the provision of methodological guides to support remedial activities (European Commission, 2020a).

The integration of key competences in the learning outcomes of VET schools, including digital skills, was finalised in 2016. The VET strategy 2016-20 also included a set of measures to modernise VET under the coordination of the National Centre for Technical and Vocational Education and Training Development, most of which started in 2019. Strengthening digitalisation in the VET system and continuous professional developments of VET teachers are seen as key interventions in the Recovery and Resilience Plan as well as of the EU-funded “Education and Employment” Operational Programme. Investing in teachers training will be key to ensure the curriculum transformation is effective and needs to be reinforced (OECD, 2020h; OECD, 2021f). Teachers’ participation in lifelong learning is among the lowest compared with OECD countries and continuing professional development is not connected to teachers’ needs and evaluation (European Commission, 2018c; Kitchen et al., 2017).

To improve matching between employers’ requirements and the educational offer in VET schools, consultative partnership-based structures have been established at the sector, regional and county levels to regularly identify labour market needs. Employers are involved in the definition of training standards every five years through sectoral committees and sit in VET school administration boards. A part of curricula are defined at the local level to adapt training to local labour market needs, developed by each VET school after consulting economic operators. Involvement of employers in committees has been uneven though and could be rather low in some sectors. The partnership networks were reorganised in 2019 and grouped by VET domains, improving participation.

Interaction with employers has not led to the rationalisation and streamlining of vocational programmes, including the decommissioning of outdated programmes (World Bank, 2019). Ensuring that the school network is responsive to the labour market needs requires improving capacity for school network planning, not least through the collection and the use of high-quality data (OECD, 2018f). It is thus welcome that feedback from VET students on the quality of VET courses has been collected since 2020 and will be used to review VET programmes. In addition, there is large room to improve skill anticipation. An effective assessment of skills needs at the national and sectoral levels is still missing and the forecasting of skills remains unused (European Commission, 2019). A forecasting system analysing changes in skills requirements and labour market developments, like the Estonian OSKA system, can provide relevant inputs for the design of curricula and the financing of educational institutions (OECD, 2019h). The abovementioned “ReCONECT” project is a step in the right direction.

Employers’ involvement in VET provision, through the recruitment of entrepreneurs as teachers and the development of in-job training for both teachers and students can improve labour market relevance of VET programmes (OECD, 2021f). Learning in the workplace allows trainees to develop hard skills on modern equipment and soft skills, including communication, teamwork, and negotiation. It facilitates recruitment for employers by allowing employers testing trainees’ competences. The share of pupils in upper secondary VET who participate in workplace training sessions is relatively low, reaching 35.8% in 2019. Until very recently, the Romanian VET system has been biased towards school based learning, as work-based training was removed from programmes in 2009. Compared to the 2011/2012 school year, the number of students enrolled in professional schools where work-based-learning is part of the VET programme increased seven-fold. Of the 85,000 students pursuing this study field in 2019, 15% were enrolled in dual education. The number of new entrants to dual VET was almost three times higher than in 2017/2018, revealing strong interest among students and companies in this training path (European Commission, 2020a).

Administrative procedures and financial cost related to logistical difficulties undermine the development of in-work training, especially in SMEs (European Commission, 2018c). Small firms may not have the capacity to train all the skills students need to acquire (Kuczera, 2017). Encouraging firms to offer training jointly, as done in many OECD countries including Germany and Austria would facilitate their participation in workplace-based learning. A body that coordinates the placement of students, evaluates the needs and the pedagogical capacity of firms, helps with administrative procedures, planning and implementing training on the job should be established. Inspiration could be taken, for instance, from Koreas’ Human Resources Development Service (HRD Korea) that connects apprenticeship programmes with SMEs seeking skilled workers and offer a wide range of services to firms including long-term low interest loans to establish training facilities or equipment (World Bank, 2018c). A mechanism to coordinate work-based learning in initial VET is envisaged under the “Education and Employment” Operational Programme for the 2021-2027 period, notably to support the placement of students in firms. This institution could operate on the basis of a public-private partnership.

The COVID-19 crisis risks undermining the development of the dual VET system, as employers tend to offer fewer work-based learning opportunities during recessions, mostly due to the need to reduce costs (OECD, 2021b). Options to support the continuity of VET provision in this context include bringing more practical component in the classroom and the use of digital technologies (simulators, augmented or virtual reality). The latter will be supported by EU funds and enlarged for qualifications in all main economic sectors.

Promoting digital skills in initial education

More emphasis should be put on digital skills in initial education to ensure all students have a minimum digital background. School curriculum and teaching practices increasingly include digital aspects with the introduction of ICT and programming classes in secondary schools in 2017 (European Commission, 2017 and 2018c). The share of teachers who frequently use ICT in class has significantly increased between 2013 and 2018 (from 23% to 56%, above the OECD average of 52%). While they have accelerated since 2020 following school closures, efforts need to continue to improve ICT infrastructure and equipment in school as well as teacher training. Half of principals reported shortage or inadequacy of digital technology for instruction in 2018, double the OECD average before the pandemic (OECD, 2019g). Despite recent investments, the need for equipment and training for ICT use in teaching remains large. Investment planned in the Recovery and Resilience Plan (i.e. the modernisation of around 6 000 IT laboratories) will help.

High-quality training to teachers on how to integrate digital elements in the pedagogical practices is crucial to make the most of available technologies. The use of ICT for teaching has been included in teachers' initial education, but a relatively large share of teacher declare they highly need additional training (OECD, 2019g). Moreover, while the perceived need for training has increased, participation in professional development in ICT skills for teaching has declined before the COVID-19 crisis (OECD, 2019g). In 2020, a range of measures has been implemented to ensure the continuity of learning following school closures and the transition to remote learning. The "Relevant Curriculum, open education to all" programme aimed at developing competences of teachers in primary and secondary education for the use of ICT tools and online learning platforms (training, webinars, events). 48 regional e-learning experts have been trained to support teachers and open digital resources have been provided via online portals and TV programs. To develop such measures further, Romania could take some inspiration from Chile and Israel, where distance-learning tools are offered to teachers providing information and concrete examples on the potential use of ICT in learning processes, with – in the case of Chile – a special component for rural schools (Box 3.3).

Box 3.3. Integrating ICT into teaching practices: selected policy initiatives

Chile

A range of policy initiatives promotes the digital transformation of teaching practices in Chile. The educational programme "Enlaces" equips schools with ICT technology and provides teachers instructional materials and strategies to incorporate new pedagogical tools into their classes. To develop ICT skills of teachers and to build attitudes conducive to the use of ICT in classrooms, the programme includes in-person training opportunities and distance learning tools, so that teachers can concretely experience the potential of the use of ICT in learning processes. "Enlaces" contains a special component for rural schools (Enlaces Rural) with specific measures including the provision of offline digital resources to schools with limited internet access (Integrando la Ruralidad). "Rural micro-centres" (microcentros rurales) also provide teachers in rural areas with a space to share best practices, especially on pedagogical innovations needed to improve student learning and to receive technical assistance. In 2018, The Education Ministry's Innovation Centre launched a Digital Language Plan, a public-private partnership initiative, for training teachers to use tools that promote computational thinking and programming in the classroom.

Israel

The national programme, Adapting the Educational System for the 21st Century, initiated curricular changes to reflect a close link between competency-based learning goals, innovative pedagogies and the use of ICT in classrooms. Teachers receive training and tools (e.g. classroom-mapping sheet) to plan their use of ICT in the classroom, as well as financial incentives to train (a wage premium). A nationally run website, Educational Cloud, offer extensive digital content for both educators and students. It allows teachers to create and upload digital content and collaborate with other teachers on teaching in their classrooms. Furthermore, the guidelines for establishing an ICT Competent School provide schools with concrete directions on how to use the resource material effectively and collaboratively.

Source: OECD (2019g), OECD (2018f), and Santiago, P., et al. (2017), OECD Reviews of School Resources: Chile 2017, OECD Reviews of School Resources, Paris, https://doi.org/10.1787/9789264285637-en

Keeping labour costs under control

The employment opportunities of youth, particularly the less skilled, might be adversely affected by too high minimum wage levels. Theoretically, a statutory minimum wage set at too high level compared to the median wage could become a barrier to employment for low productivity workers by driving a wedge between productivity and labour costs (OECD, 2018b). High minimum wages can also discourage formal employment, by increasing labour costs, in particular in countries with a high proportion of low-wage earners, a high level of informality and relatively modest law enforcement (Davidescu & Schneider, 2017; Muravyev & Oschepkov, 2016; Mora & Mujo, 2017). The quantitative and qualitative effects of minimum wages on youth employment are empirically ambiguous, though, and depend among other things on the country regulatory environment (OECD, 2015; OECD, 2018b).

The national minimum wage in Romania almost tripled since 2008, the fastest increase by large in European countries, significantly outpacing average wage growth. Nevertheless, the minimum wage remains below the levels seen in all OECD CEE countries, reaching RON 2300 (around EUR 470) in 2021. The wage distribution is relatively compressed, with around 20% of people with a full-time contract earning the minimum wage in 2018 (European Commission, 2020b). Given the relatively low level of labour costs, firms’ high profitability, and increasing tensions in the labour market, negative effects on low-paid employment are found to be minimal so far (Vasile et al., 2017; Pantea, 2020; Heemskerk et al, 2018). Nevertheless, there is limited evidence of the impact of most recent increases of the minimum wage, especially on youth employment. The shift of social security contributions paid by employers to employees in 2018 has likely partly compensated the impact of the minimum wage increases on labour costs.

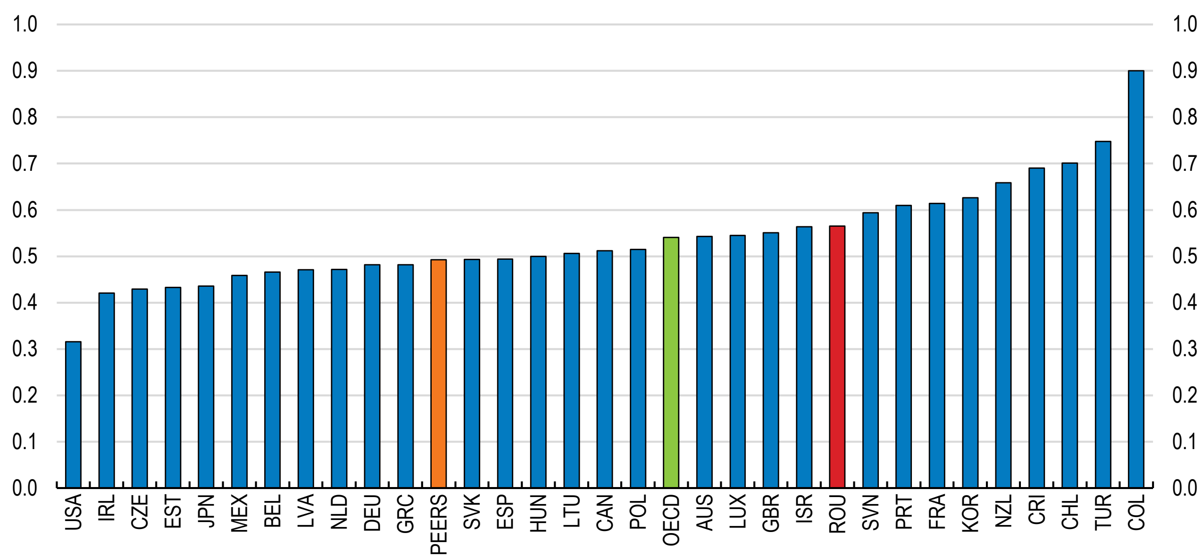
Raising the minimum wage further could hinder job creation for youth in the formal sector as it has almost reached 60% of the median wage (Figure 3.15). It can also have more adverse effects in regions with an above average unemployment rate and lower wage levels. To avoid excluding some workers from the labour market, the government should refrain from further raising the minimum wage without evaluating its impact on low-productivity workers both at the national and regional level. Limiting increases in labour costs will also be crucial to sustain the recovery of employment and support firms facing a lower level of activity due to the COVID-19 crisis. In 2020 and 2021, the minimum wage rightly increased in line with inflation and productivity growth. Over the medium term, increases of the minimum wage should not be faster than the average wage growth since the ratio of the minimum wage to the median wage is already comparatively high.

Until 2020, the government used to set the minimum wage without objective criteria and a foreseeable timetable. In 2020 2021 and 2022, impact analyses have been performed to guide the government’s decisions. The government should revise the minimum wage level on a regular basis based on a pre-defined methodology taking into account the labour market conditions and social partners’ views. Without a transparent framework and a specific schedule, political considerations and public pressure risk driving minimum wage adjustment (OECD, 2015). The government should ensure that the minimum wage remains attractive to Romanian youth, but also that the minimum wage is set in a way that does not create a disincentive for employers to hire them formally.

The introduction of an objective mechanism for establishing the minimum wage is among the objectives set out in the government programme and is included in the national Recovery and Resilience Plan. The mechanism, planned for 2023, is foreseen to be in line with the upcoming EU Directive establishing a common framework for setting minimum wages in EU member states. Establishing an independent commission of experts as done in Australia, France and the UK would help setting the right level of the minimum wage and would make the decision more transparent and predictable. At the same time, an indexation formula could be used as a benchmark to keep the minimum wage growth in real terms in line with productivity gains. Deviations from the formula would have to be justified in a transparent manner.

Figure 3.15. The minimum wage has converged to the median wage

Minimum wage relative to median earnings of full time workers, 2019



Note: PEERS comprises Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia, and Slovak Republic.
Source: OECD Earnings database.

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A separate minimum wage for construction workers was introduced in January 2019 to address labour shortages and reduce undeclared wages. At RON 3000 per month (around EUR 610), it was almost 30% higher than the national minimum wage in 2021. The impact on wage under-declaration is uncertain, but employers risk declaring fewer hours and pay the same salary following this strong hike (Raei et al., 2016). Another minimum wage is also applied to jobs requiring tertiary education, but at a much lower level (RON 2350) and will not be applicable starting from 2022. The necessity and effectiveness of having different minimum wages should be carefully assessed. Particular attention should be given to developments in the construction sector.

Strengthening workers' adaptive capacity to technological changes

Keeping pace with rapid technological changes, especially in catching-up countries like Romania, requires offering reskilling options to all citizens. Doing so would also sustain productivity gains and related increases in workers remuneration. This can contribute to addressing mismatch on the labour market and improving the employability of older workers.

In Romania, the adult education system is nascent. A large share of the population lacks basic skills that are needed to access adult education and to use digital technologies. Besides, technological change increases the risk of displacement for low- as well as medium-skilled workers, in particular those with a considerable share of repetitive tasks that can be automatized and substituted with new technologies (Nedelkoska and Quintini, 2018). To ensure that all Romanians benefit from opportunities created by technological progress, the authorities should ensure that those who might lose their jobs are supported by an effective and adequate social safety net, conducive to upskilling.

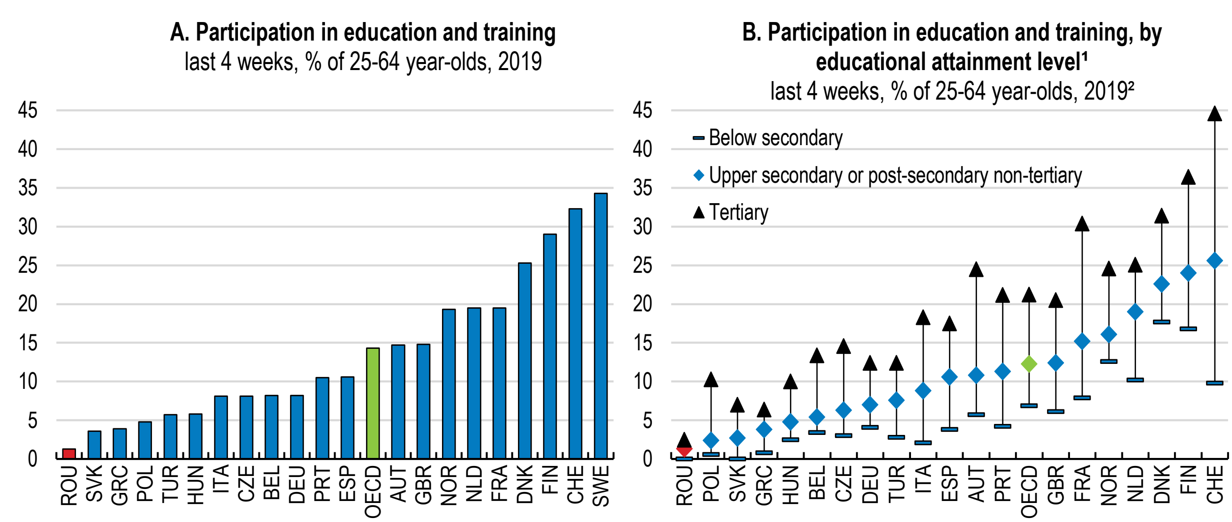
Developing adult education

Around a quarter of Romanian adults have below upper secondary education and may not be well equipped to adapt to a fast changing environment. Furthermore, participation in adult education is low by international standards, although estimates diverge on recent progress made in this area. Since 2015, only 7% of the working age population declared participating in adult education over the last four weeks, well below the OECD average (Figure 3.16). Participation is even lower for the 55-64 age cohort, which is unfortunate given the low employment rate of older workers. At the same time, 21% of employees participated in continuing training courses in enterprise in 2016 and this share has increased over the past decade. Like in most OECD countries, high skilled workers are more likely to participate in training than low-skilled (Figure 3.16) and have much longer training.

Inequality in access to learning opportunities needs to be addressed. Workers in occupations at high risk of automation who could benefit the most from reskilling are less likely to participate in training and have lower training duration (OECD, 2019c). Policies should thus target workers whose occupation risks changing significantly to increase their mobility, as they might require substantive training effort. Training needs are large: the OECD identified 10 out of 127 occupations for which substantive training is required, accounting for between 2 and 6% of the workers in OECD countries (OECD, 2019c). Reskilling options should also be offered to workers in sectors affected by the COVID-19 crisis, for instance by targeting those covered by the short time work scheme.

Policies should also offer remedial programs to provide basic skills needed to participate in vocational training to low-educated workers (OECD, 2019i). Such a program is in place in Romania. The "Second Chance" program, targeted at adults who have not completed primary and lower secondary education, offers the opportunity to complete compulsory education while pursuing family and professional activities and enrols around 16 000 students per year.

Figure 3.16. Participation in adult learning remains negligible



1. Below upper secondary refers to ISCED levels 0-2, Upper secondary or post-secondary non-tertiary refers to ISCED levels 3-4 and Tertiary education refers ISCED levels 5-8 of the ISCED 2011 classification.
Source*:* OECD (2020) Education at a Glance Database; Eurostat (2020), Participation rate in education and training (last 4 weeks).

StatLink https://stat.link/rpo6wm

The National Lifelong Learning Strategy 2015-20 defines a 10% target for participation in adult education. A number of measures have been initiated, including the setup of community centres for lifelong learning to reduce fragmentation of the educational offer and to centralise information on needs and available programmes (World Bank, 2018a). Unfortunately, implementation has been delayed. It is important to anticipate training needs and invest now in adult education, as training costs for helping workers to move from occupations at risk of automation can be substantial and are estimated to be relatively high in CEE countries (OECD, 2019c). Doing so requires policy continuity and strong political commitment to establish a framework for developing the educational offer in a coordinated way. Romania is elaborating the new National Strategy for Adult Education 2021-2027, and has started analysing continuing education needs of the adult population.

Boosting demand for training

Training costs are among the main barriers to participation in adult education. Employers have the obligation to ensure, at their own costs, the participation of all employees in professional training programmes. If the employer does not meet this obligation, employees are entitled to a paid training leave, up to 10 days, but do not receive any additional financial support. Adequate and sustainable financing should be put in place to improve the reach and enrolment in life-long learning. Training vouchers could be provided to all low-educated workers and directed towards training in core skills (ICT, language) with a view to prepare them for a more specialized training. For instance, France allocates individual training allowances that are either banked or cumulated over different periods of employment in personal training accounts as well as career advice for beneficiaries (OECD, 2019).

Digital technologies could be used to address financial, organisational and geographical barriers to access to training. Their importance for the continuity of training increased dramatically with the pandemic and associated containment measures. In Romania, participation in online courses is among the lowest in the EU and did not increase in 2020 according to Eurostat. Fostering open education, by defining standards to signal the quality of online courses and certify acquired skills could reduce the cost of training and offer more flexibility. In Germany, the project eVideoTransfer offers digital learning opportunities for workers with low basic skills and limited time for classroom learning.

Lack of information on the availability and the benefit of training is another barrier to participation. More than 75% of the population did not see the need to participate in education and training and only a quarter of the population looked for information on formal training in 2016. Career guidance services are not sufficiently developed (European Union, 2019). Lifelong learning centres providing education and career counselling with a focus on low-skilled workers should be made operational, as it is done in Iceland for instance. Upskilling local public servants to strengthen their guidance capacity is also key, as highlighted by the Portuguese experience (OECD, 2018i).

Large scale awareness campaigns are important tools to improve access to information on learning possibilities and their benefits. In Portugal, broad-based awareness-raising campaigns complemented with public websites played a role in raising interest in learning and thereby participation (OECD, 2018i). In addition, improving the recognition of learning outcomes acquired through non-formal and informal learning in the National Qualifications Framework is crucial to signal the importance of continuous training. Another step would be to introduce an online one-stop shop for information on adult learning that provide information on individuals' own educational and training record and directs users to potentially relevant learning opportunities based on the qualifications they have already acquired, like it is done for example in Portugal with the *Qualifica Passport*.

Engaging firms in training provision

While it is crucial for ensuring high relevance of training content, engagement of employers in training provision is limited, including for large firms. In 2015, only 26.7% of enterprises offered continued vocational training, well below the EU average. According to the 2018 Global Competitiveness Index, investment of companies in training and employee development is viewed as among the lowest worldwide (WEF, 2018). Cost of procuring, planning, and delivering training, combined with the short-term productivity loss of employees who participate in training, can be prohibitive (World Bank, 2018c). Employers benefit from financial incentives to provide training, including the immediate deductibility of training costs from taxable income when the costs are incurred. Some OECD countries, like Belgium or Finland, go one step further by compensating firms that provide upskilling opportunities to their employees (OECD, 2019h).

Employers face uncertainty about returns and might fear poaching, in particular because of the relatively high level of skilled emigration. At the same time, investing in employee training can have the opposite effect, fostering employee loyalty and reducing staff turnover (Hoeckel, 2008). Employers might also not have the capacity to anticipate their future training needs. In 2015, only 11% of firms with 50-250 employees regularly assessed their skills needs, the lowest share in the EU. Information gaps could be addressed by building networks of employers to aggregate expertise and practical experience as done in Australia or Ireland. In Ireland, 70 sectoral “Learning Networks” managed by Skillnet Ireland, a public agency, assist businesses to identify and address their skills needs and mutualises training for firms operating in the same industry. Such programmes could be targeted at small companies, which are less likely to see the need for training their workforce or to have a training plan (Kitching and Blackburn, 2002).

Strengthening protection of displaced and gig workers

Displaced workers are not adequately protected against income losses, which has adverse effects on their well-being, but also on labour market efficiency. An adequate social safety net should compensate income losses for households in case of unemployment and protect them against poverty risks. In this respect, it has become more important with the COVID-19 crisis. Providing adequate social protection for displaced workers also improves the quality of matching on the labour market, as job seekers can devote more time to find jobs that match their competences (Wulfgram and Fervers, 2013; Tatsiramos, 2009). Going forward, it will help to cushion the job turnover that is likely to occur as the labour market adapts to new technologies (OECD, 2019e).

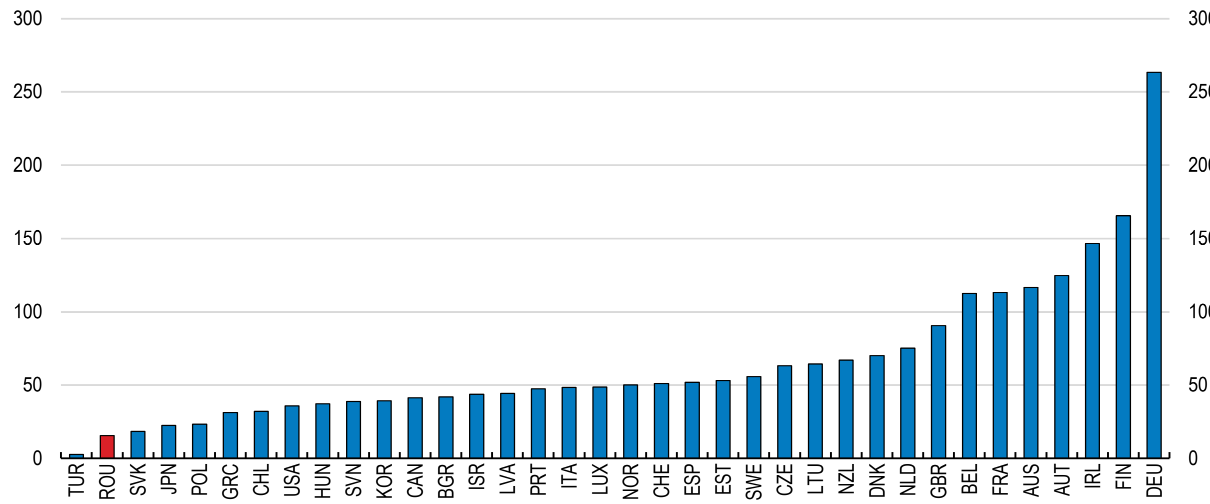
Unemployment benefits have a very limited coverage: only approximately 16% of jobseekers received unemployment benefits in 2018 (Figure 3.17). This is due to strict eligibility conditions - claimants have to contribute at least 12 months over the past 2 years - and low benefit duration (OECD, 2018j). The level of unemployment benefits is also well below international standards. Jobseekers can expect to receive around 30% of their previous revenues on average, half less than in advanced economies (Asenjo and Pignatti, 2019). The replacement rates are higher for low-income earners, but remain below OECD standards. In 2020, the payment of unemployment benefits has been extended for those having their benefits expiring during the lockdown, which helped to support job seekers. At the same time, eligibility criteria remained unchanged. New job seekers with short contribution history did not have access to unemployment benefits. The new national Employment Strategy 2021-2027 identifies the need to reform the unemployment benefit system.

The coverage of unemployment benefits should be increased by reducing the required minimum contribution period and introducing some flexibility in the system. For instance, periods when contributions are made could be accumulated across employment spells without a full reset when in receipt of the benefit. Accumulated entitlement could be reduced in proportion to the benefit duration. In addition, replacement rates should increase, especially for low wage earners. Moral hazard problems, such as reduced job search efforts, should be limited, owing to high activation requirements for benefit recipients (Immervoll and Knotz, 2018). A failure to accept an offer of suitable work or to participate in an activation programme results in a complete disqualification from receiving unemployment benefits. Making the replacement rate decreasing with unemployment length could further encourage job search. To limit the fiscal cost of these measures, the length of the benefits could vary with the economic cycle like done in

Canada or Poland, extending it in severe economic downturns and shortening it in the upturns (Moffitt, 2014).

Figure 3.17. Many jobseekers are not covered by unemployment benefits

Pseudo coverage rate of unemployment benefits, 2018



Note: The numerator of the rates shown in the Figure is the number of beneficiaries of earnings-related unemployment benefits (unemployment insurance, UI) and of non-contributory benefits (unemployment assistance, UA) for jobseekers who have exhausted their UI benefit or were not entitled to it to start with. The denominator is the number of unemployed individuals (over 15 years old) according to the ILO definition.
Source: Social Benefit Recipients Database (SOCR, http://www.oecd.org/social/recipients.htm).

StatLink https://stat.link/fykq36

Some segments of the employment protection legislation relative to displaced workers are rather weak in Romania (European Committee of Social Rights, 2018). The notice period for dismissal is only 20 days, the second lowest after Spain, and is fixed. In most OECD countries, this period is conditional to the tenure duration from one week up to six months. In addition, the Labour Code does not include explicit provisions on redundancy compensation. When the recovery will be well underway, severance pays that increase with the number of years in service without excessively increasing dismissal costs and discouraging firms from offering permanent and formal contracts should be introduced as done in many OECD countries, including CEE countries, to compensate lay-off workers for income losses and sustain living standards during the job-search period. This measure should complement a reform of unemployment benefits as discussed above.

To ensure adequate protection of Romanian workers, particular attention should also be given to the development of gig work. According to data collected from four of the largest online labour platforms, Romania was the tenth larger supplier of online labour worldwide, the second larger in Europe (Kässi and Lehdonvirta, 2017). Providing services on online platforms under on-call contracts can enable flexible working solutions and help to increase participation in the labour market. At the same time, digitally delivered freelance work could lead to an increase in the share of workers with atypical contracts that turn into false self-employment and undermine employees' protection (OECD, 2019e). Options to address that issue include requiring firms to inform employees on their status and rights like in the UK or adding a specific worker category in the labour legislation with specific protection like in Portugal or Italy. Such measures should be accompanied by strict and effective law enforcement.

Table 3.1. Policy recommendations to improve labour market conditions

MAIN FINDINGS	RECOMMENDATIONS (key in bold)
Fostering participation in the formal labour market	
Too few unemployed register with public employment services. Spending on active labour market policies is low, especially on training programmes.	**Dedicate more resources to reach vulnerable jobseekers, especially in marginalised communities, and to training programmes.**
Evaluation of active labour market policies is missing.	Implement systematic assessment of active labour market policies to focus funding on the most effective.
Bureaucracy and lack of effective policy support hamper the development of social enterprises.	Reduce the administrative burden on social enterprises and improve information on available support measures. Facilitate access of social enterprises to microcredit schemes and link them with training and business advice opportunities.
Enrolment in early childhood education is low, especially among Roma and in rural areas. Long-term care services are underdeveloped, undermining women's labour market participation. Investment in care services is envisaged in the national Recovery and Resilience Plan.	**Provide affordable and good-quality early childhood education and care and long-term care services.**
Bringing youth in	
Too many youth leave school without attaining an upper secondary education level. School closures have deepened learning gaps and accentuated inequality in access to education. The national Recovery and Resilience Plan includes a number of measures to address these issues.	**Accelerate measures to support students at risk of dropping out of school and to address learning gaps, especially in disadvantaged areas.** After a first evaluation, increase resources further, should they prove insufficient to address the needs.
The share of early school leavers in the Roma community is large. A number of initiatives are in place to reduce school dropout in this community.	Scale up school mediation and provide training courses for teacher in all schools with a high percentage of Roma pupils.
Competences acquired in vocational schools could better match labour market needs.	Strengthen engagement with employers and social partners in the design of VET programmes further. Improve skills forecasting and use it for school network planning.
Participation in the dual-education system remains low, due to difficulties to engage firms in training provision.	Establish a body that coordinates and supports the placement of students in work-based training.
Digital skills are included in curricula, but stakeholders point to a lack of resources and training.	Further increase resources devoted to ICT equipment in deprived schools and training for teachers.
Increases in the minimum wage have been unpredictable and not based on economic fundamentals in the past. Further strong increases can price out unexperienced low skilled workers from the labour market since the ratio of the minimum wage to the median wage is already comparatively high. The government plans to establish a framework for setting the minimum wage in 2023.	Over the medium term, ensure that the minimum wage does not increase faster than the average wage growth. Create a national commission on the minimum wage and consider introducing an indexation formula to keep its growth in real terms in line with productivity gains.
Strengthening adaptive capacity to technological changes	
Participation in adult education and incentives to train or provide training are low.	Introduce individual training allowances for low-skilled workers. Provide online information on training courses.
A large proportion of workers do not see the need to retrain.	Expand information dissemination on adult learning, through awareness campaigns and career guidance services.
The current design of the unemployment benefit system provides low income support.	Ease eligibility criteria and increase the replacement rates of the unemployment benefit system, especially of low wages.
The notice period for displaced workers is short and severance payments are optional.	When the recovery is firmly established, extend the notice period for dismissed workers and introduce a minimum severance pay, both increasing with seniority.

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