December 3, 1984

Dear Minister Gigea:

Thank you for your letter of November 16 and for the material enclosed with it. Such information is most helpful to us.

I am aware of the various policy measures which the Romanian Government has recently taken and hope to have an opportunity to discuss these measures and other matters with you before too long. Certainly, I look forward to seeing you at the Interim Committee meeting in the spring.

With kindest regards,

Sincerely yours,

L.A. Whittome
Counsellor and Director
European Department

Mr. Petre Gigea
Minister of Finance
Ministry of Finance
Bucharest, Romania

bcc. ERD

INTERNATIONAL MONETARY FUND

29/xi

Mr. Whittome: Thnk

I attach the two pieces on Romania that I mentioned.

Eremia's visit is set for Dec 10-11.

References to the IMF and to other aspects of international financial relations in the President's speech to the Party Congress do not seem to go much beyond what he has said before. (The total transcript of the speech runs to 38 pages!)

Peter Hole

MEMORANDUM FOR FILES November 28, 1984

Subject: Meeting with Mr. Stephen Pelletier, Manufacturers Hanover Trust (MH), New York

Mr. Pelletier came down from New York yesterday to talk about Romania. I spoke with him at some length and he also met briefly with Mr. Hole. He wanted to talk things over ahead of a meeting he expects to have with Romanian officials who will be attending the annual meeting of the U.S.-Romanian Business Council in Washington on December 10-11. The Romanian delegation is to be headed by Mr. Pungan, Minister of Foreign Trade, and will also include Mr. Eremia (Romanian Bank for for Foreign Trade). It is not clear whether Mr. Gigea will be coming.

Mr. Pelletier spelled out in more detail what he told me over the telephone last week. There were a number of recent developments which he found potentially worrying:

1. He had recently been visited by the Romanian Commercial Counsellor in the United States (a Mr. Rapano (?)) who appeared to make the following proposal. Romania would deliver to MH or a subsidiary trading company goods, mainly manufactures, that are now being held in stock in Romania. The value of the goods to be delivered was to be equal to scheduled debt repayments to MH in the remainder of 1984 and 1985. MH would sell these goods and apply the sales proceeds to the reduction of its claims on Romania. Similar approaches were being made by Romania Commercial Counsellors to European banks; other U.S. banks may also have been approached.

2. Fees which U.S. suppliers to Romania were prepared to pay for "silent confirmation" of letters of credit opened by the Romanian Bank for Foreign Trade had at least doubled in the last few weeks. The banks were seeing more demand for such confirmation and a willingness to pay higher fees than before. This was open to various interpretations. It could simply be that business with Romania was growing or it could be that some payments difficulties had already been experienced. The latter could either have been related to recently concluded transactions or perhaps to amounts due on already rescheduled debt incurred before 1983.

3. As part of the 1982 rescheduling operation MH had "taken on" certain Romanian obligations to nonguaranteed suppliers. This was an above-board procedure for which the rescheduling agreement specifically provided. Payments on the rescheduled debt were made to the bank who in turn transferred the funds less commission to the supplier. However, the underlying claims remained in the name of the supplier who bore the risk of nonpayment by the Romanians. Some suppliers had recently expressed interest in selling their claims on Romania to MH. Again this could reflect increased pessimism about the Romanian payments situation or the

explanation could be quite innocent: firms who saw opportunities for new business with Romania but who had limits on their total exposure to the country may simply be anxious to clear old claims from their books.

MH had given a very discouraging response to the proposal described in point 1 above. They were unable to accept any explicit linkage of the amount of new money to the size of maturing liabilities as this could be construed as a unilateral rescheduling which was bad policy and which the restructuring agreements forbade. And, perhaps more to the point, they were not prepared to have their financial claims settled by delivery of goods in kind especially when the latter were of such dubious saleability.

Many interpretations of the Romanian proposal were possible ranging from the sinister to the innocuous: 1) The Romanians could be intimating that they were unwilling or unable to continue to make debt repayments in cash but were covering themselves by making what they would argue was an offer of repayment, however unacceptable it might be to the intended recipients; 2) It could be a genuine offer without sinister undertones designed by beleagured officials to find ways of easing the payments position but without breaking the President's embargo on major new borrowing; or 3) It could be a ham-fisted attempt to get rid of excess stocks that had no direct connection with the payments or debt servicing position.

Whichever of these interpretations is correct, Mr. Pelletier found the whole approach quite inept and, if widely repeated, likely to have a very damaging effect on perceptions of Romania. One aspect that particularly worried him was that it had come from the Commercial Counsellor (an official of the Ministry of Foreign Trade) and not from any of the Romanian financial institutions who would normally deal with such matters. More generally, he thought that Romanian options were now narrowing, and for reasons of the Romanians' own making. Earlier in the year, had the Romanians wanted, new borrowing could probably have been arranged. MH had frequently expressed a willingness to try to do so and had itself extended a line of credit that now stood at US$30 million. Any borrowing request would now be much less well received particularly in the light of the November 1 measures and the press coverage of the President's remarks to the recent Party Congress. (However, the full text of the speech suggests that the tenor of the remarks was less hostile to Western financial interests than the summary press reports indicated. I will shortly be circulating a separate note on this.) Moreover, the apparent rebuff to the Fund was most unhelpful especially as many potential creditors would be likely to want to see a Fund program in place as a condition for resuming lending. Mr. Pelletier realized the difficulties that now existed in Fund relations with Romania.

We also talked about the balance of payments position. We agreed that with the trade surplus apparently on target, at least in the first half, and with indications that hitherto in 1984 new borrowing had been proceeding on an increased scale, the most likely cause for deviation from the official balance of payments projections was a continuation of a higher level of credit extension than officially forecast. (The authorities expected this to fall to less than US$100 million from US$500 million in 1983 despite the resumption of export growth.) This could also be a problem in 1985 which would be compounded if recent developments were to reduce confidence in Romania's creditworthiness. However, Mr. Pelletier stressed that so far, while he was concerned at some of the indications, he had no firm evidence of any unexpected balance of payments deterioration or the existence of payments arrears.

In conclusion, I should say that, while I have always found Mr. Pelletier a very helpful and honest contact, the above are after all only one person's impressions. It would be nice to know what the European banks, who have much larger exposure, were thinking.

Jim Prust

cc: Mr. Hole
Mr. Reitmaier

At the same time it is necessary to reach an overall agreement on the use of outer space by various countries for peaceful purposes. We believe that the United Nations should assume responsibility for concluding an international treaty on outer space. One may consider calling a world conference on this subject or creating a special body within the United Nations to defend outer space. One can state without fear of being wrong that mankind is at a crossroads decisive for its destiny and the future and existence of our planet. Before it is too late, let us work to save mankind from a nuclear catstrophe and destruction. Let us defend the supreme right of nations and people to existence, freedom, independence, life, and peace. [cheers, chants]

The large peace movement in Europe and on other continents represents the most powerful force of the present-day world able to halt the dangerous trends of events and to stop a new world war, a nuclear catastrophe. We are firmly convinced that it lies within the power of peoples everywhere, by acting in complete unity, to halt the arms race and to bring about the resumption of the policy of detente and of cooperation and to ensure peace in the world.

Esteemed comrades, following the world economic crisis the situation of the developing countries has worsened considerably. Gaps between the rich and poor countries have widened. Negotiations held so far and certain measures have, in fact, yielded no real results. Following the financial and price policy and owing to excessively high interest rates, practiced especially by the United States, the debts of the developing countries have increased considerably, amounting to more than $700 billion. Real negotiations are necessary between the developing countries and the developed countries, and with banks, the financial-banking bodies, including those of the international financial system, so as to reach a global solution on the debts of the developing countries.

Romania believes that one should consider canceling debts of countries with a $500-600 income per capita, considerably reduce those debts in the case of countries with $1,000-1,200 per capita, and generally reduce debts for all developing countries some 30-50 percent. Refusing to conduct negotiations and the thesis of an individual solution aim at hampering united action by the developing countries and at making it possible for the developed countries, the banks, and world financial institutions to continue their current policy and to impose on the developing countries the economic and political conditions they favor and which, in fact, mean turning the developing countries again into semicolonies. [applause]

It is also necessary that, along with resolutely reducing interest rates, new credits at rational interests should be granted so as to assist the economic and social development of the developing countries. The IMF should renounce its policy of imposing political and economic conditions on developing countries. This is unacceptable interference in the domestic affairs of those countries. The IMF and other world bodies and banks should grant credits without any political conditions, and without interfering in the domestic affairs of other states by any means.

Taking into account the seriousness of the world economic and financial situation, it is necessary to restructure the financial and monetary system and to ensure equal participation by all states in the activity of international financial bodies. Real negotiations are necessary between the developed countries and the developing countries in connection with the overall economic and social development and for working out a general program of supporting the efforts aimed at eliminating underdevelopment.

Office Memorandum

November 28, 1984

MEMORANDUM FOR FILES

Subject: Meeting with Mr. Polak

I called on Mr. Polak to discuss:

1. Israel
2. Romania
3. G-30

L.A. Whittome

IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

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THE HONORABLE DECEBAL URDEA
DEPUTY MINISTER OF FINANCE
MINISTRY OF FINANCE
STR. DOAMNEIINR. 8
BUCAREST, ROMANIA

DISPATCHED IMF
1984 NOV 23 AM 11:44

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DISTRIBUTION

ED
Area Dept.
Mr. Dannemann
MR. POLAK
EUR

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THANK YOU FOR YOUR CABLE OF NOVEMBER 6, 1984. IN CONSULTATION WITH THE FUND'S EUROPEAN DEPARTMENT, WE HAVE CAREFULLY CONSIDERED YOUR SUGGESTION THAT THE PROPOSED TECHNICAL ASSISTANCE MISSION TO REVIEW STATISTICAL ISSUES PERTAINING TO EXTERNAL TRADE, NATIONAL ACCOUNTS, AND DOMESTIC PRICES TAKE PLACE DURING ANNUAL CONSULTATIONS WITH ROMANIA. GIVEN THE PROBLEMS IDENTIFIED IN THESE AREAS OF ROMANIA'S STATISTICS, WE BELIEVE THAT THIS PROCEDURE WOULD NOT BE PRODUCTIVE. FIRSTLY, IN VIEW OF THE FACT THAT THE NEXT ARTICLE IV CONSULTATION MISSION TO ROMANIA IS TENTATIVELY PLANNED FOR THE MIDDLE OF 1985. SECONDLY, AS THERE IS UNLIKELY TO BE SUFFICIENT TIME DURING THE CONSULTATION MISSION TO UNDERTAKE AN INDEPTH APPRAISAL OF THE SOURCES AND METHODS UNDERLYING THE COMPILATION OF DATA ON EXTERNAL TRADE, NATIONAL ACCOUNTS, AND DOMESTIC PRICES. WE CONSIDER, THEREFORE, THAT IT WOULD BE DESIRABLE TO UNDERTAKE SUCH AN EVALUATION WELL BEFORE THE NEXT CONSULTATION MISSION.

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AUTHORIZED BY NAME (TYPE): Mahinder S. Gill

AUTHORIZED BY NAME (TYPE): Werner Dannemann ( )

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BUCAREST, ROMANIA

PAGE 2

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Area Dept.
Mr. Dannemann

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WE NOTE THAT THE MONTHS OF NOVEMBER AND DECEMBER 1984, WOULD NOT BE CONVENIENT FROM YOUR STANDPOINT. IN LIGHT OF THAT, WE WOULD LIKE TO PROPOSE THAT A STATISTICAL MISSION TAKE PLACE IN JANUARY OR FEBRUARY 1985. I WOULD APPRECIATE YOUR CABLED RESPONSE AS TO WHETHER THIS PROPOSAL WOULD BE ACCEPTABLE TO YOU. IF SO, MORE DEFINITIVE DATES COULD BE PROPOSED SUBSEQUENTLY.

REGARDS.

DANNEMANN

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FC. 48 REV 1
11-18-82

Mr. Wittome

Office Memorandum

TO : The Managing Director
The Deputy Managing Director

DATE: November 20, 1984

FROM : Hans Schmitt

SUBJECT : Romania - Exchange Rate and Other Measures Introduced on November 1, 1984

I attach for your approval a draft paper on the above topic to be issued for the information of the Executive Board. In view of the unusual nature of the measures in question, and the circumstances surrounding them, the paper is considerably longer than for a routine notification of an exchange rate change.

The paper has been seen by Mr. Brau (ETR), Mr. Holder (LEG), Mr. Leddy (TRE), and Mr. Wolf (RES).

Please return the paper to the European Department.

Attachment

cc: Mr. Collins

INTERNATIONAL MONETARY FUND

ROMANIA

Exchange Rate and Other Measures Introduced on November 1, 1984

Prepared by the European Department and the
The Exchange and Trade Relations Department

Approved by Hans Schmitt HS and Eduard H. Brau EB

November .., 1984

I. The Measures Taken

In a regular weekly cable dated November 2, 1984 from the National Bank of Romania the staff was informed that Romania's exchange rates were appreciated on November 1, 1984.

The currency (the leu) is pegged to a basket of the currencies of six major trading partners and rates are normally adjusted weekly. Romania maintains more than one exchange rate. Most transactions take place at the commercial rate but a small proportion, notably those involving private tourism, take place at a more appreciated noncommercial rate. In addition there is a so-called official rate at which no transactions take place but which is used for certain statistical purposes.

On November 1, 1984 the commercial rate was appreciated against the basket. The precise amount of the appreciation against the basket is not known but against the U.S. dollar the rate established on November 1 of lei 17.50 = US$1 represented an appreciation of 32.46 percent as compared with the rate established on October 29, 1984 at the previous regular weekly fixing. At the same time and on the same basis, the noncommercial rate was appreciated by 20.80 percent against the U.S. dollar and was set at a level of lei 12.50 = US$1. The official rate was appreciated from lei 5.00 = US$1 to lei 4.47 = US$1.

In a further cable dated November 12, 1984 sent in response to inquiries from the staff (Attachment 1), the National Bank of Romania gave the authorities' reasons for implementing the above changes. In essence, they state that the appreciation of the leu is justified by the stability of prices in Romania which in turn has been made possible by various measures to raise efficiency.

The staff has also learnt from Romanian press reports that certain other measures were taken on November 1, 1984. All interest rates were lowered. No information is available on the change in deposit rates or in those applying to investment financing but rates on all other categories of lending were lowered by at least 3 percentage points. In the major category of "current credits to industrial units, transportation, scientific research, public services, supplies and sales, and foreign trade" the rate was lowered from 8 percent to 5 percent; the staff was previously under the impression that this rate had in fact been set at 10 percent since January 1, 1984.

P.H. I presume that we have their statements to this effect? / Am

Certain prices have been reduced by means of lowering permitted profitability ceilings in some sectors, apparently those producing intermediate manufactured goods. In addition, with a view to raising incentives, the share of profits resulting from above-plan performance that are distributed to the work force has been increased.

II. Background - Recent Economic Developments

Economic developments in Romania since 1980 have been dominated by the effects of a sharp drop in new capital inflows and the ensuing adjustment in the external current account. The current account of the balance of payments in convertible currencies moved from a deficit of US$2.4 billion in 1980 to a surplus of almost US$1 billion in 1983. Virtually all of this turnaround was accounted for by the merchandise trade account with a sharply reduced deficit on oil trade and the achievement of a large surplus on non-oil transactions. The latter was largely attributable to import contraction as non-oil exports fell both in value and volume terms in 1982 and 1983. This trend continued in the first quarter of 1984 but was apparently reversed in the second quarter. For the first half of 1984 as a whole the U.S. dollar value of non-oil exports was recorded to have increased by 9 percent from one year earlier.

Despite the severe contraction in imports, which was only offset by increased imports from the nonconvertible area to a limited extent, the authorities claim that real domestic output grew in every year, albeit more slowly than in earlier years. For 1983 the official statistics show growth in real GNP of 3.5 percent despite a poor result in agriculture. For 1984 the authorities latest estimates appear to be for growth in aggregate output of the order of 7 percent with a similar increase in industry alone which is the largest single sector.

The Fund approved a three-year stand-by arrangement with Romania in June 1981, the objectives of which were to strengthen the balance of payments at the same time as carrying forward a reform of exchange rates and domestic prices. To this end, the number of commercial exchange rates was progressively reduced and a unified commercial rate came into effect in mid-1983. At the same time there were substantial increases in domestic prices, notably for energy products, in both 1981 and 1982. Principal among the domestic policies implemented as part of the 1983 program under the stand-by arrangement were a cumulative depreciation of the leu against the U.S. dollar of some 30 percent between end-1982 and January 1, 1984, the adoption of a basket peg for the exchange rate as from July 1, 1983, and increases in interest rates which for most lending rates amounted to a total of 5 percentage points. However, the authorities, in line with a renewed emphasis on price stability, acted to prevent more than a very partial passthrough of the effects of the latter measures to domestic prices. Both the retail and producer price indices rose by less than 1 percent in 1983 and appear to have shown no change, or perhaps even declined, so far in 1984.

III. Staff Appraisal

In discussions with the Romanian authorities on exchange rate policies over the last two years, the staff has been guided by the following two principal considerations:

1. The desire to reverse the declining trend of non-oil exports to the convertible area. Continuation of this trend, through its effects on import levels, appeared to carry the risk of increasingly severe disruption to domestic production because of shortages of imported inputs.
2. The desire to reverse the substantial but involuntary real effective appreciation of the leu which occurred in 1981-83 (see Table 1). This appreciation resulted from the leu's being pegged to the U.S. dollar until mid-1983 and was broadly reversed by the devaluations made in 1983 and at the beginning of 1984.

The Romanian authorities cite the stability of domestic retail prices as the main justification for the recent appreciation of the leu. Stable

Romanian prices did indeed contribute to a modest real effective depreciation in 1984 but this was much more than offset by the recent measures. Using retail price levels the staff estimates that against a basket of the currencies of 17 major trading partners in industrial countries the index of the export-weighted real effective commercial rate (January 1981 = 100) stood at 137 following the November 1, 1984 appreciation compared with 104 in January 1984 following the latest depreciation against the basket, and 132 at the end of 1982. In other words, the effects of the devaluations under the recent programs with the Fund were cancelled. If the reasoning which guided policy in the past still remains valid, there are grounds for believing that the chances for continuation of the recent revival in exports may be prejudiced. If this were to happen, and if Romania adheres to its objective of maintaining or even increasing the present current account surplus, the economy could be forced on to a path of lower domestic growth with tighter import controls than would otherwise be possible.

It remains to be seen whether this expectation will in fact be realized. The relationship between imports from the convertible area and the attainable rate of domestic growth is not a clear cut one. There may be compensating changes in import deliveries from the nonconvertible area, although up to 1983 this did not happen. Moreover, as noted in the preceding section, the official Romanian statistics claim that a positive rate of industrial ouput growth has been maintained throughout the period of import contraction, and that this rate has in fact risen significantly in 1983 and 1984. As indicated in the staff report for the 1984 Article IV consultation (SM/84/180), the staff is sceptical of these claims but is not in a position to provide alternative estimates of its own. With such uncertainty about the record of past performance, it is impossible to forecast with any confidence what the growth implications of changing levels of external trade might be.

There is a further major uncertainty about the effects of the recent exchange rate change. The Romanian authorities have generally maintained that exchange rate policy is only one of a number of instruments available to them in influencing foreign trade. They have stated that its role is less important in their economy than in typical market economies and that the scope for achieving adjustment by non-price measures through the central planning apparatus is correspondingly greater. Partially in reflection of this approach, the effects of the recent devaluations on domestic prices and profits have in many instances been offset, notably by compensating changes in the net flow of funds between the budget and the enterprise sector. Moreover, even where prices and profits have changed, there have apparently been further restraints on the responses in the form of changed patterns of investment and production.

For its part, the staff has argued for a fuller passthrough of the effects of exchange rate and other price reform measures both in order to improve the quality of information available to the central planners and to ensure that autonomous enterprise decisionmaking, to the extent that it is allowed, is guided by the appropriate price parameters. This view was reflected in the Chairman's summing up of the recent Executive Board discussion of the 1984 Article IV consultation reports: "Directors focussed on the severe constraints on the effectiveness of the devaluations emanating from the failure to pass on their effects to final prices...

While recognising the distinctive features of centrally planned economies, including the less central role played by the exchange rate compared with market economies, most Directors urged the Romanian authorities to reduce these constraints substantially and to allow greater flexibility of domestic prices..."

The staff has become increasingly doubtful of the extent to which the authorities share these objectives, particularly since the cancellation of the stand-by arrangement in January 1984. There are growing indications that they have moved away from their earlier stated intentions of pursuing price reform at the same time as allowing greater autonomy at the enterprise level. If this is in fact the direction which policy has taken, the exchange rate, and pricing policy generally, may be expected to have only a subordinate role in the allocation of resources.

These issues will be fully discussed during the next Article IV consultation discussions with Romania which are scheduled for about May 1985.

Table 1. Romania: Commercial Exchange Rate

End of Period	Nominal U.S. Dollar Rate	Export Weighted Effective Exchange Rate Indices 1/		
		Nominal	Real 2/	Real 3/
1981	(Lei/US$)	(January 1981 = 100)		
March	15.0	101.4	99.3	101.3
June	15.0	113.2	108.8	113.8
September	15.0	112.6	106.3	115.0
December	15.0	111.6	104.4	116.0
1982				
March	15.0	120.1	116.2	127.9
June	15.0	124.8	123.3	136.7
September	15.0	128.4	131.5	145.1
December	15.0	124.1	132.3	144.9
1983				
March	16.5	117.5	124.5	136.6
June	16.5	121.7	127.2	139.8
September	17.9	116.3	120.3	131.7
December	18.2	117.9	121.2	132.4
1984				
January	21.6	101.7	104.0	113.3
March	21.3	99.2	100.6	109.4
June	22.0	102.5	102.9	112.2
September 4/	23.6	102.8	102.3	111.9
November 1 4/	17.5	138.5	137.3	150.3

Sources: Data supplied by the Romanian authorities; and Fund staff estimates.

1/ Weights reflect the pattern of 1980 exports to 17 industrial countries; an increase in the index indicates an appreciation of the leu. Quarterly figures for Romanian prices are interpolations of annual data. It is assumed that in 1984 Romanian prices remained constant at their end-1983 level.
2/ Nominal effective exchange rate deflated by relative consumer prices.
3/ Nominal effective exchange rate deflated by relative wholesale prices for partner countries and producer prices for Romania.
4/ Partly estimated.

ATTACHMENT 1

ATTN. MR. HANS SCHMITT
ACTING DIRECTOR
EUROPEAN DEPARTMENT
INTERNATIONAL MONETARY FUND

RE: YOUR CABLE OF NOVEMBER 6, 1984

A. STARTING NOVEMBER 1, 1984 THE COMMERCIAL EXCHANGE RATE WAS CHANGED IN TERMS OF U.S. DOLLAR AT A RATE OF LEI 17.50 FOR U.S. DOLLAR 1, THE TRANSFERABLE RUBLE LEI 15.50 FOR 1 TRANSFERABLE RUBLE AND THE NONCOMMERCIAL EXCHANGE RATE LEI 12.50 FOR U.S. DOLLAR, REPRESENTING 32.46 PERCENT APPRECIATION FOR COMMERCIAL EXCHANGE RATE AND 20.80 PERCENT APPRECIATION FOR NONCOMMERCIAL EXCHANGE RATE, COMPARED WITH THE RATES ON OCTOBER 29, 1984, LEI 23.18 FOR U.S. DOLLAR 1 AND RESPECTIVELY LEI 15.10 FOR U.S. DOLLAR 1.

B. THE ALREADY EXISTING PROVISIONS REGARDING THE BASKET SYSTEM REMAINED UNCHANGED.

C. TAKING INTO ACCOUNT THE STABILITY OF RETAIL PRICES IN ROMANIA, THE IMPROVEMENT OF PRODUCTION PRICES ON THE BASIS OF IMPLEMENTING PROGRAMS REGARDING HIGHER TECHNOLOGICAL AND QUALITATIVE STANDARDS OF PRODUCTS, HIGHER PRODUCTIVITY, LOWER PRODUCTION COSTS AND BETTER CAPITALIZATION OF RAW AND SUBSIDIARY MATERIALS AND FUEL, IT WAS ESTABLISHED THAT THE EXCHANGE RATE OF THE LEU SHOULD BE IMPROVED IN RELATION TO OTHER COUNTRIES' CURRENCIES.

D. NO OTHER CHANGE OCCURRED WITH RESPECT TO THE LEU REVALUATION THAN ABOVE MENTIONED.

DIRECTOR, ION ILIE
FOREIGN EXCHANGE AND PRECIOUS METALS DEPARTMENT
NATIONAL BANK OF THE SOCIALIST REPUBLIC OF ROMANIA

Received in the Cable Room on November 12, 1984.

REPUBLICA SOCIALISTĂ ROMÂNIA

MINISTERUL FINANȚELOR
CABINETUL MINISTRULUI

cc: PH

I take this to be a deliberately friendly gesture. May I pl have a friendly draft reply.
[illegible] 30/11

8655/16.11.1984

Dear Mr. Whittome,

We hereby send you for y our information some data on the economic development of Romania on the first 10 months of this year as well as the main economic targets of 1985 annual plan and of 1986-1990 five year plan.

We let y ou know that we have sent similar data to Mr. Polak, executive director.

Yours faithfully,

PETRE GIGEA
Minister of Finance

Mr. A. Whittome

Director of European Department
International Monetary Fund

Washington D. C.

I. ACHIEVEMENTS IN INDUSTRY, INVESTMENTS AND FOREIGN TRADE
(January 1 - October 31, 1984)

	Increases against the same period of 1983 - in per cent -
1. Marketable industrial production	6.7
out of which: in october	10.5
2. Net industrial production	7.9
3. Investments	8.1
out of which:	
- Electric power	22.3
- Oil	13.6
- Agriculture	14.6
- Wood processing	13.0
4. Labour productivity	
- in state industry	6.9
- in construction	11.1
5. Retail sales	4.2
out of which: foodstuff	5.8
6. Total exports	
- nonconvertible area	7.1
- convertible area	10.1
out of which: nonoil products	6.2
7. Total imports	
- nonconvertible area	16.9
- convertible area	6.2
out of which: nonoil products	10.4

II. ACHIEVEMENTS IN AGRICULTURE

1. Summer crops

Yield production obtained: about 10 million tons.

For wheat, this year production is more than 40% over that of 1983 and about 20 % over that of 1982.

For barley the average production is more than 20% over that of 1983.

./.

2. Preliminary data for autumn crops (maize, sunflower, sugar beet, soya, fodder) and fruits and vegetables, show a good production.

It is estimated that wheat, barley and maize productions reach 1,000 kg per capita.

III. In the first 9 months of this year, the convertible trade balance shows a surplus of US dollars 1,410 million(against US dollars 1,162 million recorded in the same period of last year), and the convertible current account shows a surplus of US dollars 902 million for the first 9 months of this year (against US dollars 631 million in the same period of last year).

IV. The estimates for foreign debt show that at November 15, 1984 it will reach US dollars 7.5 billion. In the first 10 months of this year were repayed US dollars 1,218 million as principal and US dollars 680 million as interest.

1985 PLAN PROVISIONS FOR MAIN ECONOMIC TARGETS

	Increases in 1985 against 1984 (in per cent)
1. Marketable industrial production	11.6
2. Value of net industrial production	21.0
3. Production costs in state industry (reduction)	
- costs for 1,000 lei marketable production	-4.9 (by 41.1 lei lower)
- material costs for 1,000 lei marketable production	-4.2 (by 28.2 lei lower)
4. Total volume of investments in the economy	10.4
of which: building-assembling	11.1
5. Money incomes of the population	4.8
6. Average remuneration	
- net nominal	4.8
- real	4.0
7. Foreign trade	
- export	18.1
- import	11.1

MAIN TARGETS OF ECONOMIC AND SOCIAL DEVELOPMENT OF ROMANIA DURING 1986 - 1990 FIVE YEAR PLAN

	In per cent	
	Provisions for 1990 against 1985 plan	Annual average rate 1986-1990
Social product	127 - 132	5.0 - 5.7
National income	144 - 149	7.6 - 8.3
Marketable industrial production	134 - 137	6.0 - 6.5
Net industrial production	161 - 165	10.0 - 10.6
Gross agricultural production (annual average for 5 year period)	130 - 133	5.4 - 5.8
Net agricultural production (annual average for 5 year period)	140 - 144	7.1 - 7.6
Volume of investments in the national economy (for 5 years)	109 - 113	1.8 - 2.5
Foreign trade volume (for 5 years)	141 - 145	7.1 - 7.7
Number of working people	102.5 - 103.5	0.5 - 0.7
Labour productivity in state industry (calculated on marketable production basis)	161	10.0
Reduction of costs for 1,000 lei marketable production in state industry	- lei about 110	
Retail sales	109 - 110	1.7 - 2.0
Services for population	168 - 176	11 - 12

Office Memorandum

cc GT

November 16, 1984

To: Mr. Habermeier
Mr. Hood
Mr. Finch
Mr. Holder

From: Hans Schmitt HS

Subject: Romania - Exchange Rate and Other Measures Introduced on November 1, 1984

I attach for your comments a draft paper for the Executive Board. Please note that the text references and table on changes in the real effective exchange rate of the leu are provisional. It would be appreciated if your comments could be given either to Mr. Prust (ext.57884) or myself (ext. 72933) by close of business on Monday November 19.

Attachment

INTERNATIONAL MONETARY FUND

ROMANIA

Exchange Rate and Other Measures Introduced on November 1, 1984

Prepared by the European Department and the
The Exchange and Trade Relations Department

Approved by Hans Schmitt and C. David Finch

November .., 1984

I. The Measures Taken

In a regular weekly cable dated November 2, 1984 from the National Bank of Romania the staff was informed that Romania's exchange rates were appreciated on November 1, 1984.

The currency (the leu) is pegged to a basket of the currencies of six major trading partners and rates are normally adjusted weekly. Romania maintains more than one exchange rate. Most transactions take place at the commercial rate but a small proportion, notably those involving private tourism, take place at a more appreciated noncommercial rate. In addition there is a so-called official rate at which no transactions take place but which is used for certain statistical purposes.

On November 1, 1984 the commercial rate was appreciated against the basket. The precise amount of the appreciation against the basket is not known but against the U.S. dollar the rate established on November 1 of lei 17.50 = US$1 represented an appreciation of 32.46 percent as compared with the rate established on October 29, 1984 at the previous regular weekly fixing. At the same time and on the same basis, the noncommercial rate was appreciated by 20.80 percent against the U.S. dollar and was set at a level of lei 12.50 = US$1. The official rate was appreciated from lei 5.00 = US$1 to lei 4.47 = US$1.

In a further cable dated November 12, 1984 sent in response to inquiries from the staff (Attachment 1), the National Bank of Romania gave the authorities' reasons for implementing the above changes. In essence, they state that the appreciation of the leu is justified by the stability of prices in Romania which in turn has been made possible by various measures to raise efficiency.

The staff has also learnt from Romanian press reports that certain other measures were taken on November 1. All interest rates were lowered. No information is available on the change in deposit rates or in those applying to investment financing but rates on all other categories of lending were lowered by at least 3 percentage points. In the major category of "current credits to industrial units, transportation, scientific research, public services, supplies and sales, and foreign trade" the rate was lowered from 8 percent to 5 percent; the staff was previously under the impression that this rate had in fact been set at 10 percent since January 1, 1984.

Certain prices have been reduced by means of lowering permitted profitability ceilings in some sectors, apparently those producing intermediate manufactured goods. In addition, with a view to raising incentives, the share of profits resulting from above-plan performance that are distributed to the work force has been increased.

II. Background - Recent Economic Developments

Economic developments in Romania since 1980 have been dominated by the effects of a sharp drop in new capital inflows and the ensuing adjustment in the external current account. The current account of the balance of payments in convertible currencies moved from a deficit of US$2.4 billion in 1980 to a surplus of almost US$1 billion in 1983. Virtually all of this turnaround was accounted for by the merchandise trade account with a sharply reduced deficit on oil trade and the achievement of a large surplus on non-oil transactions. The latter was largely attributable to import contraction as non-oil exports fell both in value and volume terms in 1982 and 1983. This trend continued in the first quarter of 1984 but was apparently reversed in the second quarter. For the first half of 1984 as a whole the U.S. dollar value of non-oil exports was recorded to have increased by 9 percent from one year earlier.

Despite the severe contraction in imports, which was only offset by increased imports from the nonconvertible area to a limited extent, the authorities claim that real domestic output grew in every year, albeit more slowly than in earlier years. For 1983 the official statistics show growth in real GNP of 3.5 percent despite a poor result in agriculture. For 1984 the authorities latest estimates appear to be for growth in aggregate output of the order of 7 percent with a similar increase in industry alone which is the largest single sector.

Romania entered a three-year stand-by arrangement with the Fund in June 1981, the objectives of which were to strengthen the balance of payments at the same time as carrying forward a reform of exchange rates and domestic prices. To this end, the number of commercial exchange rates was progressively reduced and a unified commercial rate came into effect in mid-1983. At the same time there were substantial increases in domestic prices, notably for energy products, in both 1981 and 1982. Principal among the domestic policies implemented as part of the 1983 program under the stand-by were a cumulative depreciation of the leu against the U.S. dollar of some 30 percent between end-1982 and January 1, 1984, the adoption of a basket peg for the exchange rate as from July 1, 1983, and increases in interest rates which for most lending rates amounted to a total of 5 percentage points. However, the authorities, in line with a renewed emphasis on price stability, acted to prevent more than a very partial passthrough of the effects of the latter measures to domestic prices. The retail price index rose by less than 1 percent in the course of 1983 and appears to have shown no change, or perhaps even declined, so far in 1984.

III. Staff Appraisal

In discussions with the Romanian authorities on exchange rate policies over the last two years, the staff has been guided by the following two principal considerations:

1. Non-oil exports to the convertible area declined in 1982 and 1983 and continued to do so in the first quarter of 1984; only in the second quarter of the current year was the trend apparently reversed. As a result the burden of current account adjustment fell almost entirely on merchandise imports which contracted sharply in volume terms for both oil and non-oil items. Further decline or stagnation in convertible non-oil imports appeared to carry the risk of increasingly severe disruption to domestic production because of shortages of imported inputs and, for that reason, was to be avoided.

2. The peg of the leu to the U.S. dollar up to mid-1983 brought a substantial but involuntary appreciation of the currency in real terms on

a trade-weighted basis from the level which obtained following the major exchange rate re-alignment on January 1, 1981 (Table 1). As a minimum, in view of the needs of the balance of payment situation, it appeared desirable to reverse this involuntary real appreciation. This was broadly achieved by the devaluations made in 1983 and at the beginning of 1984.

The Romanian authorities cite the stability of domestic retail prices as the main justification for the recent appreciation of the leu. Stable Romanian prices did indeed result in a modest real effective depreciation in 1984. Using retail price levels and on the assumption that there has been no change in Romania's retail prices since the end of 1983, the staff estimates that against a basket of the currencies of 17 major trading partners in industrial countries the commercial rate depreciated by [5] percent in real effective terms in the first ten months of 1984. However, this depreciation was much more than offset by the recent measures. On a base of January 1981 = 100, the real effective exchange following the November 1, 1984 appreciation stood at [125] compared with [97] on January 1, 1984 (the date of the latest depreciation against the basket) and [132] at the end of 1982. In other words, the effects of the earlier devaluations under the recent programs with the Fund, were largely cancelled. If the reasoning which guided policy in the past still remains valid, there are grounds for believing that the chances for continuation of the recent revival in exports may be prejudiced. If this were to happen, and if Romania were to adhere to its objective of maintaining or even increasing the present current account surplus, the economy could be forced on to a path of lower domestic growth with tighter import controls than would otherwise be possible.

It remains to be seen whether this expectation will in fact be realized. The relationship between imports from the convertible area and the attainable rate of domestic growth is not a clear cut one. There may be compensating changes in import deliveries from the nonconvertible area, although up to 1983 this did not happen. Moreover, as noted in the preceding section, the official Romanian statistics claim that a positive rate of industrial ouput growth has been maintained throughout the period of import contraction, and that this rate has in fact risen significantly in 1983 and 1984. As indicated in the staff report for the 1984 Article IV consultation, the staff is sceptical of these claims but is not in a position to provide alternative estimates of its own. With such uncertainty about the record of past performance, it is impossible to forecast with any confidence what the growth implications of changing levels of external trade might be.

There is a further major uncertainty about the effects of the recent exchange rate change. The Romanian authorities have generally maintained that exchange rate policy is only one of a number of instruments available to them in influencing foreign trade. They have stated that its role is less important in their economy than in typical market economies and that the scope for achieving adjustment by non-price measures through the central planning apparatus is correspondingly greater. Partially in reflection of this approach, the effects of the recent devaluations on domestic prices and profits have in many instances been offset, notably by compensating changes in the net flow of funds between the budget and the enterprise sector. Moreover, even where prices and profits have changed, there have apparently been further restraints on the responses in the form of changed patterns of investment and production.

For its part, the staff has argued for a fuller passthrough of the effects of exchange rate and other price reform measures both in order to improve the quality of information available to the central planners and to ensure that autonomous enterprise decisionmaking, to the extent that it is allowed, is guided by the appropriate price parameters. This view was reflected in the Chairman's summing up of the recent Executive Board discussion of the 1984 Article IV consultation reports: "Directors focussed on the severe constraints on the effectiveness of the devaluations emanating from the failure to pass on their effects to final prices... While recognising the distinctive features of centrally planned economies, including the less central role played by the exchange rate compared with market economies, most Directors urged the Romanian authorities to reduce these constraints substantially and to allow greater flexibility of domestic prices..."

The staff has become increasingly doubtful of the extent to which the authorities share these objectives, particularly since the cancellation of the stand-by in January 1984. There are growing indications that they have moved away from their earlier stated intentions of pursuing price reform at the same time as allowing greater autonomy at the enterprise level. If this is in fact the direction which policy has taken, the exchange rate, and pricing policy generally, may be expected to have only a subordinate role in the allocation of resources.

The next staff visit to Romania is scheduled for about May 1985 when Article IV consultation discussions are to be held.

Table 1. Romania: Commercial Exchange Rate

End of Period	Nominal U.S. Dollar Rate	Trade Weighted Effective Exchange Rate Indices 1/ Nominal	Real 2/	Real 3/
1981	(Lei/US$)	(January 1981 = 100)		
March	15.0	104.4	102.2	104.2
June	15.0	113.7	109.3	114.3
September	15.0	114.4	108.0	116.8
December	15.0	112.3	105.0	116.7
1982				
March	15.0	118.1	114.3	125.8
June	15.0	121.5	120.0	133.1
September	15.0	125.0	128.1	141.2
December	15.0	124.0	132.1	144.8
1983				
March	16.5	113.9	120.6	132.4
June	16.5	118.1	123.4	135.6
September	17.9	112.4	116.2	127.3
December	18.2	113.1	116.2	127.0
1984				
January 1	21.6	[94.3]	[96.5]	[104.4]
March	21.2	[94.3]	[96.5]	[104.4]
June 4/				
September 4/				
November 1 4/	17.5	[125.0]	[125.0]	[125.0]

Sources: Data supplied by the Romanian authorities; and Fund staff estimates.

1/ Weights reflect 1980 non-oil trade pattern with 17 industrial countries; an increase in the index indicates an appreciation of the leu. Quarterly figures for Romanian prices are interpolations of annual data. It is assumed that in 1984 Romanian prices remained constant at their end-1983 level.
2/ Nominal effective exchange rate deflated by relative consumer prices.
3/ Nominal effective exchange rate deflated by relative wholesale prices (producer, for Romania).
4/ Partly estimated. In the months of 1984 for which price information is not available for partner countries, it is assumed that the annual rate of change of prices is the same as that in the most recent month for which such information is available.

Note: Blanks will be filled and figures in square brackets adjusted when updating calculations are complete. Also, data through 1983 above are period averages; they will be replaced by end of period data.

ATTACHMENT 1

ATTN. MR. HANS SCHMITT
ACTING DIRECTOR
EUROPEAN DEPARTMENT
INTERNATIONAL MONETARY FUND

RE: YOUR CABLE OF NOVEMBER 6, 1984

A. STARTING NOVEMBER 1, 1984 THE COMMERCIAL EXCHANGE RATE WAS CHANGED IN TERMS OF U.S. DOLLAR AT A RATE OF LEI 17.50 FOR U.S. DOLLAR 1, THE TRANSFERABLE RUBLE LEI 15.50 FOR 1 TRANSFERABLE RUBLE AND THE NONCOMMERCIAL EXCHANGE RATE LEI 12.50 FOR U.S. DOLLAR, REPRESENTING 32.46 PERCENT APPRECIATION FOR COMMERCIAL EXCHANGE RATE AND 20.80 PERCENT APPRECIATION FOR NONCOMMERCIAL EXCHANGE RATE, COMPARED WITH THE RATES ON OCTOBER 29, 1984, LEI 23.18 FOR U.S. DOLLAR 1 AND RESPECTIVELY LEI 15.10 FOR U.S. DOLLAR 1.

B. THE ALREADY EXISTING PROVISIONS REGARDING THE BASKET SYSTEM REMAINED UNCHANGED.

C. TAKING INTO ACCOUNT THE STABILITY OF RETAIL PRICES IN ROMANIA, THE IMPROVEMENT OF PRODUCTION PRICES ON THE BASIS OF IMPLEMENTING PROGRAMS REGARDING HIGHER TECHNOLOGICAL AND QUALITATIVE STANDARDS OF PRODUCTS, HIGHER PRODUCTIVITY, LOWER PRODUCTION COSTS AND BETTER CAPITALIZATION OF RAW AND SUBSIDIARY MATERIALS AND FUEL, IT WAS ESTABLISHED THAT THE EXCHANGE RATE OF THE LEU SHOULD BE IMPROVED IN RELATION TO OTHER COUNTRIES' CURRENCIES.

D. NO OTHER CHANGE OCCURRED WITH RESPECT TO THE LEU REVALUATION THAN ABOVE MENTIONED.

DIRECTOR, ION ILIE
FOREIGN EXCHANGE AND PRECIOUS METALS DEPARTMENT
NATIONAL BANK OF THE SOCIALIST REPUBLIC OF ROMANIA

Received in the Cable Room on November 12, 1984.

Office Memorandum

To: Mr. Schmitt November 13, 1984

From: J. Reitmaier J.R.

Subject: Romania--Recent Economic Measures

On October 27, in the run-up to the 13th Congress of the Communist Party (scheduled for November 19-23), the Political Executive Committee (PEC) of the Central Committee, under the chairmanship of President Ceausescu, adopted a package of economic measures justified essentially by reference to domestic price stability and advances in productivity performance. The package comprises a large revaluation of the Romanian leu, a substantial reduction in interest rates, a cut in certain prices, and a series of measures designed to link wages more closely to production results. 1/

1. Revaluation

We first got knowledge of a revaluation of the leu through a standard format cable from the National Bank (received in the Fund on November 2, in EED on November 5) quoting commercial and noncommercial exchange rates for 10 currencies for November 1, which by comparison to rates notified on October 29 implied an appreciation of the commercial leu against the basket of about 33 percent and of the noncommercial leu of about 22 percent (see my memorandum for files of November 5, Attachment II). Still ignorant of any other policy measures, and somewhat disbelieving, we responded by asking for confirmation and clarification (Attachment III). The National Bank replied on November 12 (Attachment IV) confirming the revaluation and quoting as rationale the relevant passage (paragraph 3) of the PEC resolution. The Bank also stated that the provisions regarding the basket system remained unchanged.

Seen from the perspective of exchange rate policy pursued under the last stand-by arrangement (cancelled on January 31, 1984), the latest move put the commercial exchange rate for the U.S. dollar back to lei 17.50, the level it held on July 1, 1983, after a devaluation of 5.7 percent, and at the inception of the basket peg for the leu. On January 1, 1984, after prolonged negotiations with the Fund, the commercial exchange rate of the leu was devalued by 15 percent against the basket. Overall, under the 1983 segment of the three-year stand-by arrangement, the commercial exchange rate of the leu was devalued on three occasions, by a total of 30.4 percent measured against the U.S. dollar. 2/ In the staff report for the 1984 Article IV consultation with Romania (SM/84/180; 7/19/84), the staff considered that "these measures [had] substantially removed the real effective appreciation of the leu that had occurred since ... January 1, 1981," which had led to a considerable loss of market shares for non-oil exports. Although a real effective depreciation

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1/ For an unofficial translation of the Political Executive Committee resolution, see FBIS, Daily Report, Eastern Europe, November 1, 1984, pp. H2-6 (copy in Attachment I).

2/ As a result of the operation of the basket peg, the commercial rate of the leu vis-à-vis the U.S. dollar fell a further 7.0 percent in the period January 1 to October 29, 1984.

of the leu has probably taken place between January and October 1984, it cannot have been nearly as large as the revaluation of November 1.

The noncommercial exchange rate of the leu via-à-vis the U.S. dollar was set on November 1, 1984 at leu 12.50, implying a differential to the commercial rate of five lei per U.S. dollar, compared with about four lei prevailing in 1983 and 7 to 8 lei in January-October 1984.

2. Reductions in interest rates

Unlike the exchange rate move (not quantified in the resolution), the interest rate reductions are detailed in the PEC resolution (paragraph 2), where they are linked explicitly to a proposal by President Ceausescu. The interest rate reductions, which extend to all categories of credits and to deposits of the population, became effective on November 1. The following new and old rates are specifically mentioned in the PEC resolution:

	Interest Rates in Effect	
	before Nov. 1	from Nov. 1
	(percent)	
Current credits to industrial units, transportation, scientific research, public services, supplies and sales, and foreign trade	8	5
Credits to agricultural mechanization stations	6	2
Credits to state and cooperative agricultural units	5	2
Credits granted for the creation and long-term preservation of fuels, raw and other material stocks	8	3
Credits granted (to whom?) for a number of agricultural products and foodstuffs	8	1
Credits to the population for buying commodities and receiving public services	8	5
Credits to cooperative members and private producers	6	3
Savings deposits (current)	...	3.5
Savings deposits (over 1 year)	...	5

The PEC resolution fails to specify the interest rate reductions applying to the important categories of investment credits to economic units and enterprise deposits.

For comparison, Attachment V shows the interest rate structure that was put into effect on January 1, 1984 as a precondition for the final drawing under the last stand-by arrangement. Despite some uncertainty as to coverage, it appears that the "old" rates given by the PEC resolution are generally lower than the interest rates shown in Attachment V. There is no ready explanation for this discrepancy. The presumption at the time of the Article IV consultation (Board meeting on September 12, 1984) was that the January 1 interest rate schedule was still effective.

The stability of domestic prices 1/ would tend to justify a reduction in interest rates to a level which is generally still significantly positive in real terms. Curiously, this argument is not put forward in the PEC resolution where reference is made only to the proper operation of the economic-financial mechanism and to the expectation that reducing interest rates will reduce production costs and (ill-founded) the volume of bank credit.

3. Cut in certain prices

This measure, which is implemented through the imposition of profit rate ceilings below current profitability levels, applies to "certain products, parts, and subassemblies in the horizontal industry," a term which probably refers to producers of intermediate products. The ensuing price reductions at the intermediate product level are to be passed on to consumer prices, thus validating the fall in the price level already foreseen for 1984.

4. Other measures

The other measures adopted by the PEC (paragraph 4 of resolution) relate to changes in certain profit sharing arrangements (in one case, penalty sharing) that would provide increased incentives for plan fulfillment and overfulfillment.

5. Preliminary assessment

The new package of measures amounts to a reversal of the policy stance adopted under the last stand-by arrangement, an improved implementation of which was urged on the Romanian authorities by the Executive Board as recently as September 12, 1984. The rather artificial stability of domestic prices and the strong current account position in face of high current and prospective debt service obligations do not seem to justify

1/ In its introduction, the PEC resolution states that the price index of consumer goods in 1984 is almost 2 percent below the planned level, which called for prices to be roughly unchanged from 1983.

the new measures, least of all the revaluation. Nevertheless, I would advocate a low key matter-of-fact assessment in any Board paper and in the upcoming surveillance committee proceedings, so as not to lock ourselves into pursuing the same types of measures in any new arrangement (unlikely as it may now seem) as in the previous one. The growing doubts we harbored as to the effectiveness of exchange rate depreciations and interest rate increases without accompanying fundamental price reforms under the last stand-by arrangement extend of course also to the real significance of the new measures.

Attachments

cc: Mr. Hole
Mr. Prust

The interview occasioned an assessment of the current stage and the prospects for a further deepening of the Romanian-Chinese technical-scientific cooperation, their programmes of joint interest in chemistry, physics, electronics and electrical engineering, machine building, and other fields of scientific research, technological development and the application of technical progress. The president of the Academy of Sciences of China showed that the visits to the Central Institute of Chemistry, Romania's top-ranking research unit, and to other research, development and higher learning units had highlighted the prestigious successes scored by those collectivities, the great possibilities to expand and efficiency develop scientific cooperation between the two countries.

Expressing her conviction that Romania's and China's technical-scientific potential, the relations of close friendship established between the two peoples offered the possibilities to achieve superior results in the strengthening of the Romanian-Chinese collaboration on all planes, Academician Elena Ceausescu, D.Sc., pointed out that the expansion of cooperation between the Romanian and the Chinese scientists would contribute to the two countries' economic and social progress, to the general cause of peace and understanding among nations.

RCP ECONOMIC DEVELOPMENT RESOLUTION PUBLISHED

AU291244 Bucharest SCINTEIA in Romanian 27 Oct 84 pp 1, 5

["RCP Central Committee Resolution on New Measures To Improve the Application of the Economic-Financial Mechanism, Lower Interests, and Set Maximal Profitability Limits for a Number of Products; To Stimulate the Working People and Enterprises To Increase Labor Productivity, Introduce Technological Progress, Improve Product Quality, Reduce Costs, and Increase Economic Efficiency to a Greater Extent"]

[Text] Examining the activity carried out in the current 5-year plan, the Political Executive Committee of the RCP Central Committee notes that in that period of time, through the application of the 12th party congress decisions and of the guidelines set by RCP SEcretary General Nicolae Ceausescu, noteworthy results have been attained in fulfilling plan tasks, in efficiently increasing material, technological, and human potential, in increasing national revenue, and in improving the living standard of all our people on this basis.

Particular attention was paid by the party leadership and Comrade Nicolae Ceausescu, personally, to examining systematically with each minister and in each sector separately the activity aimed at the application of the measures taken in that timespan to completely fulfill the plan provisions and special programs set for products and areas of activity. The study constantly focused on the firm application of the new economic-financial mechanism, on increasing economic efficiency in all units, primarily by reducing production costs to a greater extent, especially in material and energy consumption, in increasing labor productivity, standardizing and improving the technological and qualitative level of products, in making better use of raw and other materials and fuel and energy, and in better organization of the production process and labor.

As a result of the application of these measures and the devoted work performed by all our people under the leadership of the party bodies and organizations, the industrial commodity output increased [illegible] percent in [illegible] compared to the preceding year and the net production increased [illegible] percent. By reducing specific raw and other materials and energy consumption the national economy saved 7 billion lei.

Noteworthy results have been registered in the first 9 months of the current year. Thus, industrial commodity output increased more than 6 percent; net output, 7.2 percent; labor productivity, 6.6 percent; and production costs decreased by more than 6 billion lei. Profits and enterprises' profitability continued to increase accordingly, a positive money flow was ensured, and the budget, financial-monetary, and currency balance was consolidated.

At the same time, through the consistent application of the party policy of systematically improving the standard of living of all the working people and on the basis of recommendations made by Comrade Nicolae Ceausescu all prices were stabilized, the working people's wages were increased, and the overall contract system received general application, a fact that contributed to a closer link between the working people's incomes and production results. In 1984 the price index of consumer goods was almost 2 percent below the planned index. Following an increase in nominal wages and a lower price index than planned, a 6 percent wage increase could be ensured compared to the 5 percent initially planned in the program. At the same time a 6 percent increase in pensions was also achieved. The implementation of all these measures aimed at increasing incomes and the general standard of living of our people was possible on the basis of increasing the national income and the activity carried out by all our people to ensure the proper management of and an increase in the national wealth.

Assessing the positive results achieved in implementing the plan provisions and special programs, the RCP Central Committee Political Executive Committee examined possibilities for further improving economic activity and set forth new measures to perfect the economic-financial mechanism to increase economic efficiency and improve the qualitative aspect of the overall activity to a greater extent.

Thus the Political Executive Committee decides:

1. Proceeding from progress achieved in effectively cutting back on production costs, from program provisions on further reducing those costs, a nd from the fact that in certain products, parts, and subassemblies in the horizontal industry the level of profitability is unjustifiably high compared with the real efforts made by producers, maximal profitability levels were set for certain products and activities. Thus, in the case of products and subassemblies delivered by horizontal industry to be incorporated in the finished products, and in the case of spare parts a maximal 10 and 15 percent profitability is set per product, while in the case of machine and tools repair it is set at 8 and 12 percent. On this basis, production and delivery prices are to decrease more than 15 billion lei, thus creating conditions for further cutting back on costs and prices in finished products with positive effects on the efficiency of the overall economic activity.

2. Upon the proposal by Comrade Nicolae Ceausescu, party secretary general and president of the SR of Romania, the Political Executive Committee decided that beginning 1 November this year the interest rate of all kinds of credits should be reduced. Thus, in the case of current credits granted to industrial units, transportation, scientific research, public services, supplies and sales, and foreign trade, interest rates will decrease from 8 to 5 percent. For credits granted to agricultural mechanization stations, interest rates will decrease from 6 to 2 percent, and for credits granted to state and cooperative agricultural units interest rates will decrease from 5 to 2 percent.

For credits granted for the creation and long-term preservation of fuels, raw, and other material stocks, interest rates will decrease from 8 to 3 percent and for a number of agricultural products and foodstuffs they will decrease from 8 to 1 percent. It was also decided to decrease interest rates of other kinds of credits granted to socialist units.

It was further decided to decrease interest rates of credits granted to the people with a view to buying commodities and receiving public services paid for by installments from 8 to 5 percent. For credits granted to cooperative members and private producers, interest rates will decrease from 6 to 3 percent. At the same time interest rates for current savings accounts of the people will be 3.5 percent and those for savings bound for more than 1 year will be 5 percent.

The Political Executive Committee assesses that decreasing interest rates are necessary for the proper operation of the economic-financial mechanism and will give an impetus to economic units to appropriately fulfill their plan tasks and to rationally make use of material and financial means, and will reduce the volume of bank credits, production costs, and constantly increase accumulations.

3. Taking account of the stability of retail prices in our country, of perfecting production prices on the basis of implementing the programs to improve the qualitative and technological level of products, of increasing labor productivity, of reducing production costs, and making better use of fuels, raw, and other materials, it was decided to increase the law rate compared to the currencies of other countries. These measures will contribute to increasing the efficiency of exports, to consolidating and increasing the financial results of productive units, and to strengthening workers' self-management and self-administration.

4. Examining the incentive system of the working people and of enterprises in achieving better economic-financial results, the Political Executive Committee stressed that the application of the set of measures established upon the initiative of the party secretary general, Comrade Nicolae Ceausescu, has contributed to increasing labor productivity, to introducing technological progress, improving product quality, cutting back on costs, and increasing economic efficiency to a greater extent.

To give a greater impetus to the working people's collectives and to enterprises in commendably implementing the plan provisions, in cutting back on production costs, increasing the contribution to securing the national income, and to improving on this basis the standard of living of all our people, the Political Executive Committee decided the following:

a) To increase the responsibility of enterprises and working people by steady fulfillment of contract and plan provisions, the repayment of credits upon schedule, and elimination of production breakdowns in order to reduce and eliminate fines and penalties, 50 percent of the fines and penalties will be covered from the working people's share fund in achieving the planned production and profits and in distributing those profits.

b) To increase concern for identifying all possibilities of increasing labor productivity beyond plan provisions and of reducing material consumption, the participation fund with shares in profits will be increased by part of the sums achieved as a result of applying these measures, sums which derive from profits in excess of plan provisions as follows:

-- 50 percent in the 1st year of application;

-- 25 percent in the 2d year of application if the respective measures have an appropriate effect that year, as well.

These incentives will be given to working people's collectives that have directly participated in achieving those results.

c) To stimulate an increase in export production and a better use of fuel, energy, raw, and other materials, and to achieve on this basis the highest possible export prices, the participation fund with shares in profits will be increased by part of the sums representing the value in lei of the foreign currency achieved in excess of plan provisions as a result of better export prices than those planned, as follows:

-- 50 percent in the 1st year;

-- 25 percent in the 2d year, if the export prices are at least up to those of the preceding year.

d) To increase the material incentive of the research and technological engineering personnel in working out new technologies and in manufacturing products with better technological and operational characteristics, and to constantly improve the competitiveness of Romanian products and give an impetus to enterprise personnel to apply the results of scientific research in the production process, a part of the additional profits, achieved as a result of applying the above-mentioned measures, will be designated to increase the participation fund with shares in profits, as follows:

-- 60 percent of the additional profits in the 1st year of application;

-- 30 percent in the 2d year of application, if the respective measures ensure additional profits.

e) To give impetus to working people to contribute with new solutions to increasing labor productivity and to cutting back production costs through inventions and innovations, the participation fund with shares in profits will be increased by the amount resulting from the application in the production process of inventions and innovations, as follows:

-- 50 percent in the 1st year of application;

-- 25 percent in the 2d year if the innovations and inventions yield results.

The Political Executive Committee assesses that by applying in practice the established measures to perfect the economic-financial mechanism, all productive sections and all areas of the national economy shall ensure a constant increase in economic efficiency and in their incomes, a larger mobilization of domestic resources for the development and modernization of production technological and capacities, an improved technological and qualitative level of products, and an increase in the income of each working collective closely linked to the tangible results achieved in the production process. The Political Executive Committee stresses that for our socialist economy a cut in production costs, a reduction of interest rates and the maintenance of a rational level in this respect, the ensurance of stable prices within the planned limits, increased labor productivity, proper management of the material and financial means of all units, and constantly strengthening the national currency are a primary secure means to constantly strengthen and develop our economic potential, of increasing social wealth and national income, and of ensuring, on this basis, the necessary means for the country's constant socioeconomic development, and for improving the general standard of living and the quality of life of our people.

The Political Executive Committee calls upon all managerial councils in economic ministries, the planning, financial-banking, and supply and prices bodies, upon all managerial councils in industrial centrals and enterprises, and upon all working people to act with great determination to apply the measures aimed at perfecting the economic-financial mechanism in practice, at introducing a high sense of order and discipline in production, and at most effectively making use of the material and human resources in each productive unit.

The party bodies and organizations have to take firm measures to rally the efforts by all Communists and all working people in implementing the adopted decisions commendably and in a revolutionary spirit in order to fulfill the tasks developing upon them under most favorable conditions.

The Political Executive Committee expresses the conviction that all working people -- as owners of the means of production, producers, and direct end-users of everything that is being achieved in our homeland -- will respond to all these measures with further and increasingly important achievements in production, in fulfilling the plan tasks regarding all indexes, and in increasing the national income, thus honorably meeting the 13th RCP Congress that will open up new and broad prospects of elevating our country onto high peaks of civilization, well-being, and progress, and of Romania's advance on the road of socialism and communism.

CEAUSESCU RECEIVES U.S. BUSINESSMAN 31 OCTOBER

AU312120 Bucharest AGERPRES in English 1924 GMT 31 Oct 84

[Text] Bucharest AGERPRES. 31/10/1984 -- Romania's President Nicolae Ceausescu received on Wednesday Thomas N. Urban, president of the Pioneer Hi-Breed International of the United States of America, now on a visit to Romania.

The guest thanked for his having been received by Romania's president, a political personality whose activity for peace and disarmament is well appreciated in the USA and worldwide.

During the interview, which passed in a cordial atmosphere, aspects were approached of the collaboration between Romanian foreign trade enterprises and the Pioneer Hi-Breed International, with emphasis on new possibilities of expanding cooperation in agriculture and the food industry, of developing economic cooperation between Romania and the USA. A series of current international political questions were also approached, problems of the world economic situation included. The necessity was stressed that interstate relations should be based on fully equal rights, non-interference in internal affairs and mutual advantage.

The interview was attended by Gheorghe David, minister of agriculture and the food industry.

DEPUTY PRIME MINISTER ION NICOLAE VISITS IRAQ

For Iraqi media reportage on the visit of Deputy Prime Minister Ion Nicolae to Baghdad, including his meetings with the Iraqi first deputy prime minister, Taha Yasin Ramadan, and the Iraqi trade and industry ministers, see the Iraq section of the 31 October Middle East & Africa DAILY REPORT and subsequent issues.

ATTACHMENT II

Office Memorandum

MEMORANDUM FOR FILES   November 5, 1984

Subject: Romania--Exchange Rate

We have received an exchange rate notification from Romania (in the usual format, but outside the regular weekly notification schedule) which implied a substantial appreciation of the Romanian leu between October 29 (the date of the previous regular notification) and November 1. For the U.S. dollar, the commercial rate was changed from lei 23.18 to lei 17.50, an appreciation of 32.5 percent; the noncommercial rate from lei 15.10 to lei 12.50, an appreciation of 20.9 percent; and the official rate from lei 5.00 to lei 4.47, an appreciation of 11.9 percent. Whether by design or coincidence, the official rate was returned to the level it held from 1978 until June 1983.

The rates of appreciation vis-à-vis the ten currencies quoted in the cable are calculated to be:

	Commercial Rate	Noncommercial Rate
U.S. dollar	32.5	20.9
Deutsche mark	35.1	23.2
French franc	34.5	22.6
Pound sterling	34.3	22.4
Swiss franc	34.9	23.0
Italian lira	23.6	22.7
Japanese yen	33.8	22.1
Canadian dollar	32.9	21.1
Netherlands guilder	34.9	23.0
Swedish krona	34.2	22.4

With the exception of the change in the commercial rate of the Italian lira, which might have arisen from a misprint, the variations in the rates of change between currencies probably reflect changes in market rates between October 29 and November 1. The Romanian leu is pegged to a basket of the first six currencies listed above. The rate of change vis-à-vis the basket is not know.

J. Reitmaier J.R.

cc: Mr. Schmitt
Mr. Hole

WASHINGTON, D. C. 20431

MR. FLOREA DUMITRESCU

GOVERNOR

NATIONAL BANK OF ROMANIA

BUCHAREST, ROMANIA

MR. POLAK

ETR

1. THE EXCHANGE RATES YOU NOTIFIED FOR NOVEMBER 1, 1984, IMPLY A SUBSTANTIAL APPRECIATION OF THE LEU COMPARED WITH THE RATES PUT INTO EFFECT ON OCTOBER 29, 1984.

2. IF CONFIRMED BY YOU, THE CHANGE IN THE RATE WOULD NEED TO BE NOTIFIED TO THE EXECUTIVE BOARD. FOR THIS PURPOSE, PLEASE CABLE AS SOON AS POSSIBLE REPLIES TO THE FOLLOWING QUESTIONS:

A. WHAT WAS THE SIZE OF THE REVALUATION AGAINST THE BASKET AND ON WHICH DAY WAS IT PUT INTO EFFECT?

B. APART FROM THE REVALUATION, HAS THERE BEEN ANY CHANGE IN THE SYSTEM OF THE BASKET PEG AND THE WEEKLY DETERMINATION OF BILATERAL EXCHANGE RATES?

C. IN THE LIGHT OF THE POLICY OF EXCHANGE RATE DEPRECIATION OVER THE PAST TWO YEARS, PLEASE EXPLAIN THE REASONS FOR THE LATEST MOVE.

D. WERE ANY OTHER POLICY CHANGES ADOPTED IN CONJUNCTION WITH THE REVALUATION?

REGARDS

SPECIAL INSTRUCTIONS — TEXT MUST END HERE

TELEX NO. CABLE ADDRESS

DRAFTED BY NAME (TYPE) J.T. Reitmaier J.T.R. EXT. 58817 DEPT. EUR 11/6/84

AUTHORIZED BY NAME (TYPE) Hans Schmitt

AUTHORIZED BY NAME (TYPE)

Schmitt

WASHINGTON, D. C. 2043

MR. FLOREA DUMITRESCU

GOVERNOR

NATIONAL BANK OF ROMANIA

BUCHAREST, ROMANIA

PAGE 2

HANS SCHMITT

ACTING DIRECTOR, EUROPEAN DEPARTMENT

INTERFUND

Mr. Polak
ETR

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TELEX NO. CABLE ADDRESS

DRAFTED BY NAME (TYPE) J.T. Reitmaier EXT. 58817 DEPT. EUR DATE 11.6.84

AUTHORIZED BY NAME (TYPE) Hans Schmitt AUTHORIZED BY NAME (TYPE)

TYPE ** ON LAST OR ONLY PAGE OF MESSAGE **

Log

ATTACHMENT IV

RECEIVED
IMF CABLE ROOM

1984 NOV 12 AM 9:37

ORIG: MR. HANS SCHMIDT
CC: MR. POLAK
ETRD

INCOMING CABLE/TELEX

Rcv: @1IM/3.30087 Line: 3

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BANCANAT BUC
BUCAREST, NOVEMBRE 12, 1984

WASHINGTON D.C.
ATTN. MR. HANS SCHMIDT
ACTING DIRECTOR
EUROPEAN DEPARTMENT
IMF

RE. YOUR CABLE OF NOVEMBER 6, 1984

A. STARTING NOVEMBER 1, 1984 THE COMMERCIAL EXCHANGE RATE WAS CHANGED IN TERMS OF US DOLLAR AT A RATE OF LEI 17,50 FOR US DOLLAR 1, THE TRANSFERABLE RUBLE LEI 15,50 FOR 1 TRANSFERABLE RUBLE AND THE NON-COMMERCIAL EXCHANGE RATE LEI 12,50 FOR US DOLLAR, REPRESENTING 32.46 PER CENT APPRECIATION FOR COMMERCIAL EXCHANGE RATE AND 20.80 PER CENT APPRECIATION FOR NON-COMMERCIAL EXCHANGE RATE, COMPARED WITH THE RATES ON OCTOMBER 29, 1984, LEI 23.18 FOR US DOLLAR 1 AND RESPECTIVELY LEI 15.10 FOR US DOLLAR 1.

B. THE ALREADY EXISTING PROVISIONS REGARDING THE BASKET SYSTEM REMAINED UNCHANGED.

C. TAKING INTO ACCOUNT THE STABILITY OF RETAIL PRICES IN ROMANIA, THE IMPROVEMENT OF PRODUCTION PRICES ON THE BASIS OF IMPLEMENTING PROGRAMMES REGARDING HIGHER TCHNOLOGICAL AND QUALITATIVE STANDARDS OF PRODUCTS, HIGHER PRODUCTIVITY, LOWER PRODUCTION COSTS AND BETTER CAPITALIZATION OF RAW AND SUBSIDIARY MATERIALS AND FUEL, IT WAS ESTABLISHED THAT THE EXCHANGE RATE OF THE LEU SHOULD BE IMPROVED IN RELATION TO OTHER COUNTRIES' CURRENCIES.

D. NO OTHER CHANGE OCCURED WITH RESPECT TO THE LEU REEVALUATION THAN ABOVE MENTIONED.

DIRECTOR, ION ILIE

FOREIGN XX EXCHANGE AND PRECIOUS METALSDEPARTMENT
NATIONAL BANK OF THE SOCIALIST REPUBLIC
OF ROMANIA

Table 30. Romania: Interest Rates in Effect Since January 1, 1984

	Interest Rates on Bank Loans		Distribution of Credits 1/	
	Normal Credits	Overdue Credits		
	(In percent per annum)		(In billions of lei)	(In percent of total)
Credits for production and trade in:				
Industry, transportation, services, technical and material supply, and foreign trade	10	12	229.9	43.3
Agriculture	7	12 2/	45.8	8.6
Construction	7	12	14.5	2.7
Domestic trade	8	10	58.5	11.0
Investment credits				
To economic units				
Credits up to planned amount	7	8	154.9	29.2
Credits beyond planned amount 3/	8	12	0.4	0.1
To households 4/	5-8	8-12	26.7	5.0
			530.7 5/	100.0
	Interest Rates on Bank Deposits		Distribution of Deposits 1/	
Enterprise deposits at the National Bank and specialized banks				
Blocked	--		25.0	6.5
Freely usable	3.5-5.0		86.4	22.6
Household deposits at the Savings Bank	3.0-6.0		127.8	33.4
Deposits of Savings Bank at the National bank	5.75		143.5	37.5
			382.7	100.0

Source: Data supplied by the Romanian authorities.

1/ Data relate to the position at end-1983.

2/ Nine percent for agricultural cooperatives.

3/ These credits make up for any shortfalls in the self-financing capacity of enterprises from planned levels and therefore carry a higher interest rate.

4/ Mainly for housing loans by the Savings and Loan Bank.

5/ The amount shown here is lower than the total of credit extended to enterprises and households contained in the monetary survey because it excludes credits to joint ventures in Romania and credits in foreign currency which carry different interest rates.

ATTACHMENT IV

Rcv: @1IM/3.30087 Line: 3

RECEIVED
IMF CABLE ROOM

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1984 NOV 12 AM 9:37

248331 IMF UR

ORIG: MR. HANS SCHMIDT
CC: MR. POLAK
ETRD

BANCANAT BUC
BUCAREST,NOVEMBRE 12, 1984

WASHINGTON D.C.
ATTN. MR. HANS SCHMIDT
ACTING DIRECTOR
EUROPEAN DEPARTMENT
IMF

INCOMING CABLE/TELEX

RE. YOUR CABLE OF NOVEMBER 6, 1984

A. STARTING NOVEMBER 1, 1984 THE COMMERCIAL EXCHANGE RATE WAS CHANGED IN TERMS OF US DOLLAR AT A RATE OF LEI 17,50 FOR US DOLLAR 1, THE TRANSFERABLE RUBLE LEI 15,50 FOR 1 TRANSFERABLE RUBLE AND THE NON-COMMERCIAL EXCHANGE RATE LEI 12,50 FOR US DOLLAR, REPRESENTING 32.46 PER CENT APPRECIATION FOR COMMERCIAL EXCHANGE RATE AND 20.80 PER CENT APPRECIATION FOR NON-COMMERCIAL EXCHANGE RATE, COMPARED WITH THE RATES ON OCTOMBER 29, 1984, LEI 23.18 FOR US DOLLAR 1 AND RESPECTIVELY LEI 15.10 FOR US DOLLAR 1.

B. THE ALREADY EXISTING PROVISIONS REGARDING THE BASKET SYSTEM REMAINED UNCHANGED.

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D. NO OTHER CHANGE OCCURED WITH RESPECT TO THE LEU REEVALUATION THAN ABOVE MENTIONED.

DIRECTOR, ION ILIE

FOREIGN XX EXCHANGE AND PRECIOUS METALSDEPARTMENT
NATIONAL BANK OF THE SOCIALIST REPUBLIC
OF ROMANIA

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INCOMING CABLE/TELEX

INTERNATIONAL MONETARY FUND

11/6

Mr. Whittome,

Jim Prust will be sending his comments on the attached EBM. Your comments, if you wish to make any, can be sent on your return.

Lynne

no comments made
called SEC
11/27

INTERNATIONAL MONETARY FUND

For Immediate Attention

To: M. Whittome

I should be grateful for your comments on the attached draft minute NOT LATER THAN:

11 | 6

Kenneth S. Friedman

12-420

2. ROMANIA - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with Romania (SM/84/180, 7/19/84; Cor. 1, 9/5/84; and Sup. 1, 9/7/84). They also had before them a report on recent economic developments in Romania (SM/84/195, 8/15/84).

Mr. Polak made the following statement:

(Buff 84/149 to be inserted in final draft minutes)

Mr. Zhang said that, while the staff report contributed to the Executive Board's understanding of Romania's economic situation, some important problems either had not been addressed, or had been dealt with tentatively.

The staff had indicated that there were certain deficiencies in the development of the economy in 1983, but it had also described the considerable progress, such as the reduction in the rate of inflation, and the acceleration in the growth of GNP, despite the decline in agricultural output. In addition, the staff had emphasized the impressive turnaround in the external current account, as reflected in the increase in the convertible current account surplus since 1980 to the equivalent of 5.5 percent of GNP, a record matched by few debtor countries.

The present report raised significant issues concerning the Fund's policy recommendations for centrally planned economies, Mr. Zhang continued. For instance, it was important to consider whether the recent improvement in Romania's economy was due to the introduction of corrective measures traditionally applied in market economies, or to measures the authorities had introduced in keeping with their central plan. When the stand-by arrangement for Romania had been negotiated, it had been assumed that unifying the exchange rates, devaluing the rate, and pegging the rate to a basket of currencies would significantly affect the external position. In fact, those measures had apparently had little or no such effect. The improvement in the external current account balance had resulted from the authorities' decision to cut imports to avoid a further deterioration in the external position following the general intensification of trade restrictions, the stagnation in Romania's principal markets, and the fall in exports. There seemed no justification for the staff conclusion that the usefulness of the devaluation had been severely constrained by the authorities' efforts to prevent its effects passing through to final prices. The staff had implied that the devaluations had been ineffective because export enterprises had not been able to benefit from them. In fact, the difficulties in exporting had been due to the restricted demand for Romanian exports rather than to a lack of financial incentives for individual enterprises.

Commenting on the determination of prices in Romania, Mr. Zhang said there was a general recognition in centrally planned economies of the usefulness of prices--particularly for producer goods--that reflected relative costs and scarcities. The staff had noted that "an efficient centrally planned economy does not require the allocative function to be found in flexible factor prices," but authorities in such economies recognized that, as the staff had noted, "central planners are much more likely to be able to take correct decisions if the facts available to them include accurate information on the relative profitability of enterprises and factors." The transition to such a price system was complicated and time consuming, and it not only involved the determination of priorities for certain social sectors and changes in the distribution of income, but also ran the risk of compromising certain basic economic and social principles. Given those considerations, the authorities' slowing of price adjustments was acceptable.

The corrective measures normally applied in private enterprise economies were much less useful for centrally planned economies, Mr. Zhang continued. Budgetary and financial policies in market economies were not formulated in conjunction with plans for the real economy. As the staff had noted, Romania's financial plan and budget "are designed to accommodate rather than influence the planned development of real variables." In a centrally planned economy, all policies had to meet the requirements of the plan; there was no particular reason to insist on the implementation of specific measures for individual sectors that were independent of the central plan and its objectives. Insistence on a large number of details on policy placed an unnecessary constraint on the member countries concerned, and might explain Romania's decision to do without further access to Fund resources.

He agreed with the staff that "it might be wasteful to forgo the growth opportunities afforded by greater-than-envisaged recourse to external credits," Mr. Zhang added. However, the Romanian authorities' reluctance to undertake significant borrowing was understandable. Given the high cost of borrowing and the general instability of the world economic situation, which made it impossible to forecast future interest rates on the demand for Romania's exports with any great confidence, it was difficult to assess the balance of advantages and disadvantages of further large-scale borrowing.

Commenting on the staff's evaluation of Romania's plan for 1984, Mr. Zhang said that it was also difficult to assess the importance of the discrepancies between various output targets the staff had noted. The doubts the staff had expressed about the possibility of attaining the targets for agriculture seemed somewhat exaggerated. The staff apparently felt that the targets might not be achieved "in view of recent measures imposing quantity restrictions on sales by private producers in peasant markets and setting of maximum prices for such sales far below those prevailing previously." It seemed to assume that increases in prices received by individual produces nearly automatically resulted in improvements in output and supply. In fact, however, a decline in prices received by small peasant producers could result in an increase in supply, particularly in a period of good harvests. In any event, assessments of effective price changes should take into account a number of factors, such as weather conditions, the availability within the agricultural sector of fertilizers, fodder, consumer goods, and equipment, and changes in the scope of collective farming.

Given Romania's significant economic achievements, including meeting all the quantitative performance criteria in 1982 and 1983 and the impressive turnaround in the external accounts, he would have expected less emphasis by the Fund on accelerating the price reform efforts, increasing price flexibility, and passing through the effects of devaluations to final prices, Mr. Zhang remarked. There was no compelling reason for the effects of a devaluation to be fully reflected in domestic prices. The discussion in the staff report of Romania's experience with devaluations suggested that the staff favored far more than increased flexibility in the export sector and greater attention to world prices in order to make devaluations in Romania work as they were ideally supposed to, and by no means always did, in market economies.

The need seen by the staff for the rapid elimination of the special noncommercial exchange rate--basically a tourist rate--seemed greatly exaggerated, Mr. Zhang considered. After all, the rate covered only a small proportion of foreign exchange transactions, and its role in Romania was similar to that of special fares and prices for tourists in many market economies.

Ms. Bush recalled that Romania had voluntarily cancelled its stand-by arrangement several months before it had been due to end. Although at that time she had harbored some lingering doubts about Romania's balance of payments position, she had agreed to permit the final disbursements for 1983 to be made. She had concluded that there was an acceptable degree of certainty that a sustainable balance of payments position would be achieved, mainly because significant exchange rate and pricing measures had been introduced, and because the authorities had given assurance that the effects of the measures and of the planned increases in exports would be fully passed through to the domestic economy. She had stressed the importance of Romania attaining balance of payments sustainability because of its large repurchase obligations to the Fund—nearly $1 billion in 1985-89. In the absence of a clearcut balance of payments need, she had not been enthusiastic about Romania's use of Fund resources largely to encourage structural reforms, especially as such reforms had clearly been in Romania's own interest. At the same time, she had noted that failure to implement the structural reforms could undermine the effort to achieve a sustainable balance of payments position.

The medium-term prospects for growth and balance of payments sustainability were a cause for concern, Ms. Bush commented. Apparently, the Romanian authorities were not convinced that changes in relative prices were useful in encouraging exports and investment. In any event, if they had recognized the utility of such adjustments, they had not taken concrete steps to make them. The authorities' decisions in that area would obviously have important consequences for economic growth. As the staff had remarked, even in an essentially planned economy, the quality of policy decisions could be improved when data on the relative profitability of firms and sectors were available. The staff suggestion to improve the value and price data for exports and imports, direction of trade statistics, and the domestic price series was appropriate.

Classical monetary and fiscal policy played a passive role in Romania's centrally planned economy, and she would concentrate her remaining remarks on cost and price developments since the previous review of the economy, in January 1984, Ms. Bush said. Apparently the authorities had decided not to permit further substantial price adjustments in 1984. Accordingly, despite the understanding reached in January 1984, the authorities would not allow the full pass-through to domestic prices of cost changes resulting from the exchange rate adjustments, interest rate increases, energy price rises, and the new capital charge on financing of investment with funds supplied through the budget. Those changes should result in a reduction in the profit margins of enterprises. Productivity increases, selective tax relief for enterprises, and reduced price ceilings on sales in the peasant markets should offset some of the effects of the decision not to pass the cost changes through to the domestic economy. Price changes were admittedly politically sensitive, the efforts to increase productivity were certainly welcome, and the limitations on price increases might encourage greater productivity, but the allocative function of changes in relative prices should not be undermined. As the staff had noted, if prices were to have an allocative function in the medium term, more flexibility would obviously be needed in setting prices and in fixing targets for exports and investment.

The improvement in the convertible current account in 1980-83 was impressive, but it had been due largely to the compression of non-oil imports, especially intermediate goods and capital equipment, Ms. Bush remarked.

The composition of the convertible current account had been a cause for concern in January 1984, when it had raised questions about the durability of the improvement in the balance of payments. In its present report, the staff had posed related questions, particularly about the effect of the low non-oil import levels on Romania's ability to generate the growth of convertible exports needed to achieve the current account targets and to repay the foreign debt.

She also had doubts about the adequacy of the exchange rate, partly because the price controls apparently caused the inflationary pressures to be understated, Ms. Bush continued. In fact, the staff had concluded that the present external policies were insufficient to achieve a large and sustainable current account surplus in the medium term. Given the decline in profitability and the limitations on investment decision making, she wondered whether substantial export growth and diversification would be possible. A further comment on Romania's balance of payments prospects would be helpful, especially as the supplement to the staff report and Mr. Polak's opening statement described a somewhat better external performance in early 1984 than had been foreseen at the time of the drafting of the staff report.

The authorities' obligation to remove the multiple currency practices should be stressed, Ms. Bush considered. In the circumstances, she would not support a decision approving those practices.

She was pleased that the authorities felt no need to seek further debt relief in 1984, Ms. Bush commented. She sympathized with them in their desire to achieve a gradual reduction in the foreign debt and debt service ratios, but the staff wondered whether a somewhat less ambitious reduction in the debt burden would not be more advantageous for the medium-term growth of the economy. It had been suggested that $500 million per year in additional borrowing in 1985-89 might be tolerable. A further comment on the effects of such a shift in policy on imports and economic growth would be helpful.

Mr. Grosche commented that the staff reports gave the impression that the authorities had undertaken an economic strategy that, for the sake of short-term advantages, ran the risk of causing hardship in the longer run. The improvement in the external balance, the favorable growth performance, and the overall price stability were welcome, but they had been achieved through cuts in imports and other administrative measures that might impair the longer-run growth prospects, hamper the correction of relative prices, and adversely affect overall efficiency. The authorities should be encouraged to reassess their policy stance with a view both to providing more room for decentralized decision making and price adjustments, and to easing considerably the tight exchange and trade restrictions.

He shared the staff's skepticism about the outlook for economic growth in Romania, Mr. Grosche commented. Although there had been a sizeable increase in imports, the level of imports was still relatively low, and a further pick-up of industrial activity might be constrained by an insufficient supply of imported inputs.

Given the limited room to adjust relative prices, Mr. Grosche said he doubted whether the projected growth rate could be achieved. The authorities' decisions not to correct domestic prices and not to pass to domestic prices the effects of reform measures introduced in 1983 and January 1984 had undermined efficiency and the prospects for economic growth. It was not clear to him how enterprises in a highly centralized economy could remain competitive in face of upward pressures on the costs of inputs.

He was surprised by the sizable discretion in the application of the tax codes for the state economic units, Mr. Grosche remarked. Actual tax payments were subject to a kind of bargaining process that might create problems for consistent planning of fiscal policy. The authorities should be encouraged to design a clearly defined tax structure. Achieving that objective would depend on the authorities' general effort to provide more room for decentralized decision making.

He agreed with the staff that Romania's failure to eliminate the multiple exchange rate practices was regrettable, Mr. Grosche said. The external trade and payments system was still strictly regulated, and the authorities should be encouraged to liberalize it. He shared the staff's doubts about the official forecast for the convertible current account, including the assumption that the level of non-oil imports in 1989 would be 25 percent below the present level. In addition, the assumed improvement in the oil balance seemed over-optimistic, and the volume of net export credit might prove inadequate. He hesitated to encourage the authorities to make greater use of external financing.

As a developing country, Romania should of course be seen as a typical net importer of capital, but given the considerable structural weaknesses and distortions, he doubted whether an increased supply of foreign resources could be employed effectively. Finally, in the light of the statistical problems described by the staff, it might be advisable to provide technical assistance.

Mr. Schneider recalled that Romania had made impressive progress under the three-year stand-by arrangement approved in June 1981. Tight demand management policies, several shifts in pricing policy, and a susbtantial decrease in imports had helped to achieve the main objective under the program, namely, to improve the current account position. However, it was his impression that the cancellation of the stand-by arrangement in January 1984 at the request of the authorities had slowed the progress on structural reform measures aimed at improving efficiency and resource allocation.

The official figures for real GNP growth in 1983 and 1984--3.5 percent and 7.3 percent, respectively--seemed impressive, Mr. Schneider commented. They were considerably higher than the rates for the previous three years. However, like the staff, he had questions about them. The cumulative decline of about 45 percent in the volume of imports from the convertible area in 1980-83 should have affected industrial production, which had traditionally made the main contribution to net output. He agreed with the staff that, with net exports having remained unchanged, it was difficult to explain why the increase in output had greatly exceeded domestic demand during that period. Clear judgments about real GNP growth in Romania were difficult to make.

The convertible current account surplus had been sufficient to balance the overall external payments position in 1983 and was projected to do so as well in 1984, but only as the result of a drastic reduction in imports, Mr. Schneider said. The steady reduction in imports had clearly affected exports in 1983 and, apparently, in the first quarter of 1984. Achieving a sustainable current account surplus over the medium term would require steady growth of both imports and exports.

The structural reform measures of 1982-83, including three devaluations, and increases in the cost of capital and in the prices of natural gas and crude oil, had not affected domestic prices because of the limitations imposed by the system of centralized economic planning, Mr. Schneider remarked. The exchange rate system established in June 1983--based on a peg of the leu to a basket of currencies--would be more effective if the constraints described in detail in the staff report were eliminated.

He hoped that the World Bank would soon complete its review of the Government's investment program, and that its recommendations would be effectively implemented, Mr. Schneider commented. Finally, improvement in the statistical information and reporting system was needed to enable the Fund to gain a better understanding of the Romanian economy.

Mr. Coumbis remarked that 1984 was the first year in the previous four years that Romania had not requested a new stand-by arrangement. There had been an impressive turnaround in the external current account, from a deficit of $2.4 billion in 1980 to a surplus of $1 billion in both 1982 and 1983. An additional surplus of a little more than $1 billion was projected for 1984, even though the authorities did not intend to seek any further debt relief. Foreign reserves had risen by $658 million by end-1983 and if, as Mr. Polak had suggested, account was taken of the final two purchases of $190 million under the stand-by arrangement in January 1984, the increase in reserves was not below the target for 1983.

The authorities had attempted, and planned to continue in the future, to make every effort to reduce the country's foreign debt, Mr. Coumbis remarked. They intended to cut it from $8.8 billion at end-1983 to $2.9 billion at end-1989; and by then, more than half of the total convertible debt would be owed to international institutions, and only 9 percent to commercial banks. He agreed with the staff that, at present, it might be wasteful for Romania to forgo the growth opportunities offered by greater use of external credit than was now envisaged. However, Mr. Polak's analysis of the reasons for the authorities' conservative approach toward future foreign borrowing was convincing.

He wondered whether the major developments he had described did not indicate that Romania had been pressed somewhat too hard by the Fund under the stand-by arrangement, Mr. Coumbis commented. There were substantial differences of opinion between the staff and the authorities, for instance, on the rate of increase of GNP in 1983 and 1984, the role of prices in the economy, and the seriousness of the decline in imports during the adjustment period and its possible effects on Romania's development effort. He wondered whether those differences did not indicate that the staff and the Executive Board should carefully re-examine Fund policies toward centrally planned economies.

The Romanian authorities should be urged to make a major effort to improve the data provided to the Fund, Mr. Coumbis considered. Data on some important economic variables were lacking, thereby making it difficult to properly analyze the economy. Finally, the proposed decision was acceptable.

Mr. Clark considered that developments in 1984 in a number of areas of the economy had been encouraging, if not as positive as the authorities had forecast. Industrial production and the wheat and barley harvests had improved, and the balance of trade in convertible currencies had performed well; non-oil exports had been particularly encouraging. However, he agreed with the staff that the substantial improvement in the convertible current account had relied excessively on reductions in non-oil imports that could seriously affect non-oil exports and economic growth in the longer term. He also agreed with the staff that, while a further reduction in the debt service ratio was desirable, there was little merit in reducing total debt so rapidly that profitable investments would not be undertaken, thereby jeopardizing future development. Effective adjustment could be achieved only if structural reforms were made.

In Romania, as in other Eastern European countries, the rate of economic growth had declined sharply over the previous two decades, partly because of the difficulties in moving from a development strategy based on increasing inputs to one based on using the same inputs more effectively, Mr. Clark remarked. Experience suggested that, even in a centrally planned economy, the newer strategy required greater reliance on an effective price system. The Romanian authorities had taken some steps in that direction, but the effects of their efforts had been weakened by the methods used to stabilize domestic prices.

Although the improvement in the convertible current account in 1983 was welcome, it had relied heavily on import compression, and non-oil exports had fallen by 9 percent in nominal terms, despite the cumulative effect of three devaluations, Mr. Clark went on. The recovery of non-oil exports in 1984 was encouraging, but the experience of 1983 naturally called into question the effectiveness of devaluations in the Romanian economy and supported the staff view that the real effective exchange rate was distorted because the official price indices understated the true rate of inflation.

He agreed with the staff that there was little scope for increasing oil production in 1984, Mr. Clark said. There should be some reduction in convertible currency oil imports in coming years following the agreement by the USSR to supply Romania with 3 million tons of oil in

1985 and 3.5 million tons in 1986. Developments in Romania brought to mind the question of the relationship between convertible and nonconvertible currency accounts in centrally planned economies and its implications for Fund policy; a staff paper on the subject would be helpful.

The elimination of the restrictive features of the payments arrangements with Brazil was welcome, Mr. Clark said. The authorities should be urged to make further progress in liberalizing their payments arrangements with other countries and in eliminating the multiple currency practices. The indications of an increase in countertrade were particularly worrying.

Commenting on structural policy, Mr. Clark said that the introduction of a system of wage determination based more closely than hitherto on productivity developments was welcome. However, the authorities' forecast of an 8 percent increase in labor productivity in 1984 seemed rather optimistic. He wondered whether there were yet any indications of the effectiveness of the new wage system.

The discussion on pages 8 and 9 underscored the limitations of Romania's exchange rate and price policies owing to the existing institutional arrangements, Mr. Clark continued. In particular, there seemed to be a lack of consistency among the incentives given to foreign trade organizations, exporting enterprises, and suppliers; and a number of the incentives did not depend sufficiently on prices. He wondered whether the trade targets given to foreign traders were expressed in leu or foreign currency; that arrangement probably had an important effect on responses to exchange rate changes. Apparently the exchange rate did not directly affect producing enterprises, and profitability was an important target for those enterprises, although they were given other targets as well. The limitations on the effectiveness of exchange rate policy could be greatly mitigated by selective adjustments in tax and profit payments by exporting enterprises. The staff had noted that none of the benefits accruing to exporters from price and exchange rate changes were passed on to suppliers--an outcome that had caused problems in other Eastern European countries--and that the main response to such changes must come through the central plan. Improved price data would be valuable to planners, and the use of shadow prices based on world market prices in evaluating investment projects in the trade sector was welcome.

However, Mr. Clark went on, it was unrealistic to expect that the complex implications for the whole economy of price and exchange rate changes could be taken account of through modifications to the central plan. That conclusion was just one aspect of the more general question of the role of market mechanisms in planned economies; the Executive Board intended to discuss programs for those economies in the near future. It was already clear that improvements in the exchange and pricing systems of those economies were needed, and that they must be accompanied by measures to ensure that the signals given by the systems could be transmitted effectively.

The continuing inadequacies in the statistics provided by the Romanian authorities to the Fund were a cause for concern, Mr. Clark commented. The data were incomplete and inconsistent, seriously hampered economic analysis, and were not in keeping with Romania's obligations under Article VIII, Section 5. The authorities should be urged to make a major effort to improve their statistics, and he hoped that substantial progress would be made by the time of the next Article IV consultation.

Mr. Blandin considered that Romania had clearly made significant progress in its adjustment efforts. The turnaround in the current account balance and the rate of growth of GNP were particularly impressive, and he agreed with Mr. Polak that "the country has overcome its most difficult moments and that recovery is underway." Nevertheless, he was somewhat less optimistic than Mr. Polak about the sustainability of the present pace of growth, for two reasons. First, the authorities' decision in January 1984 terminating the stand-by arrangement had apparently been accompanied by the suspension of planned structural reforms, particularly in the price and exchange rate policy areas. Second, the longer-run strategy of sharply reducing the external debt was a cause for concern.

It was essential to permit a full pass-through to domestic prices of the effects of the depreciation of the exchange rate, Mr. Blandin commented. The staff and the authorities held different views on the extent to which domestic prices should reflect market conditions. There were domestic constraints on adjusting prices and, in the absence of competition, the level of prices was difficult to fix, but it was still surprising that no increase in prices was expected in 1984 despite the several recent devaluations. The effect of the devaluations would have to be felt somewhere along the line. The most competitive sectors would probably bear the cost of the devaluations and experience negative effects on productivity, incentives to produce, and tax payments. The authorities apparently felt that there was some room for maneuver in the economy by reducing the use of imported materials and by cutting costs. He wondered how far that policy could be taken, and whether it was not preferable for the authorities to take the more realistic view on costs and prices described by Mr. Polak in his opening statement. Domestic energy prices should be increased, particularly in the light of the negative effect on the external accounts of the present differential between Romanian and world energy prices.

Mr. Polak's comments on wage increases in Romania were helpful, Mr. Blandin remarked. The timing of the wage adjustments had been inopportune, but the decision to tie wage determination to productivity performance was welcome.

The devaluations of the leu had been critically important in restoring external competitiveness, Mr. Blandin commented. The staff had expressed some concern about the appropriateness of the present level of the exchange rate and about the multiple currency market, and further comments on the authorities' views on those matters would be helpful. The comprehensive exchange rate restrictions were regrettable.

Commenting on the medium-term outlook, Mr. Blandin said that the staff had usefully questioned the realism of the authorities' plan to record annual current account surpluses in 1984-89 considerably in excess of the 1983 result, and the appropriateness, in terms of optimal economic growth, of their goals of rapidly reducting the external debt. The two issues were closely linked: further increases in the current account surplus in coming years would probably require significant restrictions on imports that could adversely affect productive capacity. He had read with interest Mr. Polak's description of the authorities' approach to foreign borrowing, but a good case could perhaps be made for Romania resorting to financial markets in order to ease the import constraint.

A further comment on the so-called statistical shortcomings in Romania would be helplful, Mr. Blandin commented. The inconsistencies between the data on the growth of output and the level of demand seemed too great to be explained by the evolution of trade alone.

The authorities' objective of consolidating the large current account surplus while maintaining rapid growth was desirable, Mr. Blandin considered. Their ability to do so would be enhanced if they fully implemented the staff recommendations, and if there was a clear understanding that short-term considerations should not undermine the achievement of sustainable growth. The effort to rapidly reduce the external debt was commendable, but staggering the reductions over the coming years might be preferable.

Mr. Shaw stated that he generally agreed with the staff appraisal. He accepted the proposed decision, under which the Executive Board would not approve Romania's multiple currency practices.

The staff had clearly shown that a strong turnaround in the convertible current account balance had occurred in 1980-83, Mr. Shaw continued. The improvement, from a deficit of $2.4 billion in 1980 to an estimated surplus of more than $1 billion in 1984, demonstrated the authorities' commitment to correcting the imbalances in the external sector. The overall external balance had improved from a deficit of $1.4 billion in 1981 to an estimated surplus of $56 million in 1984, despite significant debt service payments. The authorities were to be commended for what appeared to be a sustainable short-term balance of payments position.

He, like Ms. Bush, was concerned about the sustainability of the economic turnaround in the medium term, Mr. Shaw continued. The reduction in the external deficit had been due mainly to import compression, rather than export growth. That approach to adjustment would not be conducive to a durable improvement in the balance of payments as the economic recovery in Romania became better established. In addition, as previous speakers had stressed, more comprehensive reforms in exchange rate, interest rate, and pricing policies would have helped create stronger incentives for export growth, energy conservation, savings, and the efficient use of capital. Such structural changes would probably have permitted a higher rate of domestic growth and helped to restore foreign investor confidence and net capital inflows. In the absence of realistic structural reforms to achieve more efficient resource allocation, the economic imbalance would merely be shifted from the external sector to the internal sector.

However, Mr. Shaw went on, some progress had been made over the previous three years in the priority areas of the exchange rate, interest rates, and prices. The arrangements for pegging the leu had been altered, and the commercial exchange rate had been devalued by 30.4 percent. However, the authorities' commitment to unify commercial and noncommercial exchange rates during 1984 had not yet been met. A further comment on their intentions with respect to that commitment would be helpful.

The 2 percentage point increase in lending and deposit interest rates in January 1984 was commendable, Mr. Shaw considered, and the authorities had indicated that they would keep interest rates under review. However, he doubted whether the adjustment had been sufficient to encourage savings; if the 5.5 percent inflation forecast for 1984 was correct, deposit rates would be negative in real terms. He also doubted whether the inflation indices used to calculate real rates fully reflected the actual inflationary pressures. The possible existence of significant hidden inflation added to the uncertainty about the adequacy of interest rates and the exchange rate.

The pricing proposals by the staff were a major part of the structural adjustment needed to achieve a medium-term economic recovery, Mr. Shaw remarked. Some gradual increases in energy prices had been made, but they were still well below world levels, and the failure to raise gas prices in particular was a cause for concern. Achieving the targets for energy conservation and increased domestic production could be jeopardized if energy prices were not increased significantly. In the agricultural sector, the measures in early 1984 requiring private producers to sell minimum quantities to the Government at below market prices would act as a disincentive to production.

Romania had achieved a significant turnaround in its balance of payments, but a number of structural adjustment measures still must be introduced to consolidate it, Mr. Shaw considered. When the authorities cancelled the stand-by arrangement in January 1984, Mr. Polak had stated that they intended to negotiate a new one-year arrangement. A new program would be welcome, but it must include structural measures for the medium term, including reforms in prices, the exchange rate, and interest rates. Such changes were clearly in Romania's best interest, as they would likely favorably affect growth and the balance of payments prospects.

He shared the staff's concern about the shortcomings of Romania's economic data, Mr. Shaw commented. There was a considerable lag in the availability of data on the national accounts and trade, including the volume and price data, and trade with the nonconvertible area in particular. It was vitally important for the authorities to provide adequate data on a timely basis to the Fund, the international financial markets, and official creditors if confidence in the Romanian economy were to be restored.

Mr. Linda said that the authorities were to be commended for their strong adjustment efforts in 1981-83. Their record was matched by few other debtor countries, and Romania's debt situation had improved much more quickly than expected.

He agreed with the staff that the reductions in imports were likely to affect non-oil exports in the long run, although there was admittedly not yet much evidence to that effect, Mr. Linda continued. Indeed, the authorities had projected that the volume of non-oil imports in 1989 would still be 25 percent less than the volume in 1980. Finally, the proposed decision was acceptable.

Mr. Prowse remarked that the Fund was still seeking both a fuller understanding of the workings of nonmarket economies and agreement with the authorities of those countries on the optimum policy stance for their economies. The present staff report did not reflect the significant increase in knowledge and understanding of the Romanian economy that had apparently been the objective of the staff mission. Although Romania had been a member of the Fund since 1972, the staff was still exploring the fundamental nature of the economic system and was still attempting to reach a basic agreement with the authorities on economic policy.

The present consultation was the first in four years in which the authorities had not included a request to use Fund resources, but that fact was not necessarily a signal of progress, Mr. Prowse commented. He had hoped that the stand-by arrangement would be implemented through the entire agreed period. Not all the reasons for the cancellation of the arrangement had been positive ones; indeed, the cancellation apparently reflected an on-going difference of opinion between the staff and the authorities on economic policy objectives. The authorities' decision in late 1983 to keep domestic prices stable was particularly regrettable, as it had seriously constrained the effectiveness of earlier price reforms.

Although it was important to recognize the impressive turnaround in the convertible current account during the period of the stand-by arrangement, it had been due partly to restrictive energy and incomes policies and increased energy efficiency and, most important, to administrative restraints on imports. Mr. Polak had suggested that the trend in imports had apparently been reversed in 1984. But it was important to remember that the volume of non-oil imports from the convertible area in 1983 had been half that of 1979, and that there had been no corresponding reduction in imports from the nonconvertible area; in fact, imports from that area had increased from one third of total imports in 1982 to more than half of total imports in 1983. Trade developments, and particularly the stagnation of exports to the nonconvertible area, showed little evidence that the structural objectives under the stand-by arrangement had been achieved. The devaluations of the leu apparently had had little of the hoped-for effect on trade, thereby re-inforcing Mr. Zhang's argument that the exchange rate played different roles in market and nonmarket economies.

While the stabilization of external financing and the turnaround in the current account were welcome, some of the methods of achieving them were regrettable, Mr. Prowse commented. Trade with the nonconvertible area had fallen, a trend that would not support strong economic growth and efficient development in the medium term. In the circumstances, the staff and the authorities were to be commended for their agreement on the need for steady export growth and greater efficiency to achieve a sustainable external current account surplus over the medium term.

However, the staff had expressed reservations about the prospects for achieving that objective because of the nature of the authorities' commitment to price reform.

It was not clear to him, Mr. Prowse said, whether the so-called sectoral balance in foreign trade desired by the authorities was compatible with the objective of achieving more efficient resource allocation. A further comment on the matter would be helpful.

The staff's discussions with the authorities had appropriately centered on the external accounts, Mr. Prowse remarked. In that connection, Mr. Polak's comments on the authorities' attitude toward the role of prices in the economy were not encouraging. He had noted that "the authorities remain firmly committed to the cost-plus principle, and their pricing system is flexible enough to allow price increases whenever other means of offsetting higher production costs are exhausted." Such a system was unlikely to encourage efficient resource allocation. The main question at hand was the kind of resource allocation mechanisms that were best suited to Romania; the staff and the authorities apparently continued to have different views on the matter.

The authorities' policy on borrowing abroad, as described by Mr. Polak, seemed appropriate, Mr. Prowse said. By any standard, the debt service ratio required a cautious borrowing policy. The medium-term scenario was encouraging, as it indicated a reduction in the debt service ratio to 12.4 percent of current receipts by 1989. However, that forecast assumed a considerable decline in external debt and strong capital inflows, which would have important implications for economic growth. While cautious external debt management was desirable, Romania apparently could handle the marginal increase in borrowing suggested by the staff.

The Director of the European Department remarked that there were marked differences in the economies of Eastern Europe. The staff conclusions on Romania were not meant to be applicable to all planned economies. Moreover, there was a grey area between so-called market and nonmarket economies. At the same time, it was important to note that, while the constraints facing Romania were similar to those in other Eastern European economies, the Romanian authorities had chosen a significantly different policy course, which was reflected in particular in Romania's record of economic growth and the relationship of imports to growth.

During the period of the extended arrangement, the Government's exchange rate measures had helped to improve the current account because the authorities had permitted the effects of the changes to be passed through to domestic prices, the Director commented. However, because of the difficulties in Romania caused by the price increases, the authorities had decided toward the end of 1983 that thenceforth prices should be kept virtually stable. Since then, consumer prices had been essentially unchanged. Once the decision to keep prices stable had been made, the Fund's recommendations concerning the exchange rate and prices had become irrelevant. The authorities' decision to cancel the stand-by arrangement had been due in part to the realization that, after the decision to keep prices stable, they would be under pressure from the Fund to adopt measures that they believed were unacceptable. He agreed with Mr. Zhang that relative prices played a minor role in Romania's centrally planned economy. In fact, the Government's ability to maintain price stability was even greater than was implied by the staff report and Mr. Polak's opening statement. The authorities could encourage improved labor productivity, alter tax rates, and vary grants from the budget to individual enterprises for investment and working capital. Moreover, within branches of industry, tax rates could vary from one enterprise to the next.

As Mr. Zhang had noted, the staff suspected that the Government's agricultural projections for 1984 were over-optimistic, the Director said. For instance, the yields of two important crops, wheat and rye, were expected to increase 100 percent, and the production of an even more important crop, maize, was estimated to rise 50 percent; and those improvements were on top of the sizeable increases recorded in 1982.

It was not yet clear to the staff whether or not the balance of payments would prove sustainable, particularly given the compression of imports in recent months, the Director remarked. The staff had suspected 12 months previously that the position was not sustainable, but it had been proved wrong. Still, there was a sufficiently strong relationship between the balance of payments and import compression to cause the staff some unease. In addition, there had been a switch in imports of machinery away from the convertible area and toward the nonconvertible area, suggesting potential significant difficulties in maintaining adequate supplies of spare parts.

Commenting on the prospects for the balance of payments, the Director said that the sharp increase in convertible area exports and imports in the second quarter of 1984 was welcome, but the staff had no detailed information on the destination of the exports. The staff suspected that much of the increase was accounted for by the United States, which had experienced a sharp rise in imports in the second quarter of 1984. There was also no information on either the particular commodities that had benefited from the increase in exports, or the evolution of the capital account. Nor did the staff know the extent to which the increased exports had been financed by export credit extended by Romania. The nonconvertible trade surplus had fallen substantially, suggesting that there might have been a switch of exports from the nonconvertible area to the convertible area, probably a one-time-only occurrence. In sum, the balance of payments data for the second quarter of 1984 were promising, but there was no certainty that the trend would continue through the rest of the year.

The staff had suggested that a significant increase in long-term capital inflows--$500 million a year--in 1985-89 above the figures in the official scenario would permit more rapid growth of imports, thereby helping to stabilize the current account surplus, the Director remarked. The figure of $500 had been used for presentational purposes. The staff did not know for certain whether Romania could actually borrow that amount. However, if such an amount was used for productive purposes, it could provide room for more rapid growth of imports, thereby paving the way for an improved export performance. It might also provide some room for an increase in net credit for exports extended by Romania, without which the official export projections were unlikely to prove accurate. Capital inflows of approximately $500 million in 1985-89 would be compatible with a sharp decline in Romania's outstanding external debt in that period.

The deficiencies in Romania's data were serious, the Director commented. The authorities were considering the staff's offer of technical assistance.

There were as yet no indications of the effectiveness of the new wage system, the Director remarked.

As the staff understood it, the Director said, most foreign trade organizations in Romania had targets expressed both in foreign exchange and in domestic currency, including separate targets for the convertible and nonconvertible areas. The targets of some organizations were expressed only in domestic currency. The exchange rate used to convert the targets to domestic currency often was a rate in force before the period in which the target had been set.

The authorities believed that the present exchange rate was appropriate, the Director remarked. In their view, other factors--productivity, product quality, and the introduction of new products--had a more important effect on trade performance than the exchange rate.

The noncommercial exchange rate applied primarily to individual tourists, the Director of the European Department explained; the commercial exchange rate was applied to groups of tourists. The authorities were reluctant to unify the rates because of the difference in the rates for the convertible and nonconvertible areas that would result.

The staff representative from the European ~~Western Hemisphere~~ Department remarked that the staff had drawn the authorities' attention to the possible dangers of trade balanced targets set by the central authorities. The main potential drawback was a cumulative contraction in trade following an initial decline in imports for a particular sector. The authorities had noted that the targets were applied and adjusted in a flexible manner that provided sufficient room to prevent the possible adverse consequences the staff had described.

Mr. Polak recalled that, during the previous discussion on Romania, the staff had mentioned the possibility that the Government's trade restrictions would inevitably restrain output in general, and exports in particular. In fact, that fear had proved unwarranted. Many countries, for instance, Mexico, had been able to run their economies with a much lower level of imports during the previous two years than in 1980-81, when there had been an ample supply of imported capital to finance a large volume of imports for major investment projects. Romania had been able to reduce imports in 1982-83 without adversely affecting the economy; and the reduction had not been significant. During the previous discussion, he had stressed that the authorities had concluded that they had reduced imports to the extent possible, and that thenceforth they would not aim for a sizeable trade surplus; instead, they hoped to record roughly equal increases in imports and exports. In fact, imports had risen by some 10 percent in the first half of 1984, compared with the same period in 1983.

There was insufficient information to know for certain the extent to which the exchange rate influenced exports, Mr. Polak remarked. He doubted whether the influence was as limited as Mr. Zhang had suggested. The exchange rate appeared to have some influence on exports through various channels, including adjustments of the national plan.

Some Executive Directors had complained that the authorities had not permitted the effects of exchange rate adjustments to be passed fully through to domestic prices, Mr. Polak noted. However, passing through prices without attempting to take other steps to limit the consumption of imports or improve productivity would be inappropriate; and it was not characteristic of market-oriented economies. The Romanian authorities had made a considerable effort to increase productivity at some cost in terms of the efficiency of resource allocation. They had not taken the inappropriate route of maintaining prices while introducing budgetary subsidies. Consumer subsidies were virtually nonexistent in Romania.

Speakers had noted that the inadequate data provided by the authorities made it difficult to reach prompt conclusions on developments in the economy, Mr. Polak commented. The Fund and private creditors would benefit from the provision of more timely data, and the authorities should appreciate that improvements in that direction would be Romania's best interest.

The Chairman made the following summing up:

Directors noted the impressive rate of improvement of Romania's convertible current account position in the three years 1981-1983, which was matched by few debtor countries. However, they also noted that the improvement had been largely brought about by administrative cuts in non-oil imports, although efforts to enhance economic efficiency, and restrictive energy and incomes policies had also played a role. A number of Directors thought that the very low level of imports of intermediate and capital goods may well have had an important bearing on the fall in convertible non-oil exports since 1981 and an inhibiting effect on growth. The unfavorable international environment was also seen as a factor in the development of exports to the convertible area in recent years.

Directors noted the need for further surpluses on convertible current account in 1984 and beyond, given the large debt service payments, the decision by the authorities not to seek further debt rescheduling, and the expected low inflow of new credit. They believed that for large current account surpluses to be sustainable it would be essential to ensure the steady growth of exports and further improve the efficiency of the economy. Although there appeared to have been a recovery of convertible non-oil exports and imports in the second quarter of 1984, many Directors questioned whether present policies were sufficient to achieve the goal of sustainable large current account surpluses, and regretted that the effectiveness of the structural price reform measures taken in the recent past had been limited. With the Government's decision in early 1983 to return to the goal of domestic price stability, prices have shown little response to the structural price reform measures of 1983 and January 1984, including three devaluations, and increases in the cost of capital and in the prices of crude oil and natural gas.

Directors focused on the severe constraints on the effectiveness of the devaluations emanating from the failure to pass on their effects to final prices; the limited flexibility of the export sector in expanding exports in response to the devaluations; the ability of the authorities to "tax away" extra profits accruing to exporting firms; and the limited autonomy of enterprises with respect to investment decisions.

While recognizing the distinctive features of centrally planned economies, including the less central role played by the exchange rate compared with market economies, most Directors urged the Romanian authorities to reduce these constraints substantially and to allow greater flexibility of domestic prices and interest rates as a precondition for improving their allocative role. Directors welcomed the recent replacement of the system of minimum wages by a new system of wage determination tied to productivity performance.

Directors also focused on certain aspects of the official medium-term scenario for 1984-89, which assumes a large and rising convertible current account surplus, low external borrowing and, by the end of the decade, the elimination of net external debt. They doubted whether the predicted growth of convertible exports could be realized without a more rapid than predicted growth of convertible non-oil imports, which even in 1989 are assumed to be considerably below the 1980 level. While some sympathy was shown to the Romanian authorities' approach toward future borrowing abroad, several Directors believed that, provided that foreign borrowing was put to productive use and the allocative system was improved, it would be appropriate for a developing country like Romania to utilize medium- and long-term borrowing abroad, although not to the extent of preventing desirable reductions in the debt service ratio.

A number of Directors urged the Romanian authorities to eliminate as soon as possible the multiple currency practice implicit in the maintenance of a more appreciated exchange rate for noncommercial transactions in relation to the commercial exchange rate.

Directors also urged Romania to make a major effort to eliminate a number of statistical shortcomings that are inhibiting economic analysis, including those in the national accounts and in the fields of foreign trade and domestic prices. It was suggested that Romania could request technical assistance from the Fund for that purpose.

It is expected that the next Article IV consultation with Romania will take place on the standard 12-month cycle.

The Executive Board then took the following decision:

(to be inserted in final draft minutes)

MR. FLOREA DUMITRESCU

GOVERNOR

NATIONAL BANK OF ROMANIA

BUCHAREST, ROMANIA

MR. POLAK
ETR

1. THE EXCHANGE RATES YOU NOTIFIED FOR NOVEMBER 1, 1984, IMPLY A SUBSTANTIAL APPRECIATION OF THE LEU COMPARED WITH THE RATES PUT INTO EFFECT ON OCTOBER 29, 1984.

2. IF CONFIRMED BY YOU, THE CHANGE IN THE RATE WOULD NEED TO BE NOTIFIED TO THE EXECUTIVE BOARD. FOR THIS PURPOSE, PLEASE CABLE AS SOON AS POSSIBLE REPLIES TO THE FOLLOWING QUESTIONS:

A. WHAT WAS THE SIZE OF THE REVALUATION AGAINST THE BASKET AND ON WHICH DAY WAS IT PUT INTO EFFECT?

B. APART FROM THE REVALUATION, HAS THERE BEEN ANY CHANGE IN THE SYSTEM OF THE BASKET PEG AND THE WEEKLY DETERMINATION OF BILATERAL EXCHANGE RATES?

C. IN THE LIGHT OF THE POLICY OF EXCHANGE RATE DEPRECIATION OVER THE PAST TWO YEARS, PLEASE EXPLAIN THE REASONS FOR THE LATEST MOVE.

D. WERE ANY OTHER POLICY CHANGES ADOPTED IN CONJUNCTION WITH THE REVALUATION?

REGARDS

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TELEX NO.: CABLE ADDRESS:

DRAFTED BY NAME (TYPE): J.T. Reitmaier J.T.R. EXT. 58817 DEPT. EUR DATE 11/6/84

AUTHORIZED BY NAME (TYPE): Hans Schmitt

Schmitt

WASHINGTON, D. C. 20431

MR. FLOREA DUMITRESCU

GOVERNOR

NATIONAL BANK OF ROMANIA

BUCHAREST, ROMANIA

PAGE 2

HANS SCHMITT

ACTING DIRECTOR, EUROPEAN DEPARTMENT

INTERFUND

Mr. Polak
ETR

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TELEX NO. CABLE ADDRESS

DRAFTED BY NAME (TYPE) J.T. Reitmaier EXT. 58817 DEPT. EUR DATE 11.6.84

AUTHORIZED BY NAME (TYPE) Hans Schmitt AUTHORIZED BY NAME (TYPE) **

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FC 48 REV 1 11-18-82

Mr. Schmitt
[illegible]

Office Memorandum

MEMORANDUM FOR FILES

November 5, 1984

Subject: Romania--Exchange Rate

We have received an exchange rate notification from Romania (in the usual format, but outside the regular weekly notification schedule) which implied a substantial appreciation of the Romanian leu between October 29 (the date of the previous regular notification) and November 1. For the U.S. dollar, the commercial rate was changed from lei 23.18 to lei 17.50, an appreciation of 32.5 percent; the noncommercial rate from lei 15.10 to lei 12.50, an appreciation of 20.9 percent; and the official rate from lei 5.00 to lei 4.47, an appreciation of 11.9 percent. Whether by design or coincidence, the official rate was returned to the level it held from 1978 until June 1983.

The rates of appreciation vis-à-vis the ten currencies quoted in the cable are calculated to be:

	Commercial Rate	Noncommercial Rate
U.S. dollar	32.5	20.9
Deutsche mark	35.1	23.2
French franc	34.5	22.6
Pound sterling	34.3	22.4
Swiss franc	34.9	23.0
Italian lira	23.6	22.7
Japanese yen	33.8	22.1
Canadian dollar	32.9	21.1
Netherlands guilder	34.9	23.0
Swedish krona	34.2	22.4

With the exception of the change in the commercial rate of the Italian lira, which might have arisen from a misprint, the variations in the rates of change between currencies probably reflect changes in market rates between October 29 and November 1. The Romanian leu is pegged to a basket of the first six currencies listed above. The rate of change vis-à-vis the basket is not know.

J. Reitmaier J.R.

cc: Mr. Schmitt
Mr. Hole

IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

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MR. FLOREA DUMITRESCU
CHAIRMAN OF THE EXECUTIVE BOARD AND GOVERNOR
NATIONAL BANK OF THE SOCIALIST REPUBLIC OF ROMANIA
STRADA LIPSCANI 25, BUCHAREST
ROMANIA

START TEXT HERE

FOR YOUR INFORMATION, THE FOLLOWING TELEX WAS SENT TODAY TO THE MINISTER OF FINANCE, PETRE GIGEA:

"THIS REFERS TO OUR CABLE OF OCTOBER 16, 1984, PROPOSING A TEN-DAY MISSION TO ROMANIA ON GENERAL ECONOMIC STATISTICS BY MR. CHANDRAKANT PATEL, ASSISTANT DIRECTOR IN CHARGE OF OUR GENERAL ECONOMY DIVISION AND MR. REZA KIBRIA, ECONOMIST IN THE GENERAL ECONOMY DIVISION. BOTH OF THEM PLAN TO VISIT BUCHAREST FROM DECEMBER 6 TO DECEMBER 14, SUBJECT TO MANAGEMENT APPROVAL. IN ORDER TO FINALIZE TRAVEL ARRANGEMENTS, WE WOULD APPRECIATE YOUR CABLE RESPONSE AS TO WHETHER THE PROPOSED MISSION AND THE SUGGESTED DATES ARE ACCEPTABLE."

REGARDS

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MR. DANNEMANN

MR. POLAK

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DRAFTED BY NAME (TYPE): CAPATEL/RKIBRIA/CS EXT.: (5)7952 DEPT.: STAT DATE: 10/29/84

AUTHORIZED BY NAME (TYPE): CHANDRAKANT A. PATEL

AUTHORIZED BY NAME (TYPE): WERNER DANNEMANN (**)

TYPE ** ON LAST OR ONLY PAGE OF MESSAGE

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SIGNATURE (PLEASE KEEP SIGNATURE IN SPACE ALLOWED) SIGNATURE

C. 48 REV 1 11-18-82

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WASHINGTON, D. C. 20431

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cc: [illegible]

START ADDRESS IN THE BOX

THE HONORABLE
PETRE GIGEA, GOVERNOR
MINISTER OF FINANCE, MINISTRY OF FINANCE
STR. DOAMNEI NR. 8
BUCHAREST, ROMANIA

START TEXT HERE

THIS REFERS TO OUR CABLE OF OCTOBER 16, 1984, PROPOSING A TEN-DAY MISSION TO ROMANIA ON GENERAL ECONOMIC STATISTICS BY MR. CHANDRAKANT PATEL, ASSISTANT DIRECTOR IN CHARGE OF OUR GENERAL ECONOMY DIVISION AND MR. REZA KIBRIA, ECONOMIST IN THE GENERAL ECONOMY DIVISION. BOTH OF THEM PLAN TO VISIT BUCHAREST FROM DECEMBER 6 TO DECEMBER 14, SUBJECT TO MANAGEMENT APPROVAL. IN ORDER TO FINALIZE TRAVEL ARRANGEMENTS, WE WOULD APPRECIATE YOUR CABLE RESPONSE AS TO WHETHER THE PROPOSED MISSION AND THE SUGGESTED DATES ARE ACCEPTABLE.

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MR. DANNEMANN

MR.POLAK

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C TELEX NO.: CABLE ADDRESS:

D DRAFTED BY NAME (TYPE): CAPATEL/RKIBRIA/CS EXT.: (5)7952 DEPT.: STAT DATE: 10/29/84

E AUTHORIZED BY NAME (TYPE): CHANDRAKANT A. PATEL AUTHORIZED BY NAME (TYPE): WERNER DANNEMANN (**)

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Office Memorandum

To: Mr. Whittome

From: Peter Hole

Subject: Schulmann/Glofcheski on Romania

Date: September 20, 1984

1. Glofcheski, whom we have spoken with several times (although not previously on the foreign assets matter that you mentioned) has prepared a draft report on Romania for the IIF. A key question he addresses is the likelihood of a rescheduling in 1985. The draft, which went to Schulmann, mentions a buildup in foreign assets of some US$1 billion in 1982-83.

2. The arithmetic is as follows. In 1982-83, Romania's convertible current account was in surplus by US$1.6 billion. Over the same period, Romania's convertible currency debt fell by US$1.3 billion. However, US$0.8 billion of this fall was due to valuation factors (specifically, the strengthening of the dollar against other currencies in which some of the debt is denominated). Hence only US$0.5 billion of the current account surplus was reflected in a reduction in debt, leaving some US$1.1 billion to be channelled into a buildup in foreign assets--principally net claims on other countries through the extension of trade credits. We have no difficulty with this analysis, which broadly matches the figuring we have shown in our reports; in particular, we have shown net credit extended by Romania averaging US$450 million a year over 1982-83 (excluding movements in Romania's advance import deposits which are also classified under this heading in the official data).

3. Glofcheski goes on to take the position that if Romania has actually extended credits in the reported amounts and if they are of good quality and sufficiently liquid, a rescheduling is likely to be avoided in 1985. If, however, either or both of those conditions have not been realized, he draws two conclusions. First, it will be more difficult to avoid a rescheduling. Second, the international financial community may need to "look again" at the reported balance of payments figures--certainly at their meaning, and perhaps also their truthfulness. In fact, he questions whether such a rapid extension of credit is plausible given that exports were falling.

4. We have for some time now discounted the quality both of the assets that Romania has built up and thus of the current account surpluses. Implicitly, I guess that we have taken the view that the Romanians have shown bad judgment in pushing out exports and credits to uncreditworthy customers, or that the system (with its trade targets) has impelled such an outturn, or both.

5. We have not, however, challenged the figures provided by the authorities for the period in question. To be sure, it is not difficult to be sceptical: the commercial attachés in Bucharest have little or no faith in some of the numbers; credit extended by Romania did jump sharply

(by US$300 million) after 1981; and clearly one could speculate on a situation in which the trade surplus was inflated to meet performance tests under the stand-by and make a good impression on the international community, while net credit extended was marked up by a comparable amount. But this would have done nothing to strengthen the reserves--also a performance test (although an annual, not quarterly, one and one which was waived in both 1982 and 1983) and a barometer watched by banks. More to the point, perhaps, partner country data have given us no compelling reason to challenge the reported trade figures. In addition, there has been scattered anecdotal evidence of large-scale credit extension by Romania--notably to developing countries--that appears to derive from sources other than the official balance of payments data.

cc: Mr. Prust
Mr. Reitmaier

Brief for the Thirty-Ninth Annual Meeting

Exchange rate: Since July 1, 1983 Romania has had a unified commercial exchange rate which applies to almost all convertible currency transactions. A more appreciated noncommercial rate applies to certain service transactions. Both rates are pegged to a basket of the currencies of Romania's six main trading partners. On September 3, 1984 the commercial and noncommercial rates were lei 22.53 = US$1 and lei 14.68 = US$1, respectively. In the context of negotiation of the 1983 program under the last stand-by arrangement the Romanian authorities undertook to unify these two rates by July 1, 1984. This has not been done.

Quota: SDR 523.4 million.

Fund position: On January 31, 1984 the three-year stand-by arrangement approved in June 1981 (for SDR 1,102.5 million or 300 percent of the then quota) was cancelled, leaving SDR 285 million not purchased. As of August 31, 1984, Fund holdings of Romanian lei amounted to 297.3 percent of quota, or 256.2 percent excluding CFF purchases.

Last consultation: Board discussion, September 1984.

Romanian delegation: Mr. Petre Gigea is Minister of Finance and Governor of the Fund and Bank. Mr. Eremia is President of the Foreign Trade Bank. Mr. Marin is Director, International Financial Relations in the Ministry of Finance.

Balance of payments: New capital inflows have fallen sharply since 1980, necessitating substantial current account adjustment despite major debt reschedulings in 1982 and 1983. For the second consecutive year, a convertible current account surplus was recorded in 1983 (US$0.9 billion) bringing the cumulative turnaround since 1980 to the equivalent of 6 percent of GNP. This has mainly resulted from a curtailment of imports as non-oil exports fell in both 1982 and 1983. Convertible non-oil imports in 1983 were approximately 50 percent lower than in 1980 in current dollar terms. Convertible external debt was US$8.8 billion at end-1983 (with only a small short-term component) compared with a total of US$10.1 billion two years earlier. The debt service ratio in 1984 is projected at nearly 29 percent of convertible exports of goods and services.

The Romanian authorities do not intend to seek any debt relief in 1984. Although external perceptions of Romania's creditworthiness appear to have improved somewhat, total new borrowing, at US$0.6 billion, is officially projected to be lower than in 1983; this partially reflects the President's policy of rapidly reducing foreign debt. The authorities project a slightly higher convertible current surplus than in 1983 to be accompanied by some growth in non-oil trade. After falling in the first quarter, non-oil imports and exports rose strongly in the second quarter and registered significant increases for the first half as a whole compared with one year earlier. One area of particular uncertainty in the official 1984 forecasts concerns the extension of export credit by Romania: net outflows are expected to be greatly reduced from the high levels of the two previous years which averaged almost US$0.5 billion annually. At end-May 1984 reserves at US$0.8 billion were equivalent to two months of 1983 convertible imports.

Domestic developments: Despite the severe import curtailment, the authorities claim that respectable rates of output growth have been achieved in recent years--3.5 percent in 1983--and that substantially faster growth is being achieved in 1984 as a result of increased import substitution, improved labor productivity, and greater economy in the use of material inputs. Such developments, promoted largely through administrative means, are viewed by the authorities as an alternative to price reform. After considerable price adjustment in 1981 and 1982, prices have changed little since early 1983 which has limited the efficacy of measures introduced under the 1983 Fund program, notably the devaluations.

September 1984

INTERNATIONAL MONETARY FUND

Mr. Whittome

I asked Mr. Thomsen to prepare the attached in answer to your question the other week. The attached memo may be of interest to others in the Department.

E. Brehmer EB 7/20/84

Country: Romania

Date: Sept. 7, 1984

	1981	1982	1983	1984
1. Current account in convertible currencies				
US$ million	-818	655	922	1,030
Percent of GNP	-1.9	1.3	2.1	2.7
2. Non-oil exports in convertible currencies (percent change)				
Value	21.5	-11.0	-8.9	4.1 1/
Volume	30.0	-7.7	-5.9	2.0
3. Non-oil imports in convertible currencies (percent change)				
Value	-15.0	-38.5	-6.5	7.1 1/
Volume	-13.6	-37.7	-8.4	5.0
4. Outstanding external debt in convertible currencies				
US$ billion	10.07	9.70	8.76	7.90
(Of which: short-term)	(0.64)	(0.96)	(0.40)	(0.30)
Percent of GNP	23.5	19.5	19.7	20.6
5. Debt service in convertible currencies in percent of exports of goods and services in convertible currencies	23.5	22.6	24.3	28.5
6. Gross official convertible reserves				
US$ billion	0.55	0.59	0.66	0.65
Weeks of convertible imports	4	6	7	7
7. Growth of real GNP (percent)	2.7	2.8	3.5	3.0
8. Change in CPI (percent)	2.2	16.9	5.3	2.0
9. Budget balance (percent of GNP)	1.3	2.7	2.9	2.9

1/ Official forecast provided by Romanian authorities in May 1984.

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Mr Whittome
9-120

CC: FED

ROMANIA PLANS RAPID GROWTH BUT OFFERS LITTLE TO CONSUMERS:
BY JONATHAN LYNN

VIENNA, SEPT 5, REUTER - ROMANIA HAS SET ITSELF AMBITIOUS INDUSTRIAL AND EXPORT TARGETS IN ITS NEXT FIVE-YEAR PLAN, DETAILS OF WHICH WERE PUBLISHED TODAY BY THE OFFICIAL NEWS AGENCY AGERPRES.

BUT ALTHOUGH ROMANIA HAS ONE OF THE POOREST LIVING STANDARDS IN EUROPE, DOMESTIC CONSUMPTION AGAIN TAKES A LOW PRIORITY.

THE DRAFT PLAN, COVERING 1986-1990, AIMS FOR A RISE IN NATIONAL INCOME, ROUGHLY EQUIVALENT TO GROSS NATIONAL PRODUCT, OF 7.6-8.3 PER CENT A YEAR, THE AGENCY, MONITORED HERE, SAID.

BUT THE INCREASES WILL COME FROM HIGHER PRODUCTIVITY -- TO RISE BY 10 PER CENT A YEAR ON AVERAGE -- RATHER THAN INCREASED INVESTMENT, WHICH WILL GROW BY ONLY 1.8-2.5 PER CENT ANNUALLY.

THE VOLUME OF FOREIGN TRADE (IMPORTS PLUS EXPORTS) IS SCHEDULED TO GROW BY 41-45 PER CENT OVER THE PERIOD, WITH EXPORTS RISING BY 52-56 PER CENT.

THE AGENCY SAID LIVING STANDARDS WILL BE MAINTAINED AND WAGES WILL RISE, BUT A PLANNED INCREASE IN RETAIL SALES OF ONLY 1.7-2.0 PER CENT A YEAR SHOWS THAT ECONOMIC GROWTH WILL BE USED TO BUILD UP THE INDUSTRIAL BASE OR CHANNELLED INTO EXPORTS RATHER THAN RAISING CONSUMPTION AT HOME.

MORE JL HP JO

NNNN
EUN169 DXA142
051110 :AM-ROMANIA 2 VIENNA:

INDUSTRIAL GROWTH HAS CONTINUALLY BEEN EMPHASISED BY PRESIDENT NICOLAE CEAUSESCU WHO WANTS TO MAKE ROMANIA SELF-SUFFICIENT IN LINE WITH HIS NATIONALIST POLICIES.

BUCHAREST REGULARLY REPORTS HIGH GROWTH FIGURES BUT OFTEN

Office Memorandum

pl. circulate
to FO & copy to
cc: LFD

TO : Mr. Brehmer

DATE: July 20, 1984

FROM : P. Thomsen

SUBJECT : Romania--Different Forms of Countertrade

As requested, this memo explains the difference between "barter", "compensation","counterpurchase", and "buy back", all of which constitute different forms of countertrade. As your question was triggered by a table in "Payment Practices in Eastern Europe", published by Business International in September 1983, the following definitions are based on this publication.

Barter involves the direct exchange between the buyer and the supplier of specified quantities of different products. While this means that the price of any of the two products can be expressed in terms of quantities of the other product, the deal may in practice involve the quotation of prices in terms of a hard currency but with no currency payments involved. Barter trade accounts for only 3-5 percent of East-West countertrade. It involves usually an exchange of agricultural products offered by developing countries to Eastern European countries in exchange for technical products. Under a full compensation arrangement, the seller agrees to take full payment in kind as in the case of a barter agreement but, contrary to the barter agreement, the delivery does not immediately trigger an offsetting payment in kind as the invoice value is temporarily credited to a clearing account until the Western seller has found a suitable "end-user" in the West or until he has found products in the Eastern European country of appropriate quality. Trade under compensation arrangements account for the bulk of countertrade of Poland, Romania and Yugoslavia (well over 50 percent). Compensation contracts are mainly concluded particularly in the fields of machinery and equipment, foodstuffs, textiles and some chemical products. Under a counterpurchase arrangement, the Western seller does actually receive payment in hard currency upon delivery or soon thereafter but signs a separate contract that commits him to purchase (often nonspecified) products from the Eastern European country within a certain period of time. For instance, if a Western European exporter sells US$1 million worth of typewriters to Romania, he may receive US$1 million in cash upon delivery and commit himself to purchase for US$1 million of Romanian goods within 6 months, in which case he has entered into a counterpurchase arrangement, or he may grant Romania a credit of US$1 million until he has found appropriate products in which case he has entered into a compensation agreement. (The compensation arrangement is clearly less favorable to the Western seller and the literature refers to many cases where the Western company has not been able to find suitable products or where it has been told by the Eastern European authorities that products are presently not available.) Trade under counterpurchase contracts exceeds 60 percent of countertrade in Hungary, Albania and Czechoslovakia. Under a pay-back arrangement, a Western exporter of a plant accepts to be paid back with the products produced by this plant; Olivetti may set up a typewriter plant in Romania and accept typewriters in return.

Attachment
cc: Mr. Hole

cc. [illegible] TB EB
cc. T[illegible]

From: J. [illegible]

Countertrade

Could you [illegible] understand what exactly is the definition of these four categories of CT. 13/7

Changing Forms of CT

While in the early '70s compensation and counterpurchase (generally of freely selected goods) accounted for the lion's share of an East European country's CT, counterpurchase and buy-back now fairly equally head the list. This is caused by the changing structure of EE imports from the West: the value of EE exports of finished goods is stagnating in comparison to the prices of EE imports of production technology to make the goods.

Barter has practically faded out of EE trade with Western industrialized countries. It still exists, however, with some developing countries that offer surpluses of agricultural produce and foodstuffs to EE in exchange for technical products and machinery. Its total volume of East-West CT business may not exceed 3-5%.

	End-1982 CT as % of total imports from nonsocialist countries	Of total CT, % accounted through: Barter	Compensation	Counterpurchase	Buy-back
Albania	40-50	1-3	12-15	67-75	12-15
Bulgaria	50-60	5-7	27-30	38-46	22-25
Czechoslovakia	50-60	4-6	18-21	60-68	10-13
GDR	65-75	3-5	24-27	12-15	53-61
Hungary	30-40	3-5	9-12	66-74	14-17
Poland	90-100	5-7	75-78	3-11	9-12
Romania	80-90	4-6	50-53	16-24	22-25
Soviet-Union	20-30	5-7	18-21	9-17	60-63
Yugoslavia	60-70	1-3	57-60	20-28	14-17

Source: Western trading houses and East European FTOs.

Compensation seems to be regaining some of its previous importance. Bulgaria, the GDR, Poland, Romania and sometimes the USSR prefer this form of CT, since it is convenient (for the East Europeans) to have the EE purchase and sale in one contract. Western companies and trading houses report compensation contracts particularly in the fields of machine tools, electrical (household) equipment, electronics, transport equipment, foodstuffs, textiles and some chemical products such as cosmetics. Some 12-15% of the total value of present CT contracts may be compensations.

Counterpurchases as defined in this report, account for an estimated 35-40% of the value of all CT transactions. Counterpurchases will probably settle at this level because of the limited range of EE products available to free Western selection. Unattractive goods and fixed export capacity place additional limitations on counterpurchases in EE.

They [illegible] as a [illegible] figure

INTERNATIONAL MONETARY FUND

Mr. Whittome

You may find the attached of some interest. It is difficult to find out what the Rumanians are really after. One day they reject loan offers, the other day they seek loans.

EB/PH We have Schwarzenberg who is UBS desk man for E.E. Why doesn't EE phone him in a week's time to discuss what has happened.

E. Brehmer EBr.

21/7

Mr. Brehmer

Office Memorandum

MEMORANDUM FOR FILES July 19, 1984

Subject: Telephone Call from Mr. Schwarzenberg, Union Bank of Switzerland, Zurich, July 19, 1984

Mr. Schwarzenberg called because he had recently been visited by Mr. Eremia, President of the Romanian Bank for Foreign Trade, who had asked UBS to try to arrange a loan. In presenting this request, Eremia said that the trade surplus was large, agricultural prospects good in 1984, and debt was being repaid rapidly. But some help to finance more imports would be helpful. He stressed Romania's good performance under the Fund stand-by with, he claimed, all conditions met and appeared to suggest that Romania could be approaching the Fund again.

Mr. Schwarzenberg thought the idea of a new loan was a sensible one but asked for my views. I confirmed that the trade surplus was large, told him what the Romanians had said in January and more recently about the possibility of a new stand-by, and said that in general one could see the case for a slower reduction in external debt than was now taking place. However, the commercial decision was not for the Fund to make and at this stage our attitude to any specific loan proposal would probably be neutral.

I asked about the size of the loan under consideration. Mr. Schwarzenberg replied that it would be discretely arranged and would be small, or at least "not large." His initial objective was to get 10-15 banks involved and to ask them to put up 5-10 percent of their Romanian exposure; we did not discuss other terms. One can only speculate about the amounts that this formula might imply. At end-1983, financial loans from commercial banks were US$3.5 billion (see attached table). If the banks to be involved were to account for 50 percent of this total and to put up 7.5 percent of their exposure, the new loan would amount to US$130 million.

Mr. Schwarzenberg said he had not yet contacted any other banks. When the situation was clearer he would call me again. His telephone numnber in Zurich is 234-2666.

JP

Jim Prust

Attachment

cc: Mr. Brehmer
Mr. Hole
Mr. Reitmaier

Romania: External Debt

(In millions of U.S. dollars)

	Outstanding at end-83	Repayments 1/ 1984	1985	1986	1987	1988	1989	1990
Total convertible debt	8,880	1,665	1,510	1,422	1,455	1,287	593	256
Of which:								
Financial loans from banks	3,504	345	775	638	740	677	255	49
Of which:								
Austria	95	14	16	15	21	19	10	--
Belgium	136	11	34	30	30	28	2	--
Canada	202	3	30	35	34	34	29	25
France	861	79	179	173	203	177	46	3
Germany	354	57	70	57	69	60	37	3
Italy	123	3	32	27	29	29	4	--
Japan	284	31	57	57	51	47	25	10
Netherlands	126	20	24	24	24	22	8	3
Switzerland	128	25	25	16	25	25	11	--
United Kingdom	537	56	123	109	109	103	26	7
United States	160	7	30	28	42	37	17	--

Source: Romania, 1984 Economic Memorandum.

1/ Excludes repayments of post-1983 borrowings.

Office Memorandum

July 16, 1984

MEMORANDUM FOR FILES

Subject: Romania

I spoke this morning with Jim Prust about further thinking concerning performance criteria for Romania, and will talk to him again on Friday next.

HS

Hans Schmitt

cc: Mr. Whittome
Mr. Hole

Mr. Whittome

Office Memorandum

CONFIDENTIAL

TO : Mr. Whittome

DATE: July 5, 1984

FROM : Ekhard Brehmer EBr 7/5

SUBJECT : Romania

I called Mr. Pelletier, Manufacturer's Hanover Trust, to obtain confirmation that Romania actually has turned down a government guaranteed credit to buy basic commodities (see Mr Prust's memorandum for files of 6/11/84). Mr. Pelletier said that it was the Commodity Credit Corporation (CCC) which had made a credit offer to the Romanian Bank for Foreign Trade (RBFT) which the latter has turned down. He added that it has become quite clear that Romania has also borrowed less from other banking sources than it could have obtained. He related this behavior of Romania to the President's strict order to rapidly reduce foreign debt - an objective which is not expected to be relaxed for the time being.

cc: Mr. Hole
Mr. Prust

Office Memorandum

To: Mr. Whittome

July 11, 1984

ARBoote

From: A. R. Boote

Subject: <u>Corrections to My Paper on Romania's Future Fund Involvement</u>

<u>Page 10</u>

Footnote 1/ should end with "end-1985", not "end-1983".

<u>Page 25</u>

A line is missing. This page should begin with:

"None is attractive. Even in an economic crisis, it is doubtful in my ...".

An amended page 25 is attached. Apologies.

[illegible]

Attachment

cc: All recipients of Lynne's July 9 meeting note.

[illegible]

none is attractive. Even in an economic crisis, it is doubtful in my view whether the current Romanian regime would accept systemic reform into even a quasi-market oriented regime a la Hungary. It is also doubtful whether this would work. Hence the best of the bad lot is some form of reform of key sectors in collaboration with the Bank.

Happily we are not yet forced down this unsatisfactory road. The Romanian authorities' latest balance of payments projections show no prospective need for Fund resources. They also show a considerable margin before an unsustainable external position would be reached--with current account surpluses exceeding US$1 billion in each of the next five years. The staff have good grounds in thinking these forecasts optimistic. But some slippage--provided it did not bring into question the sustainability of the adjustment--could easily by accommodated by new credits. If it were thought politically expedient, a minimalist Fund program--for a maximum of perhaps 30 percent of quota--could act as an umbrella for such new credits. I do not think we could expect such a program to have much substantive domestic content.

In my view, this is an appropriate juncture to review Fund relations with Romania. While we may still harbor doubts about the sustainability of Romania's adjustment effort--achieved as it has been by import compression--we should no longer be guided by these doubts which have so far proved groundless. Romania no longer has a program with the Fund and has not (yet) asked for a new one; indeed the latest indications are that this is not under current consideration. Given our record of relations with Romania, this is a development we should welcome. In the event of a deterioration in Romania's balance of payments position from current

Office Memorandum

TO : Mr. Whittome

FROM : Hans Schmitt HS

SUBJECT : Boote on Romania

DATE: July 5, 1984

I found Boote's memorandum on Romania, dated July 3, 1984 thoughtful and stimulating. Nevertheless, I would draw somewhat different conclusions from my admittedly very limited knowledge of our experience with that country.

The Romanians have fixed their balance of payments deficit and are repaying debt. They have got to this point by compressing imports -- a method that leaves us wondering about the sustainability of the present position. Whether it is sustainable depends, it seems to me, on whether the Romanian economy is currently operating at normal capacity or not.

Suppose it is not. Then there may well come a point when the Romanian authorities will wish to expand capacity utilization again. If nothing else has changed meanwhile they find their import requirements rise again -- to unsustainable levels as before. Will they ask the Fund for new financing at that point?

If they do we will have to explain to them again that adjustment requires a reallocation of resources such that the external position will be sustainable with full resource utilization. We meant to achieve that in the past by asking for various reforms to give prices a greater role in a more decentralized system of decision making. I wonder if the Romanians ever really understood the connection.

Instead they seem to me to have interpreted our reform efforts as an essentially ideological rather than practical concern. We need on the next occasion to make special efforts to dispel that misunderstanding. In a broadly similar effort in Yugoslavia I found the attached chart a useful heuristic device. It shows the sectoral growth rates in the economy in relation to each sector's performance in international markets. The adjustment process we look for requires a positive correlation.

A positive correlation between sectoral growth rates and competitiveness does not necessarily require market processes to achieve. But whatever processes are to be used we will need to be fully informed of them. It may be that only the planners can determine those processes. It will then be they with whom we will have to negotiate the next program.

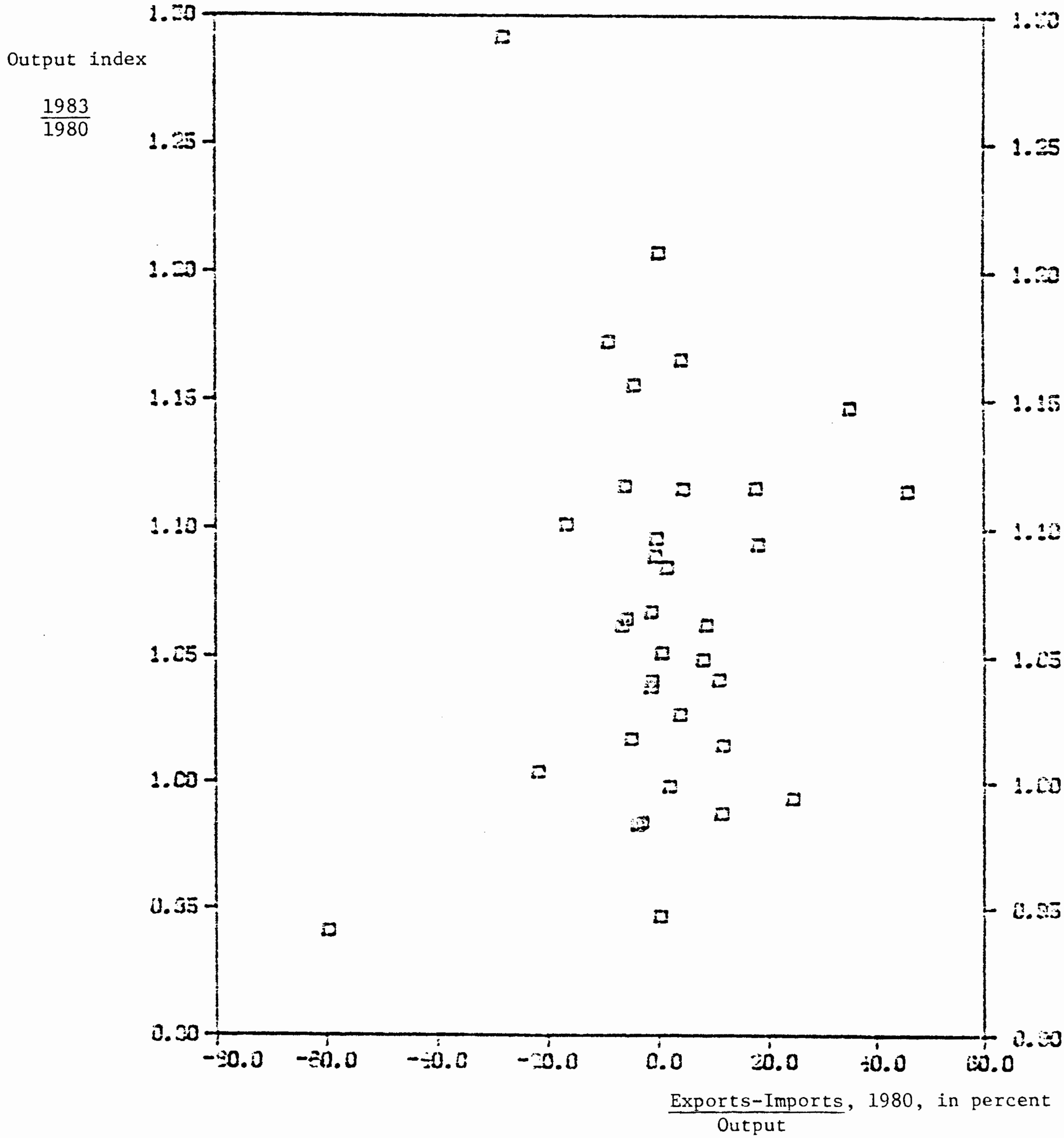
It may be easier to insist on that once a new external deficit can be traced to an effort to restore capacity production without a parallel reallocation of resources. It is in any case only under such circumstances that a case for renewed Fund involvement can plausibly be made. But we need also to make a fresh effort to explain to them that out motivation is practical rather than ideological.

Against this background I would warn against getting ourselves involved in the World Bank's sectoral loan program as advocated by Boote.

Attachment

cc: Mr. Boote
Mr. Brehmer
Mr. Hole
Mr. Prust
Mr. Reitmaier

Chart 1. Yugoslavia: Output Performance and Ratio of Net Exports to Output, by Industrial Branch



BR

Office Memoranaum

TO : Mr. Whittome

DATE: July 3, 1984

FROM : A.R. Boote ARBoote

SUBJECT : Romania: Future Fund Involvement

As requested, I attach a note on future Fund relations with Romania.

Prices productive [illegible] alternative sources of supply profit tax before & after profit are calc [illegible] rates of interest [illegible]

1) Background

(a) [illegible] in tradition of industrial entrepreneur & financial sophisticated

(b) gradually weaning a SPE economy from its [illegible] [illegible]

2) all SPEs in Eur

3) [illegible]

cc: Mr. Brehmer
Mr. Hole
Mr. Prust
Mr. Reitmaier

TL

CONFIDENTIAL

Romania: Future Fund Involvement

Introduction

The history of Romania's recent involvement with the Fund is paradoxical. While Romania enjoyed a sharp swing in its convertible current account into substantial surplus in 1982 and 1983, this was achieved primarily by the compression of imports. The limited reforms agreed with the Fund were largely peripheral to this adjustment process. Partly because of this, and partly because of a lack of knowledge of how the Romanian economy operates, the staff have repeatedly expressed doubts about the sustainability of this adjustment. So far, no convincing evidence has emerged to support these doubts. This recent history poses the question of the justification for any future Fund financial involvement with Romania, in view of the continuing large balance of payments surpluses projected by the Romanian authorities for the remainder of the decade and the Fund's lack of knowledge of and influence on the Romanian economy.

I. Background

1. Difficulties in relations

There are a number of problems in the Fund's current relations with Romania namely:

a. Lack of statistics. Examples are a lack of any breakdown of trade by commodity or by destination on a quarterly or monthly basis or volume and price trade data. Despite the recent provision of some information on prices, we lack knowledge of the bulk of domestic prices. annual?

b. Interpretation of statistics. It is often difficult to interpret the statistics we do receive. In 1983 provisional data show GNP growing by 3.5 percent compared to aggregate demand rising 1.5 percent with the current account surplus broadly unchanged; reconciliation of the increases in industrial and agricultural output with the sectoral breakdowns is also difficult.

c. Lack of cooperation on reforms. The Romania authorities have recently introduced potentially far-reaching reforms linking earnings more closely to output, encouraging more efficient use of inputs and greater product quality. In contrast to Hungary, there has been no attempt to involve the Fund in the formulation of these reforms most of which we might--given the opportunity--have welcomed and our knowledge of these reforms is patchy.

d. Lack of effective involvement with the World Bank. While disbursements under old projects continue, there is yet no sign of any agreement on new project lending by the Bank to Romania. The Bank's request for more debt reporting, improved procurement procedures, and more information on the investment program, sector, and country policies effectively rests on the table.

e. Romania does not appear to have carried out an undertaking given in the 1983 program to unify the commercial and noncommercial rates of exchange on July 1, 1984. 1/

1/ This undertaking was recorded in the August 1983 staff report (SM/83/173) and reflected in the September 14, 1983 Board discussion (SM/83/173, Supplement 2). The February 11, 1983 letter of intent (Appendix III to EBS/83/54) paragraph 11 also contains the undertaking that the unification of the two rates will "be completed in the course of 1984."

In sum, pace the February fact-finding mission, we still lack basic knowledge on how the Romanian economy performs and the economic policies of the Romanian authorities. The limits of our policy dialogue with Romania were underlined by the President's reported 1983 decisions to adopt targets of eliminating Romania's indebtedness to the West and of price stability: the first of these targets could be considered to eliminate the need for Fund resources, the second to nullify the main thrust of our efforts to reform the domestic economy.

2. Romania's Unique Position

The problems outlined above militate against further financial Fund involvement with Romania. However:

a. To a considerable extent, our lack of knowledge of the Romanian economy reflects a dilemma which has remained unresolved since Communist countries have joined the Fund. This is how does the Fund perform its traditional role of promoting external and internal adjustment in a centrally-controlled economy where the authorities are reluctant to share their knowledge or control about how the economy works? The conflict between a member state's right to determine its economic system and the Fund's right to impose conditionality highlighted in such a case has never been satisfactorily resolved. In this sense, some of the problems outlined above are not new, but rather inherent in the Fund's relationship with a Communist country, and therefore do not justify an ending of Fund involvement with Romania. This is particularly the case in view of:

b. Romania's unique position as the "licensed dissenter" of the Eastern bloc, symbolized by Romania's prospective attendance at the Los Angeles olympics. This is likely to predispose industrialized countries

and particularly the U.S. to view sympathetically any further application for Fund resources by Romania despite failings in its economic system. The fact that the Board's adverse reaction in September 1983 to a possible breakdown in the program was directed at both the Romanian authorities and the staff probably partly reflected this underlying political reality.

For these reasons, it is in my judgement unrealistic to rule out Fund involvement with Romania even if the difficulties outlined above, in our knowledge of and influence on the Romanian economy, persist. Whether further Fund program(s) with Romania would be justified would depend at least initially on Romania's current account position and the question of need.

II. Current Account/Need

1. Formal position

The December 20, 1983 letter of intent, paragraph 4, records the Romanian intention to request a new one-year stand-by arrangement. At the conclusion of the latest mission on May 29, Minister Gigea indicated the Romanian authorities were not at the present time considering the further use of Fund resources.

2. Fund attitude

The Fund's response to any request for the additional use of resources by Romania would be conditioned by:

- Decisions on the continuation/phasedown of enlarged access (Mr. Hauvonen's note of May 11 refers) and

- The Fund's liquidity position.

3. <u>Latest balance of payments projections</u>

The Romanian authorities latest convertible currency forecast--handed to the May mission--are attached in Table 1. These show:

a. A current account surplus exceeding US$1 billion in 1984 and rising to US$1.5 billion in 1989 based on annual trade surpluses approaching US$2 billion.

b. External debt falling rapidly from US$7.9 billion in 1984 to US$2.9 billion in 1989.

c. A fall in reserves in 1985 (partially reversing a US$0.1 billion increase in 1984) followed by a slow increase in subsequent years with a large jump in 1989.

It is presumably on the basis of these projections that the Romanian authorities:

- no longer seem so immediately interested in a Fund program, and

- have reportedly recently refused various offers of credit.

It would not appear attractive to enter into a program with Romania on the basis of such projections. The only justification for such a program would be the US$60 million fall in reserves in 1985 in a country where reserves have historically been inadequate (this would leave reserves at around 1.7 months of convertible goods imports). However, such a justification would appear highly tenuous in a country where imports are tightly controlled and therefore reserves do not play their Western role. In any case, it is probably unlikely that the Romanian authorities would approach the Fund for a further program merely to avoid a small rundown in reserves. The remainder of this note therefore assumes some deterioration--potential or actual--from the projections in Table 1.

4. Likely changes to authorities' projections

In the staff's view, the authorities' projections in Table 1 are optimistic in several respects:

1. The sharp turnaround postulated in short-term credit extended from a net outflow of around US$500 million a year in 1982-83 to rough balance in 1984-85 followed by credit extensions of around US$300 million a year in subsequent years.

2. The recovery postulated in non-oil imports volumes leaves those in 1988 still about 25 percent below the average level of 1980-81 despite rising domestic demand and exports to 1988.

3. Equally, the postulated expansion of oil exports by 22 percent in volume terms by 1988 seems inconsistent with the permitted 2 percent growth of oil imports.

4. The general growth of non-oil exports.

At the risk of overschematization, I think it is worth distinguishing two variants under which Romania could seek Fund assistance.

Variant 1 involves a small deterioration (of say US$0.5 billion) in Romania's capital account position, perhaps because of the need to extend more credit to sell Romanian exports. Following tradition, the Romanian authorities achieve their trade balance targets. 1/ This deterioration, while not threatening the achievement of persistent current account surpluses of more than US$1 billion, leads the Romanians to seek further Fund assistance.

1/ Conceptually, it makes little difference if some of the deterioration is on the trade or services account, though given Romania's history, the former would seem less likely. The key requirement is that the sustainability of Romania's current account position is not questioned.

Variant 2 involves a much more serious deterioration in Romania's balance of payments position, which threatens the sustainability of their adjustment. The most likely version of this is a continued decline/stagnation of Romanian exports such that trade balance targets could no longer be met by import compression without unacceptable affects on the domestic economy. It would probably be heralded by indications of some crisis in the domestic economy. As it became obvious Romania could not meet its current account targets and repayment obligations, foreign credit would dry up and Romania would be obliged to approach the Fund.

There are, as yet, no firm signs of Variant 2 emerging. In my view, at least in the short-term, Variant 1 is much more likely. The Fund's response to a Romanian request for assistance under these variations is discussed below.

5. Fund response: Variant 1

Romania is:

a. Still running a substantial (more than US$1 billion) current account surplus; and

b. Its external debt is being reduced rapidly, but

c. It is in difficulties meeting its existing debt repayment obligations.

Essentially, the problem in banking terminology is one of liquidity not solvency; Romania, while fully able to meet its repayment obligations given sufficient time, is not able to do so on the current repayment schedule.

There would appear three possible Fund responses to Romania's request:

1. A refusal to entertain a new stand-by,

2. A classical stand-by in the sense the Fund promised resources against a further deterioration in Romania's position, or

3. A Fund program.

Response 1, (no) has considerable merits. The problem is essentially that Romania's creditors (particularly Western banks) are seeking to be repaid too fast. While Romania would obviously wish to avoid rescheduling, a de facto spreading out of its liabilities from 1985--and to a lesser extent 1986 and 1987--to beyond 1988 by new credits would remove Romania's problem. It is not clear that the Fund has a role to play in this process (e.g., Venezuela). The Fund is not in the business of providing repayments for Western banks or providing residual gap finance, particularly in a country which had been rejecting other offers of finance. The balance of payments need in such a case would be demonstrably weak. The general lack of Romanian cooperation on domestic conditionality would strengthen this view.

Response 2 (classical stand-by) I see as having considerable disadvantages. The basis of such a stand-by arrangement is normally agreement that the main economic policies of the country are appropriate. Given the current state of our cooperation on policies with Romania, we would hardly be able to offer such an assurance. Equally, I doubt whether the Romanians would be interested in such an arrangement.

The arguments for Response 3 (yes) are essentially those against Response 1. The Romanians would no doubt argue that it would be difficult

for them to raise funds in the market without a Fund seal of approval, particularly after so many years of close involvement with the Fund. The low level of Romanian reserves could, if required, provide sufficient justification to pass the criterion of need. Romania's unique political position as described above could lead to strong pressure for a further program.

The issues raised are of wider import. Romania is ahead of the pack in seeking a rundown in its external debt, but presumably some others will (eventually) follow. Does the Fund have any role in securing a satisfactory timescale for the repayment of debt for a country in such a position? If the Fund is seen solely as a provider of temporary balance of payments assistance, interpreted narrowly, the answer would appear no. On the other hand, some of the Fund's main constituents might see the Fund as having some role in "managing" the repayment of the West's assets in a Communist country like Romania.

Table 2 further illustrates this problem. Fund resources are being repaid at around US$0.2 billion a year in each of the key years 1985-87. As a result, outstanding Fund credit declines from 12 1/2 percent of all debt outstanding at end-1984 to 7 1/2 percent at end-1987. This trend is reversed if credit from the World Bank is included: debt to international institutions rises from 32 1/2 percent of total debt at end-1984 to 43 1/2 percent at end-1987.

Any presumption that the Fund should be repaid at the same rate as other creditors would undermine the temporary nature of Fund assistance. But if it were decided that Fund assistance were appropriate to facilitate

Romania to move its debt repayment onto a more acceptable timetable, Table 2 could be used to suggest an appropriate range for Fund assistance. Clearly, a prerequisite for additional Fund lending would need to be further credits from other sources to prevent the Fund providing residual finance. Given that the other debtors (except the World Bank) were reducing their net indebtedness, an upper limit to Fund gross advances would be Romania's scheduled repayments to the Fund--around US$180 million in 1985. At end-1984, the ratio of Romania's debt to the Fund and debt to commercial banks was around 1:3. 1/ Assuming a "gap" of US$500 million to be financed in 1985, and on the (highly unfavorable) assumption of no alternative sources of finance (e.g., governments), if these proportions were to be continued, US$125 million additional Fund resources should be matched by US$375 million new credits by the banks. For the Fund, this would involve lending around 23 percent of Romania's quota; for the banks, re-lending slightly less than 50 percent of the scheduled 1985 repayments.

The case for an additional Fund stand-by for Romania is that it would facilitate a reordering of Romania's debt repayment schedule. As such, its role would be primarily catalytic. It should in my view be accompanied by a guarantee of sufficient credits from banks to overcome the whole of the 1985-87 hump. I would recommend a one-year program with Fund assistance between 20 to 30 percent of quota as the appropriate range, with 30 percent (around US$160 million) the maximum. Whether such a stand-by would be preferable to the refusal of assistance is primarily a

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1/ The actual ratio calculated for end-1984 is 1:3.29; the projections in Table 1 show this falling to 1:3.06 at end-198~~6~~.
5

matter for political judgement in the context of the Fund's liquidity position. Such a program, in my view, is unlikely to contain much meaningful domestic content, though this is discussed further below in Chapter III; Chapter IV examines possible performance criteria.

6. Fund's response: Variant 2

Under this variant, with a crisis at least incipient in the Romanian economy, Romania is forced by the shortage of alternative credits to seek Fund assistance. Since Romania has already achieved external adjustment, the problem is essentially that domestic adjustment has not been sufficient to sustain the external adjustment effort. Attention is therefore focused on the domestic economy and domestic reforms. The size of any program would need to be determined in the light of Romania's need and the reforms that could be agreed. The next section examines the possible approaches to improving the performance of the Romanian economy.

III. Domestic Economy: Possible Reform

1. Current Romanian Economic System

a. Planning

Economic activity in Romania is governed by a series of plans: a physical plan, a financial plan, an investment plan, a labor force plan, and an export or external plan. While the Romanian authorities have emphasized to the staff the importance of profitability in influencing both investment and earnings (under the new wages law), we simply do not know the relative importance of the various plans described above. While the process of planning has been described to the staff, the criteria

which govern the formulation of the plan remain a mystery. For example, the staff were told that the main criterion for appraising investment projects was the "social need for consumption."

b. Enterprise autonomy

Nor do we know the extent of enterprise autonomy. The process of formulating the plan begins at the enterprise level, but we have no means of assessing the relative importance of enterprises in the final product. While we have been told enterprises have considerable freedom, for example, in their utilization of excess profits, the extent of enterprise autonomy is probably severely limited by the multiplicity of plans outlined above. We do know, for example, that investments of more than a certain size require higher approval which is only given if surplus capacity in the industry concerned does not exist and that banks audit all enterprise expenditure as it takes place to ensure conformity with the relevant regulations. And enterprises have little or no autonomy in price setting.

c. Prices

Prices are set centrally by the Price Committee. All price changes appear to require approvement by this Committee. We lack comprehensive information on the structure of Romanian prices. We do, however, know that certain domestic prices such as energy prices appear generally low. And assessment of investment projects involving foreign exchange at domestic and foreign shadow prices often produces different results to be resolved by "judgemental factors." We also know that prices do not perform the equilibrating role that they perform in Western economies.

Pries

For example, an enterprises' response to an external shock--e.g., the increase in the price of an imported input--would be first to increase productivity, then reduce profit margins and only very much as a final resort consider applying for a price increase. As a result, there appears to have been little pass through of successive devaluations into the final product price of products with import content. Equally, price setting in foreign markets seems essentially passive with few enterprises suggesting a price reduction in response to a devaluation. Indeed, by law, Romanian enterprises are required to sell at the prevailing world market price though occasionally, e.g., in fertilizers, Romania has been accused of dumping.

d. Taxation/profit transfers to the budget

Whatever enterprise autonomy may exist may also be effectively diminished by the tax system and profit transfers to the budget. Tax rates are set by the industry central, with the approval of the relevant Ministry and the Ministry of Finance. There appears to be a considerable variation in enterprise tax rates within the same industry, with centrals able to set (in advance, though not apparently change during the year) widely different enterprise tax rates. There is some evidence that both enterprise tax rates and transfers to the budget vary directly and more than proportionately with enterprise profits, thus potentially nullifying any incentive effects of higher profitability.

e. Summary

In short, we lack knowledge of the key determinants of the Romanian's economy. We do not know:

- How plans are formulated
- How they interact
- How much autonomy enterprises have
- How prices are centrally set
- How wages are determined
- How investment is determined
- How taxation of profits and profit transfers is determined.

We do know that

- Some prices vary considerably from international prices
- Enterprise autonomy, e.g., on investment is circumscribed
- Competition between enterprises in the same industry is limited as enterprise investment is not approved when there is spare capacity
- The system is effective in limiting imports.

f. Assessment of previous reforms

Given our state of knowledge, we have little more than a presumption that the reform measures that were taken under Fund programs over the past few years have worked in the right direction. Devaluations should encourage exports provided physical plans permit some transfers to exports, and that prices/tax rates/profit transfers are not changed to nullify their impact. If Romanian exporters are passive price takers, the process could, however, take a long time--until potential exporters realized it was now profitable to export, and plans were ultimately modified. The Romanian authorities, admittedly with their own axe to grind, have repeatedly told us that devaluations have little effect and that other (more direct actions) are more efficacious. Equally, increases in,

e.g., energy prices toward world market levels <u>should</u> lead to more efficient energy use. But since we have been mainly talking about producer prices and not final product prices, and we do not know the structure of taxation/profit transfers concerned, this is far from certain. The Pearce World Bank report attributes the improvement in Romania's energy balance to a whole range of measures of which price rises is only one. Equally, it is doubtful whether shortening of depreciation schedules and raising the cost of capital--whose effects could be negated by price/tax changes--are anything like as important as approval or rejection of investment projects. [Indeed, if one assumes the planners have ordered things to their satisfaction prior to any Fund intervention, it would be entirely logical for them to seek to negate any measures imposed by the Fund.]

Quoi faire?

2. <u>Reform</u>

There seem to me two principal approaches to improving the Romanian economic mechanism--systemic reform and a sectoral approach.

a. <u>Systemic reform</u>

This is following the Hungarian model, in itself a strong argument against in the Romanian perspective. Its essentials are:

(1) More flexible prices reflecting supply and demand, elimination of subsidies with increasing decentralization of price setting.

(2) Enterprise autonomy to respond to these prices.

(3) Primacy of the financial plan over physical plans with the latter reduced to an indicative role (with the exception of intra-Comecon trade which needs careful integration).

(4) Enterprise responsibility for their decisions, with inefficient enterprises ultimately closed down.

(5) Greater uniformity of enterprise tax rates and profit transfers to the budget.

(6) The imposition of credit ceilings on the household and enterprise sector (separate unless and until financial intermediation develops) to control overall demand in the economy. (Allocation of these ceilings raises important issues.)

(7) Establishment of instruments of macroeconomic management (instruments of monetary and fiscal control, e.g., to deal with liquidity overhang, perhaps import controls until exchange rate is fully able to adjust exports and imports).

This program of reforms is ambitious in the Hungarian context. In the Romanian context, it would appear a nonstarter. It is difficult to envisage a domestic crisis of sufficient depth to force the current Romanian regime to embrace such comprehensive reform--with its implied decentralization of power both over price control and enterprise activity. Indeed, it is doubtful whether such a reform policy would work without a long period of transition from the present highly-centralized Romanian economic structure. Moreover, such reforms would need a wide body of political support to survive as their most likely immediate result would be economic disruption and a sharp surge in inflation.

It is possible to envisage a variation of the "Hungarian model" which might be more attractive to the Romanian authorities, under which prices were still determined centrally by the Prices Committee, but once so determined, enterprises were free to respond without central control. But such a system would remove one of the main advantages of market mechanisms-the automatic adjustment of prices. And the benefits for more efficient resource allocation would only accrue to the extent that the Romanian authorities forebore or were prevented by the Fund from administering prices in contradiction to market mechanisms. This would appear an extremely inefficient and unattractive compromise system; at best only a temporary expedient on the road to decentralized price fixing.

b. <u>Sectoral reform</u>

The alternative to systemic reform is an attempt to improve the functioning of the Romanian economy on a sectoral basis. This is admittedly an area where the Fund has little expertise, and assistance from the World Bank would undoubtedly be required. The aim of such an exercise would be to take an in-depth analysis of key sectors of the Romanian economy to try and improve the functioning of these sectors. Candidates might be agriculture, machine-building, chemicals and oil. At the end of the analysis, a series of recommendations would be agreed--with appropriate quantitative performance criteria (e.g., input/output ratios) between the Romanian authorities and the Bank/Fund to improve the performance of the given sector. Implementation of these recommendations for sectoral reform could provide the basis of both project-lending by the Bank--if

viable new projects were identified--and more general Fund balance of payments assistance. Clearly this would be helped if the sectors had a considerable export content.

The advantages of such an approach would be that it did not attempt to reform the current Romanian economic system of centralized planning. The attempt rather would be to improve current planning of the given sector by detailed examination of the plans and expert dialogue. Systemic changes would only be proposed where they were clearly necessary for improved sectoral performance. The disadvantages are that this deviates from the Fund's traditional macroeconomic approach to imbalances and has little direct relevance for the external imbalance. There is also no disposition currently from the Romanian authorities to accept this degree of involvement in their domestic economy--e.g., from the World Bank.

A possible alternative, with more direct relevance to the Fund's role of temporary financing of external payments' imbalances, would be to attempt a detailed assessment of Romania's external plan. This would involve examination of Romania's main export products/sectors 1/ and attempting to assess the measures proposed by the Romanian authorities to meet the export plans. Clearly this would require consultation with World Bank experts, as well as outside experts in the markets concerned. Again, the result of these consultations would be agreement on a series

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1/ In 1983, the five most important export sectors to nonsocialist countries were machinery and equipment, industrial consumer goods, fuel minerals raw materials and metals, chemical fertilizers and rubber, and foodstuffs. The 11 products where exports were worth more than US$100 million were gasoline, diesel oil, heavy oil, steel rollings, chemical fertilizers, furniture, tractors and spare parts, ready-made textile clothes, timber, aluminium ingots and rollings and knitted textiles. Source: 1984 Economic Memorandum.

of measures--with performance criteria--to improve export performance by sector with perhaps some agreed revision to the external plans. Permitted imports would then be determined by the planned trade surplus. The aim of such an approach would be to reduce Romania's reliance on import curbs to meet its debt repayment, by providing a series of concrete measures to improve export performance. Such measures would provide detailed underpinning for export targets as a performance criterion (see Chapter IV below).

The advantage of this approach is that again the Fund would be working within and not against current Romanian economic mechanisms directly to promote balance of payments adjustment while strengthening the international trading system. The disadvantages are that the Fund would be involved in detailed work in a field where it lacked expertise; mistakes could certainly be made. In addition, the Fund could become embodied in trade disputes, e.g., accusations of dumping.

3. <u>Assessment of reform</u>

(a) <u>Variant 2</u>

The above approaches are all effectively tailored to Variant 2--ensuring the sustainability of external adjustment in a situation where this is threatened. All would require a period of several years to have any significant impact. An incipient crisis in the Romanian economy would be required before the Romanian authorities would accept any of these approaches. Even then, I think it implausible that the current regime would accept the loss of power implicit in the systemic reforms described above required to make their economy more market-oriented. It

well, disagree [illegible] term

would, in my view, be counterproductive for the Fund to attempt to impose such reforms. We are therefore forced to work within the existing system. It is impossible for us to attempt to improve the efficacy of the whole system. Despite their manifest disadvantages, I would therefore recommend we attempt to improve the workings of key export-oriented sectors of the Romanian economy in collaboration with the World Bank. I would also favor an attempt to assess Romania's export plans, as underpinning export targets. One advantage of this sectoral approach is that we should start talking to the more important decision-makers/planners in the Romanian economy. At present, we suffer from the singular disadvantage of dealing largely with the analysts rather than the key decision-makers of a centrally-planned economy.

b. Variant 1

Under Variant 1, the sustainability of external adjustment is not threatened; what would be the appropriate domestic content of a catalytic program if one were favored? My preference would be for no domestic content, or the minimum possible content if this is considered not acceptable. The logic of a program under Variant 1 is that the Fund is providing an umbrella for Romania to receive sufficient new credits for its debt repayment to be moved onto an acceptable timescale. In a sense, no further adjustment measures are required in that existing adjustment is sufficient but existing debt repayments too fast. Repayment

of the Fund's temporary finance would be guaranteed by Romania's existing adjustment effort plus its record of achieving trade targets. Such a bold approach runs counter to the Fund's doctrine of conditionality. Equally, it could be considered difficult to justify given the tenor of the Board's January discussion stressing the need for further structural adjustment. If some domestic content were considered essential, the main possibilities would appear:

(1) A continuation of the existing policy of exchange rate devaluations and selected price increases designed to promote more efficient resource allocation. The problem with this is that we have no assurance it has any effect in the current Romanian system. Indeed, unless we convince planners of the need for our proposed measures, I would presume they would take steps to offset the effects, to return to the status quo ante.

(2) Some involvement of the World Bank. While the extent of such involvement would necessarily be limited by the short duration of the program, it might be possible for the Bank to prepare some appraisal for example of Romania's investment program and perhaps for the release of some funds to be tied to measures recommended under this appraisal. The modalities of such an arrangement would need careful exploration with the Bank.

(3) An analysis of peasant agricultural markets. These appear the only legal "free" markets in Romania. In 1983, limits on prices were reduced leading probably to less production and more self-consumption on

the farm. There seems to me a strong a priori assumption that an increase in prices would be likely to produce overall economic gains, both in increased production and more marketing.

In the context of a one-year program for perhaps 25 percent of quota, our bargaining position with the Romanian authorities on domestic measures is unlikely to be strong. Their opposition to further price increases is bound to be tenacious, in view of the President's aim of price stability. While it would be possible to use the lack of domestic measures to refuse a program, this hardly seems necessary in view of the much stronger arguments of balance of payments need that could be used to the same end. It might be possible to provide for some input from the World Bank even for a short-term program. Another possibility is further price measures, including perhaps a small increase in prices on peasant markets. In my view, all such domestic measures will inevitably be largely cosmetic.

IV. Performance Criteria

1. Variant 1

If a program were agreed under this variant, the main aim of performance criteria would be to secure the external position. Hence criteria on a quarterly basis as in 1983 relating to

(i) Reserves

(ii) The convertible trade surplus.

(iii) Short-term debt 1/

1/ To prevent the agreed level of exports being financed by excessive short-term credit.

would seem appropriate. I would also favor a quarterly convertible export clause. The modalities of such a clause would need discussion with the Romanian authorities. It should probably:

1. Either exclude exports financed on credit or provide a separate limit for export credit to prevent exports being "financed away."

X not pd for a time because credit?

2. Be based on export values rather than volumes. No volume data exist and value data would reduce the incentive to dump.

3. Exclude oil given Romania's large reprocessing role.

It would need to be set with some margin below Romania's external plans (perhaps on a cumulative basis) so that quarterly fluctuations like in the first quarter of 1984 would not trigger a breach. This note has overschematized the issue of balance of payments need into Variants 1 and 2: there is clearly some danger that Romania could slip from Variant 1 to Variant 2 with the sustainability of large current account surpluses in question and reflected in exports falling well below target. The maintenance of a catalytic Fund program in such a situation--which would no longer be securing necessary adjustment--would clearly be inappropriate. A performance clause relating to exports would trigger a needed review in such a situation, with cancellation of the program if sustainability of the current account position were questioned. Both quarterly trade and export performance clauses would require improved quarterly trade data. On grounds of general orthodoxy, ceilings for the growth of net domestic assets would probably also be required, though it is doubtful whether these have much effect in the Romanian situation.

2. Variant 2

All the performance criteria suggested above would be appropriate. In addition, quarterly export targets could be underpinned by detailed analysis of the external plan. Further performance criteria could only be decided in the light of the detailed sectoral analysis. While some money would no doubt have to be released at the beginning of a program, it would be desirable to link release of the majority to the implementation of agreed measures in the sectors, to avoid a repetition of the 1983 experience in relation to the four "studies."

V. Conclusion/Implications for Current Relations with Romania

Fund relations with Romania have been difficult. We have not solved the dilemma of how to deal with a centrally-planned economy. In part, this is because the Romanian authorities have not chosen to share with us their knowledge of the workings of their economic control system. Equally in part our approach to domestic imbalances is to seek appropriate macroeconomic policies against a background of a functioning market-oriented economic system. This systemic and macroeconomic policy approach is perhaps inevitable given the Fund's prime concern with temporary balance of payments funding. But it does not mesh well with an economy centrally-planned on nonmarket criteria.

Given our lack of knowledge of the Romanian economic system, it is difficult if not impossible to devise satisfactory economic reforms to apply in Romania. The possibilities outlined above show this clearly:

none is attractive. Even in an economic crisis, it is doubtful in my view whether the current Romanian regime would accept systemic reform into even a quasi-market oriented regime a la Hungary. It is also doubtful whether this would work. Hence the best of the bad lot is some form of reform of key sectors in collaboration with the Bank.

Happily we are not yet forced down this unsatisfactory road. The Romanian authorities' latest balance of payments projections show no prospective need for Fund resources. They also show a considerable margin before an unsustainable external position would be reached--with current account surpluses exceeding US$1 billion in each of the next five years. The staff have good grounds in thinking these forecasts optimistic. But some slippage--provided it did not bring into question the sustainability of the adjustment--could easily by accommodated by new credits. If it were thought politically expedient, a minimalist Fund program--for a maximum of perhaps 30 percent of quota--could act as an umbrella for such new credits. I do not think we could expect such a program to have much substantive domestic content.

In my view, this is an appropriate juncture to review Fund relations with Romania. While we may still harbor doubts about the sustainability of Romania's adjustment effort--achieved as it has been by import compression--we should no longer be guided by these doubts which have so far proved groundless. Romania no longer has a program with the Fund and has not (yet) asked for a new one; indeed the latest indications are that this is not under current consideration. Given our record of relations with Romania, this is a development we should welcome. In the event of a deterioration in Romania's balance of payments position from current

projections, we should encourage the Romanian authorities in the first instance to approach the banks for new credits. We might also suggest Romania approaches the World Bank. This implies that we should encourage Romania to become more self-reliant by limiting our visits to annual consultation missions and eschewing further fact-finding missions which are inevitably seen as preparatory for a new program.

In short, our present relations with Romania represent a carryover from the close involvement of the program era. There is now a good prospect that a substantive Fund program with Romania will not be required in the foreseeable future. Fund relations with Romania should now be based on this prospect.

JR 6/25/84:15

Table 1. Romania: Official Medium-Term Balance of Payments and Debt Outlook, 1984-88

(In convertible currencies)

	1984	1985	1986	1987	1988	1989
	(In millions of U.S. dollars)					
Payments flows						
Current account balance	1,030	1,200	1,310	1,380	1,470	1,520
Trade balance	1,750	1,850	1,890	1,890	1,890	1,910
Exports	6,480	6,780	7,240	7,720	8,260	8,830
Imports	-4,730	-4,930	-5,350	-5,830	-6,370	-6,920
Services, net	-720	-650	-580	-510	-420	-390
Of which: Interest payments	(-750)	(-700)	(-600)	(-520)	(-380)	(-325)
Capital inflows	215	220	470	450	450	450
IBRD 1/	115	100	200	200	200	200
Commercial banks	100	--	50	50	--	--
Medium- and long-term	--	--	--	--	--	--
Short-term, net	100	--	50	50	--	--
Other	--	120	220	200	250	250
Medium- and long-term	200	140	200	200	200	200
Short-term, net	-200	-20	20	--	50	50
Capital outflows	-1,190	-1,296	-1,450	-1,572	-1,637	-1,153
Amortization of medium- and long-term debt, total	-1,120	-1,385	-1,250	-1,372	-1,337	-753
On debt incurred by end-1983	-1,120	-1,285	-1,195	-1,267	-1,182	-543
Of which: Commercial banks	(-471)	(-783)	(-639)	(-740)	(-677)	(-255)
On inflows after 1983		100	55	105	155	210

Table 2. Romania: Fund and Bank Credit Outstanding as a Percentage of Total Debt 1983-1989 (End-Year)

	1983	1984	1985	1986	1987	1988	1989
Use of Fund credit: total outstanding	947	991	808	570	332	172	59
As a percentage of:							
Medium- and long-term debt	11.3	13.0	12.9	11.0	8.4	6.0	2.4
Total debt	10.8	12.5	12.3	10.3	7.6	5.2	2.0
Outstanding credit to international institutions (Fund and World Bank) 1/	2,620 1/	1659 2,560	1505 2,313	5 1~~0~~33 2,103	1563 1,895	1578 1,750	1585 1,644
As a percentage of:							
Medium- and long-term debt	31.3	33.7	36.9	40.6	47.7	60.9	68.2
Total debt	29.9	32.4	35.3	38.0	43.4	52.6	56.5

Source: Staff calculations based on projections provided by the Romanian authorities.

1/ Includes US$90 million outstanding to BIS at end-1983 but to be repaid in 1984.

BR

Office Memorandum

TO : Mr. Whittome

DATE: July 3, 1984

FROM : A.R. Boote *ARBoote*

SUBJECT : Romania: Future Fund Involvement

Th

As requested, I attach a note on future Fund relations with Romania.

cc: Mr. Brehmer
Mr. Hole
Mr. Prust
Mr. Reitmaier

1) Background

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AB: 7/3/84:14

CONFIDENTIAL

Romania: Future Fund Involvement

Introduction

The history of Romania's recent involvement with the Fund is paradoxical. While Romania enjoyed a sharp swing in its convertible current account into substantial surplus in 1982 and 1983, this was achieved primarily by the compression of imports. The limited reforms agreed with the Fund were largely peripheral to this adjustment process. Partly because of this, and partly because of a lack of knowledge of how the Romanian economy operates, the staff have repeatedly expressed doubts about the sustainability of this adjustment. So far, no convincing evidence has emerged to support these doubts. This recent history poses the question of the justification for any future Fund financial involvement with Romania, in view of the continuing large balance of payments surpluses projected by the Romanian authorities for the remainder of the decade and the Fund's lack of knowledge of and influence on the Romanian economy.

I. Background

1. Difficulties in relations

There are a number of problems in the Fund's current relations with Romania namely:

a. Lack of statistics. Examples are a lack of any breakdown of trade by commodity or by destination on a quarterly or monthly basis or volume and price trade data. Despite the recent provision of some information on prices, we lack knowledge of the bulk of domestic prices.

b. Interpretation of statistics. It is often difficult to interpret the statistics we do receive. In 1983 provisional data show GNP growing by 3.5 percent compared to aggregate demand rising 1.5 percent with the current account surplus broadly unchanged; reconciliation of the increases in industrial and agricultural output with the sectoral breakdowns is also difficult.

c. Lack of cooperation on reforms. The Romania authorities have recently introduced potentially far-reaching reforms linking earnings more closely to output, encouraging more efficient use of inputs and greater product quality. In contrast to Hungary, there has been no attempt to involve the Fund in the formulation of these reforms most of which we might--given the opportunity--have welcomed and our knowledge of these reforms is patchy.

d. Lack of effective involvement with the World Bank. While disbursements under old projects continue, there is yet no sign of any agreement on new project lending by the Bank to Romania. The Bank's request for more debt reporting, improved procurement procedures, and more information on the investment program, sector, and country policies effectively rests on the table.

e. Romania does not appear to have carried out an undertaking given in the 1983 program to unify the commercial and noncommercial rates of exchange on July 1, 1984. 1/

1/ This undertaking was recorded in the August 1983 staff report (SM/83/173) and reflected in the September 14, 1983 Board discussion (SM/83/173, Supplement 2). The February 11, 1983 letter of intent (Appendix III to EBS/83/54) paragraph 11 also contains the undertaking that the unification of the two rates will "be completed in the course of 1984."

In sum, pace the February fact-finding mission, we still lack basic knowledge on how the Romanian economy performs and the economic policies of the Romanian authorities. The limits of our policy dialogue with Romania were underlined by the President's reported 1983 decisions to adopt targets of eliminating Romania's indebtedness to the West and of price stability: the first of these targets could be considered to eliminate the need for Fund resources, the second to nullify the main thrust of our efforts to reform the domestic economy.

2. Romania's Unique Position

The problems outlined above militate against further financial Fund involvement with Romania. However:

a. To a considerable extent, our lack of knowledge of the Romanian economy reflects a dilemma which has remained unresolved since Communist countries have joined the Fund. This is how does the Fund perform its traditional role of promoting external and internal adjustment in a centrally-controlled economy where the authorities are reluctant to share their knowledge or control about how the economy works? The conflict between a member state's right to determine its economic system and the Fund's right to impose conditionality highlighted in such a case has never been satisfactorily resolved. In this sense, some of the problems outlined above are not new, but rather inherent in the Fund's relationship with a Communist country, and therefore do not justify an ending of Fund involvement with Romania. This is particularly the case in view of:

b. Romania's unique position as the "licensed dissenter" of the Eastern bloc, symbolized by Romania's prospective attendance at the Los Angeles olympics. This is likely to predispose industrialized countries

and particularly the U.S. to view sympathetically any further application for Fund resources by Romania despite failings in its economic system. The fact that the Board's adverse reaction in September 1983 to a possible breakdown in the program was directed at both the Romanian authorities and the staff probably partly reflected this underlying political reality.

For these reasons, it is in my judgement unrealistic to rule out Fund involvement with Romania even if the difficulties outlined above, in our knowledge of and influence on the Romanian economy, persist. Whether further Fund program(s) with Romania would be justified would depend at least initially on Romania's current account position and the question of need.

II. Current Account/Need

1. Formal position

The December 20, 1983 letter of intent, paragraph 4, records the Romanian intention to request a new one-year stand-by arrangement. At the conclusion of the latest mission on May 29, Minister Gigea indicated the Romanian authorities were not at the present time considering the further use of Fund resources.

2. Fund attitude

The Fund's response to any request for the additional use of resources by Romania would be conditioned by:

- Decisions on the continuation/phasedown of enlarged access (Mr. Hauvonen's note of May 11 refers) and

- The Fund's liquidity position.

3. Latest balance of payments projections

The Romanian authorities latest convertible currency forecast--handed to the May mission--are attached in Table 1. These show:

a. A current account surplus exceeding US$1 billion in 1984 and rising to US$1.5 billion in 1989 based on annual trade surpluses approaching US$2 billion.

b. External debt falling rapidly from US$7.9 billion in 1984 to US$2.9 billion in 1989.

c. A fall in reserves in 1985 (partially reversing a US$0.1 billion increase in 1984) followed by a slow increase in subsequent years with a large jump in 1989.

It is presumably on the basis of these projections that the Romanian authorities:

- no longer seem so immediately interested in a Fund program, and
- have reportedly recently refused various offers of credit.

It would not appear attractive to enter into a program with Romania on the basis of such projections. The only justification for such a program would be the US$60 million fall in reserves in 1985 in a country where reserves have historically been inadequate (this would leave reserves at around 1.7 months of convertible goods imports). However, such a justification would appear highly tenuous in a country where imports are tightly controlled and therefore reserves do not play their Western role. In any case, it is probably unlikely that the Romanian authorities would approach the Fund for a further program merely to avoid a small rundown in reserves. The remainder of this note therefore assumes some deterioration--potential or actual--from the projections in Table 1.

4. Likely changes to authorities' projections

In the staff's view, the authorities' projections in Table 1 are optimistic in several respects:

1. The sharp turnaround postulated in short-term credit extended from a net outflow of around US$500 million a year in 1982-83 to rough balance in 1984-85 followed by credit extensions of around US$300 million a year in subsequent years.

2. The recovery postulated in non-oil imports volumes leaves those in 1988 still about 25 percent below the average level of 1980-81 despite rising domestic demand and exports to 1988.

3. Equally, the postulated expansion of oil exports by 22 percent in volume terms by 1988 seems inconsistent with the permitted 2 percent growth of oil imports.

4. The general growth of non-oil exports.

At the risk of overschematization, I think it is worth distinguishing two variants under which Romania could seek Fund assistance.

Variant 1 involves a small deterioration (of say US$0.5 billion) in Romania's capital account position, perhaps because of the need to extend more credit to sell Romanian exports. Following tradition, the Romanian authorities achieve their trade balance targets. 1/ This deterioration, while not threatening the achievement of persistent current account surpluses of more than US$1 billion, leads the Romanians to seek further Fund assistance.

1/ Conceptually, it makes little difference if some of the deterioration is on the trade or services account, though given Romania's history, the former would seem less likely. The key requirement is that the sustainability of Romania's current account position is not questioned.

Variant 2 involves a much more serious deterioration in Romania's balance of payments position, which threatens the sustainability of their adjustment. The most likely version of this is a continued decline/stagnation of Romanian exports such that trade balance targets could no longer be met by import compression without unacceptable affects on the domestic economy. It would probably be heralded by indications of some crisis in the domestic economy. As it became obvious Romania could not meet its current account targets and repayment obligations, foreign credit would dry up and Romania would be obliged to approach the Fund.

There are, as yet, no firm signs of Variant 2 emerging. In my view, at least in the short-term, Variant 1 is much more likely. The Fund's response to a Romanian request for assistance under these variations is discussed below.

5. Fund response: Variant 1

Romania is:

a. Still running a substantial (more than US$1 billion) current account surplus; and

b. Its external debt is being reduced rapidly, but

c. It is in difficulties meeting its existing debt repayment obligations.

Essentially, the problem in banking terminology is one of liquidity not solvency; Romania, while fully able to meet its repayment obligations given sufficient time, is not able to do so on the current repayment schedule.

There would appear three possible Fund responses to Romania's request:

1. A refusal to entertain a new stand-by,

2. A classical stand-by in the sense the Fund promised resources against a further deterioration in Romania's position, or

3. A Fund program.

Response 1, (no) has considerable merits. The problem is essentially that Romania's creditors (particularly Western banks) are seeking to be repaid too fast. While Romania would obviously wish to avoid rescheduling, a de facto spreading out of its liabilities from 1985--and to a lesser extent 1986 and 1987--to beyond 1988 by new credits would remove Romania's problem. It is not clear that the Fund has a role to play in this process (e.g., Venezuela). The Fund is not in the business of providing repayments for Western banks or providing residual gap finance, particularly in a country which had been rejecting other offers of finance. The balance of payments need in such a case would be demonstrably weak. The general lack of Romanian cooperation on domestic conditionality would strengthen this view.

Response 2 (classical stand-by) I see as having considerable disadvantages. The basis of such a stand-by arrangement is normally agreement that the main economic policies of the country are appropriate. Given the current state of our cooperation on policies with Romania, we would hardly be able to offer such an assurance. Equally, I doubt whether the Romanians would be interested in such an arrangement.

The arguments for Response 3 (yes) are essentially those against Response 1. The Romanians would no doubt argue that it would be difficult

for them to raise funds in the market without a Fund seal of approval, particularly after so many years of close involvement with the Fund. The low level of Romanian reserves could, if required, provide sufficient justification to pass the criterion of need. Romania's unique political position as described above could lead to strong pressure for a further program.

The issues raised are of wider import. Romania is ahead of the pack in seeking a rundown in its external debt, but presumably some others will (eventually) follow. Does the Fund have any role in securing a satisfactory timescale for the repayment of debt for a country in such a position? If the Fund is seen solely as a provider of temporary balance of payments assistance, interpreted narrowly, the answer would appear no. On the other hand, some of the Fund's main constituents might see the Fund as having some role in "managing" the repayment of the West's assets in a Communist country like Romania.

Table 2 further illustrates this problem. Fund resources are being repaid at around US$0.2 billion a year in each of the key years 1985-87. As a result, outstanding Fund credit declines from 12 1/2 percent of all debt outstanding at end-1984 to 7 1/2 percent at end-1987. This trend is reversed if credit from the World Bank is included: debt to international institutions rises from 32 1/2 percent of total debt at end-1984 to 43 1/2 percent at end-1987.

Any presumption that the Fund should be repaid at the same rate as other creditors would undermine the temporary nature of Fund assistance. But if it were decided that Fund assistance were appropriate to facilitate

Romania to move its debt repayment onto a more acceptable timetable, Table 2 could be used to suggest an appropriate range for Fund assistance. Clearly, a prerequisite for additional Fund lending would need to be further credits from other sources to prevent the Fund providing residual finance. Given that the other debtors (except the World Bank) were reducing their net indebtedness, an upper limit to Fund gross advances would be Romania's scheduled repayments to the Fund--around US$180 million in 1985. At end-1984, the ratio of Romania's debt to the Fund and debt to commercial banks was around 1:3. 1/ Assuming a "gap" of US$500 million to be financed in 1985, and on the (highly unfavorable) assumption of no alternative sources of finance (e.g., governments), if these proportions were to be continued, US$125 million additional Fund resources should be matched by US$375 million new credits by the banks. For the Fund, this would involve lending around 23 percent of Romania's quota; for the banks, re-lending slightly less than 50 percent of the scheduled 1985 repayments.

The case for an additional Fund stand-by for Romania is that it would facilitate a reordering of Romania's debt repayment schedule. As such, its role would be primarily catalytic. It should in my view be accompanied by a guarantee of sufficient credits from banks to overcome the whole of the 1985-87 hump. I would recommend a one-year program with Fund assistance between 20 to 30 percent of quota as the appropriate range, with 30 percent (around US$160 million) the maximum. Whether such a stand-by would be preferable to the refusal of assistance is primarily a

1/ The actual ratio calculated for end-1984 is 1:3.29; the projections in Table 1 show this falling to 1:3.06 at end-1983.

matter for political judgement in the context of the Fund's liquidity position. Such a program, in my view, is unlikely to contain much meaningful domestic content, though this is discussed further below in Chapter III; Chapter IV examines possible performance criteria.

6. Fund's response: Variant 2

Under this variant, with a crisis at least incipient in the Romanian economy, Romania is forced by the shortage of alternative credits to seek Fund assistance. Since Romania has already achieved external adjustment, the problem is essentially that domestic adjustment has not been sufficient to sustain the external adjustment effort. Attention is therefore focused on the domestic economy and domestic reforms. The size of any program would need to be determined in the light of Romania's need and the reforms that could be agreed. The next section examines the possible approaches to improving the performance of the Romanian economy.

III. Domestic Economy: Possible Reform

1. Current Romanian Economic System

a. Planning

Economic activity in Romania is governed by a series of plans: a physical plan, a financial plan, an investment plan, a labor force plan, and an export or external plan. While the Romanian authorities have emphasized to the staff the importance of profitability in influencing both investment and earnings (under the new wages law), we simply do not know the relative importance of the various plans described above. While the process of planning has been described to the staff, the criteria

which govern the formulation of the plan remain a mystery. For example, the staff were told that the main criterion for appraising investment projects was the "social need for consumption."

b. Enterprise autonomy

Nor do we know the extent of enterprise autonomy. The process of formulating the plan begins at the enterprise level, but we have no means of assessing the relative importance of enterprises in the final product. While we have been told enterprises have considerable freedom, for example, in their utilization of excess profits, the extent of enterprise autonomy is probably severely limited by the multiplicity of plans outlined above. We do know, for example, that investments of more than a certain size require higher approval which is only given if surplus capacity in the industry concerned does not exist and that banks audit all enterprise expenditure as it takes place to ensure conformity with the relevant regulations. And enterprises have little or no autonomy in price setting.

c. Prices

Prices are set centrally by the Price Committee. All price changes appear to require approvement by this Committee. We lack comprehensive information on the structure of Romanian prices. We do, however, know that certain domestic prices such as energy prices appear generally low. And assessment of investment projects involving foreign exchange at domestic and foreign shadow prices often produces different results to be resolved by "judgemental factors." We also know that prices do not perform the equilibrating role that they perform in Western economies.

For example, an enterprises' response to an external shock--e.g., the increase in the price of an imported input--would be first to increase productivity, then reduce profit margins and only very much as a final resort consider applying for a price increase. As a result, there appears to have been little pass through of successive devaluations into the final product price of products with import content. Equally, price setting in foreign markets seems essentially passive with few enterprises suggesting a price reduction in response to a devaluation. Indeed, by law, Romanian enterprises are required to sell at the prevailing world market price though occasionally, e.g., in fertilizers, Romania has been accused of dumping.

d. Taxation/profit transfers to the budget

Whatever enterprise autonomy may exist may also be effectively diminished by the tax system and profit transfers to the budget. Tax rates are set by the industry central, with the approval of the relevant Ministry and the Ministry of Finance. There appears to be a considerable variation in enterprise tax rates within the same industry, with centrals able to set (in advance, though not apparently change during the year) widely different enterprise tax rates. There is some evidence that both enterprise tax rates and transfers to the budget vary directly and more than proportionately with enterprise profits, thus potentially nullifying any incentive effects of higher profitability.

e. Summary

In short, we lack knowledge of the key determinants of the Romanian's economy. We do not know:

- How plans are formulated
- How they interact
- How much autonomy enterprises have
- How prices are centrally set
- How wages are determined
- How investment is determined
- How taxation of profits and profit transfers is determined.

We do know that

- Some prices vary considerably from international prices
- Enterprise autonomy, e.g., on investment is circumscribed
- Competition between enterprises in the same industry is limited as enterprise investment is not approved when there is spare capacity
- The system is effective in limiting imports.

f. Assessment of previous reforms

Given our state of knowledge, we have little more than a presumption that the reform measures that were taken under Fund programs over the past few years have worked in the right direction. Devaluations should encourage exports provided physical plans permit some transfers to exports, and that prices/tax rates/profit transfers are not changed to nullify their impact. If Romanian exporters are passive price takers, the process could, however, take a long time--until potential exporters realized it was now profitable to export, and plans were ultimately modified. The Romanian authorities, admittedly with their own axe to grind, have repeatedly told us that devaluations have little effect and that other (more direct actions) are more efficacious. Equally, increases in,

e.g., energy prices toward world market levels should lead to more efficient energy use. But since we have been mainly talking about producer prices and not final product prices, and we do not know the structure of taxation/profit transfers concerned, this is far from certain. The Pearce World Bank report attributes the improvement in Romania's energy balance to a whole range of measures of which price rises is only one. Equally, it is doubtful whether shortening of depreciation schedules and raising the cost of capital--whose effects could be negated by price/tax changes--are anything like as important as approval or rejection of investment projects. [Indeed, if one assumes the planners have ordered things to their satisfaction prior to any Fund intervention, it would be entirely logical for them to seek to negate any measures imposed by the Fund.]

Quoi faire?

2. Reform

There seem to me two principal approaches to improving the Romanian economic mechanism--systemic reform and a sectoral approach.

a. Systemic reform

This is following the Hungarian model, in itself a strong argument against in the Romanian perspective. Its essentials are:

(1) More flexible prices reflecting supply and demand, elimination of subsidies with increasing decentralization of price setting.

(2) Enterprise autonomy to respond to these prices.

(3) Primacy of the financial plan over physical plans with the latter reduced to an indicative role (with the exception of intra-Comecon trade which needs careful integration).

(4) Enterprise responsibility for their decisions, with inefficient enterprises ultimately closed down.

(5) Greater uniformity of enterprise tax rates and profit transfers to the budget.

(6) The imposition of credit ceilings on the household and enterprise sector (separate unless and until financial intermediation develops) to control overall demand in the economy. (Allocation of these ceilings raises important issues.)

(7) Establishment of instruments of macroeconomic management (instruments of monetary and fiscal control, e.g., to deal with liquidity overhang, perhaps import controls until exchange rate is fully able to adjust exports and imports).

This program of reforms is ambitious in the Hungarian context. In the Romanian context, it would appear a nonstarter. It is difficult to envisage a domestic crisis of sufficient depth to force the current Romanian regime to embrace such comprehensive reform--with its implied decentralization of power both over price control and enterprise activity. Indeed, it is doubtful whether such a reform policy would work without a long period of transition from the present highly-centralized Romanian economic structure. Moreover, such reforms would need a wide body of political support to survive as their most likely immediate result would be economic disruption and a sharp surge in inflation.

It is possible to envisage a variation of the "Hungarian model" which might be more attractive to the Romanian authorities, under which prices were still determined centrally by the Prices Committee, but once so determined, enterprises were free to respond without central control. But such a system would remove one of the main advantages of market mechanisms-the automatic adjustment of prices. And the benefits for more efficient resource allocation would only accrue to the extent that the Romanian authorities forebore or were prevented by the Fund from administering prices in contradiction to market mechanisms. This would appear an extremely inefficient and unattractive compromise system; at best only a temporary expedient on the road to decentralized price fixing.

b. Sectoral reform

The alternative to systemic reform is an attempt to improve the functioning of the Romanian economy on a sectoral basis. This is admittedly an area where the Fund has little expertise, and assistance from the World Bank would undoubtedly be required. The aim of such an exercise would be to take an in-depth analysis of key sectors of the Romanian economy to try and improve the functioning of these sectors. Candidates might be agriculture, machine-building, chemicals and oil. At the end of the analysis, a series of recommendations would be agreed--with appropriate quantitative performance criteria (e.g., input/output ratios) between the Romanian authorities and the Bank/Fund to improve the performance of the given sector. Implementation of these recommendations for sectoral reform could provide the basis of both project-lending by the Bank--if

viable new projects were identified--and more general Fund balance of payments assistance. Clearly this would be helped if the sectors had a considerable export content.

The advantages of such an approach would be that it did not attempt to reform the current Romanian economic system of centralized planning. The attempt rather would be to improve current planning of the given sector by detailed examination of the plans and expert dialogue. Systemic changes would only be proposed where they were clearly necessary for improved sectoral performance. The disadvantages are that this deviates from the Fund's traditional macroeconomic approach to imbalances and has little direct relevance for the external imbalance. There is also no disposition currently from the Romanian authorities to accept this degree of involvement in their domestic economy--e.g., from the World Bank.

A possible alternative, with more direct relevance to the Fund's role of temporary financing of external payments' imbalances, would be to attempt a detailed assessment of Romania's external plan. This would involve examination of Romania's main export products/sectors 1/ and attempting to assess the measures proposed by the Romanian authorities to meet the export plans. Clearly this would require consultation with World Bank experts, as well as outside experts in the markets concerned. Again, the result of these consultations would be agreement on a series

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1/ In 1983, the five most important export sectors to nonsocialist countries were machinery and equipment, industrial consumer goods, fuel minerals raw materials and metals, chemical fertilizers and rubber, and foodstuffs. The 11 products where exports were worth more than US$100 million were gasoline, diesel oil, heavy oil, steel rollings, chemical fertilizers, furniture, tractors and spare parts, ready-made textile clothes, timber, aluminium ingots and rollings and knitted textiles. Source: 1984 Economic Memorandum.

of measures--with performance criteria--to improve export performance by sector with perhaps some agreed revision to the external plans. Permitted imports would then be determined by the planned trade surplus. The aim of such an approach would be to reduce Romania's reliance on import curbs to meet its debt repayment, by providing a series of concrete measures to improve export performance. Such measures would provide detailed underpinning for export targets as a performance criterion (see Chapter IV below).

The advantage of this approach is that again the Fund would be working within and not against current Romanian economic mechanisms directly to promote balance of payments adjustment while strengthening the international trading system. The disadvantages are that the Fund would be involved in detailed work in a field where it lacked expertise; mistakes could certainly be made. In addition, the Fund could become embodied in trade disputes, e.g., accusations of dumping.

3. Assessment of reform

(a) Variant 2

The above approaches are all effectively tailored to Variant 2--ensuring the sustainability of external adjustment in a situation where this is threatened. All would require a period of several years to have any significant impact. An incipient crisis in the Romanian economy would be required before the Romanian authorities would accept any of these approaches. Even then, I think it implausible that the current regime would accept the loss of power implicit in the systemic reforms described above required to make their economy more market-oriented. It

need to be recognized as such by them.

would, in my view, be counterproductive for the Fund to attempt to impose such reforms. We are therefore forced to work within the existing system. It is impossible for us to attempt to improve the efficacy of the whole system. Despite their manifest disadvantages, I would therefore recommend we attempt to improve the workings of key export-oriented sectors of the Romanian economy in collaboration with the World Bank. I would also favor an attempt to assess Romania's export plans, as underpinning export targets. One advantage of this sectoral approach is that we should start talking to the more important decision-makers/planners in the Romanian economy. At present, we suffer from the singular disadvantage of dealing largely with the analysts rather than the key decision-makers of a centrally-planned economy.

b. Variant 1

Under Variant 1, the sustainability of external adjustment is not threatened; what would be the appropriate domestic content of a catalytic program if one were favored? My preference would be for no domestic content, or the minimum possible content if this is considered not acceptable. The logic of a program under Variant 1 is that the Fund is providing an umbrella for Romania to receive sufficient new credits for its debt repayment to be moved onto an acceptable timescale. In a sense, no further adjustment measures are required in that existing adjustment is sufficient but existing debt repayments too fast. Repayment

of the Fund's temporary finance would be guaranteed by Romania's existing adjustment effort plus its record of achieving trade targets. Such a bold approach runs counter to the Fund's doctrine of conditionality. Equally, it could be considered difficult to justify given the tenor of the Board's January discussion stressing the need for further structural adjustment. If some domestic content were considered essential, the main possibilities would appear:

(1) A continuation of the existing policy of exchange rate devaluations and selected price increases designed to promote more efficient resource allocation. The problem with this is that we have no assurance it has any effect in the current Romanian system. Indeed, unless we convince planners of the need for our proposed measures, I would presume they would take steps to offset the effects, to return to the status quo ante.

(2) Some involvement of the World Bank. While the extent of such involvement would necessarily be limited by the short duration of the program, it might be possible for the Bank to prepare some appraisal for example of Romania's investment program and perhaps for the release of some funds to be tied to measures recommended under this appraisal. The modalities of such an arrangement would need careful exploration with the Bank.

(3) An analysis of peasant agricultural markets. These appear the only legal "free" markets in Romania. In 1983, limits on prices were reduced leading probably to less production and more self-consumption on

the farm. There seems to me a strong a priori assumption that an increase in prices would be likely to produce overall economic gains, both in increased production and more marketing.

In the context of a one-year program for perhaps 25 percent of quota, our bargaining position with the Romanian authorities on domestic measures is unlikely to be strong. Their opposition to further price increases is bound to be tenacious, in view of the President's aim of price stability. While it would be possible to use the lack of domestic measures to refuse a program, this hardly seems necessary in view of the much stronger arguments of balance of payments need that could be used to the same end. It might be possible to provide for some input from the World Bank even for a short-term program. Another possibility is further price measures, including perhaps a small increase in prices on peasant markets. In my view, all such domestic measures will inevitably be largely cosmetic. ?

IV. Performance Criteria

1. Variant 1

If a program were agreed under this variant, the main aim of performance criteria would be to secure the external position. Hence criteria on a quarterly basis as in 1983 relating to

(i) Reserves

(ii) The convertible trade surplus.

(iii) Short-term debt 1/

1/ To prevent the agreed level of exports being financed by excessive short-term credit.

would seem appropriate. I would also favor a quarterly convertible export clause. The modalities of such a clause would need discussion with the Romanian authorities. It should probably:

1. Either exclude exports financed on credit or provide a separate limit for export credit to prevent exports being "financed away."

& not fd for a time became credit?

2. Be based on export values rather than volumes. No volume data exist and value data would reduce the incentive to dump.

3. Exclude oil given Romania's large reprocessing role.

It would need to be set with some margin below Romania's external plans (perhaps on a cumulative basis) so that quarterly fluctuations like in the first quarter of 1984 would not trigger a breach. This note has overschematized the issue of balance of payments need into Variants 1 and 2: there is clearly some danger that Romania could slip from Variant 1 to Variant 2 with the sustainability of large current account surpluses in question and reflected in exports falling well below target. The maintenance of a catalytic Fund program in such a situation--which would no longer be securing necessary adjustment--would clearly be inappropriate. A performance clause relating to exports would trigger a needed review in such a situation, with cancellation of the program if sustainability of the current account position were questioned. Both quarterly trade and export performance clauses would require improved quarterly trade data. On grounds of general orthodoxy, ceilings for the growth of net domestic assets would probably also be required, though it is doubtful whether these have much effect in the Romanian situation.

2. Variant 2

All the performance criteria suggested above would be appropriate. In addition, quarterly export targets could be underpinned by detailed analysis of the external plan. Further performance criteria could only be decided in the light of the detailed sectoral analysis. While some money would no doubt have to be released at the beginning of a program, it would be desirable to link release of the majority to the implementation of agreed measures in the sectors, to avoid a repetition of the 1983 experience in relation to the four "studies."

V. Conclusion/Implications for Current Relations with Romania

Fund relations with Romania have been difficult. We have not solved the dilemma of how to deal with a centrally-planned economy. In part, this is because the Romanian authorities have not chosen to share with us their knowledge of the workings of their economic control system. Equally in part our approach to domestic imbalances is to seek appropriate macroeconomic policies against a background of a functioning market-oriented economic system. This systemic and macroeconomic policy approach is perhaps inevitable given the Fund's prime concern with temporary balance of payments funding. But it does not mesh well with an economy centrally-planned on nonmarket criteria.

Given our lack of knowledge of the Romanian economic system, it is difficult if not impossible to devise satisfactory economic reforms to apply in Romania. The possibilities outlined above show this clearly:

view whether the current Romanian regime would accept systemic reform ~~into~~ even a quasi-market oriented regime a la Hungary. It is also doubtful whether this would work. Hence the best of the bad lot is some form of reform of key sectors in collaboration with the Bank.

Happily we are not yet forced down this unsatisfactory road. The Romanian authorities' latest balance of payments projections show no prospective need for Fund resources. They also show a considerable margin before an unsustainable external position would be reached--with current account surpluses exceeding US$1 billion in each of the next five years. The staff have good grounds in thinking these forecasts optimistic. But some slippage--provided it did not bring into question the sustainability of the adjustment--could easily by accommodated by new credits. If it were thought politically expedient, a minimalist Fund program--for a maximum of perhaps 30 percent of quota--could act as an umbrella for such new credits. I do not think we coud expect such a program to have much substantive domestic content.

In my view, this is an appropriate juncture to review Fund relations with Romania. While we may still harbor doubts about the sustainability of Romania's adjustment effort--achieved as it has been by import compression--we should no longer be guided by these doubts which have so far proved groundless. Romania no longer has a program with the Fund and has not (yet) asked for a new one; indeed the latest indications are that this is not under current consideration. Given our record of relations with Romania, this is a development we should welcome. In the event of a deterioration in Romania's balance of payments position from current

projections, we should encourage the Romanian authorities in the first instance to approach the banks for new credits. We might also suggest Romania approaches the World Bank. This implies that we should encourage Romania to become more self-reliant by limiting our visits to annual consultation missions and eschewing further fact-finding missions which are inevitably seen as preparatory for a new program.

In short, our present relations with Romania represent a carryover from the close involvement of the program era. There is now a good prospect that a substantive Fund program with Romania will not be required in the foreseeable future. Fund relations with Romania should now be based on this prospect.

Table 1. Romania: Official Medium-Term Balance of Payments and Debt Outlook, 1984-88

(In convertible currencies)

	1984	1985	1986	1987	1988	1989
			(In millions of U.S. dollars)			
Payments flows						
Current account balance	1,030	1,200	1,310	1,380	1,470	1,520
Trade balance	1,750	1,850	1,890	1,890	1,890	1,910
Exports	6,480	6,780	7,240	7,720	8,260	8,830
Imports	-4,730	-4,930	-5,350	-5,830	-6,370	-6,920
Services, net	-720	-650	-580	-510	-420	-390
Of which: Interest payments	(-750)	(-700)	(-600)	(-520)	(-380)	(-325)
Capital inflows	215	220	470	450	450	450
IBRD 1/	115	100	200	200	200	200
Commercial banks	100	—	50	50	—	—
Medium- and long-term	—	—	—	—	—	—
Short-term, net	100	—	50	50	—	—
Other	—	120	220	200	250	250
Medium- and long-term	200	140	200	200	200	200
Short-term, net	-200	-20	20	—	50	50
Capital outflows	-1,190	-1,296	-1,450	-1,572	-1,637	-1,153
Amortization of medium- and long-term debt, total	-1,120	-1,385	-1,250	-1,372	-1,337	-753
On debt incurred by end-1983	-1,120	-1,285	-1,195	-1,267	-1,182	-543
Of which: Commercial banks	(-471)	(-783)	(-639)	(-740)	(-677)	(-255)
On inflows after 1983	—	-100	-55	-105	-155	-210

Table 2. Romania: Fund and Bank Credit Outstanding as a Percentage of Total Debt 1983-1989 (End-Year)

	1983	1984	1985	1986	1987	1988	1989
Use of Fund credit: total outstanding	947	991	808	570	332	172	59
As a percentage of:							
Medium- and long-term debt	11.3	13.0	12.9	11.0	8.4	6.0	2.4
Total debt	10.8	12.5	12.3	10.3	7.6	5.2	2.0
Outstanding credit to international institutions (Fund and World Bank) 1/	2,620 1/	2,560	2,313	2,103	1,895	1,750	1,644
As a percentage of:							
Medium- and long-term debt	31.3	33.7	36.9	40.6	47.7	60.9	68.2
Total debt	29.9	32.4	35.3	38.0	43.4	52.6	56.5

Source: Staff calculations based on projections provided by the Romanian authorities.

1/ Includes US$90 million outstanding to BIS at end-1983 but to be repaid in 1984.

Office Memorandum

TO : Mr. Whittome

DATE: July 3, 1984

FROM : A.R. Boote ARBoote

SUBJECT : Romania: Future Fund Involvement

As requested, I attach a note on future Fund relations with Romania.

cc: Mr. Brehmer
Mr. Hole
Mr. Prust
Mr. Reitmaier

AB: 7/3/84:14

CONFIDENTIAL

Romania: Future Fund Involvement

Introduction

The history of Romania's recent involvement with the Fund is paradoxical. While Romania enjoyed a sharp swing in its convertible current account into substantial surplus in 1982 and 1983, this was achieved primarily by the compression of imports. The limited reforms agreed with the Fund were largely peripheral to this adjustment process. Partly because of this, and partly because of a lack of knowledge of how the Romanian economy operates, the staff have repeatedly expressed doubts about the sustainability of this adjustment. So far, no convincing evidence has emerged to support these doubts. This recent history poses the question of the justification for any future Fund financial involvement with Romania, in view of the continuing large balance of payments surpluses projected by the Romanian authorities for the remainder of the decade and the Fund's lack of knowledge of and influence on the Romanian economy.

I. Background

1. Difficulties in relations

There are a number of problems in the Fund's current relations with Romania namely:

a. Lack of statistics. Examples are a lack of any breakdown of trade by commodity or by destination on a quarterly or monthly basis or volume and price trade data. Despite the recent provision of some information on prices, we lack knowledge of the bulk of domestic prices.

b. Interpretation of statistics. It is often difficult to interpret the statistics we do receive. In 1983 provisional data show GNP growing by 3.5 percent compared to aggregate demand rising 1.5 percent with the current account surplus broadly unchanged; reconciliation of the increases in industrial and agricultural output with the sectoral breakdowns is also difficult.

c. Lack of cooperation on reforms. The Romania authorities have recently introduced potentially far-reaching reforms linking earnings more closely to output, encouraging more efficient use of inputs and greater product quality. In contrast to Hungary, there has been no attempt to involve the Fund in the formulation of these reforms most of which we might--given the opportunity--have welcomed and our knowledge of these reforms is patchy.

d. Lack of effective involvement with the World Bank. While disbursements under old projects continue, there is yet no sign of any agreement on new project lending by the Bank to Romania. The Bank's request for more debt reporting, improved procurement procedures, and more information on the investment program, sector, and country policies effectively rests on the table.

e. Romania does not appear to have carried out an undertaking given in the 1983 program to unify the commercial and noncommercial rates of exchange on July 1, 1984. 1/

1/ This undertaking was recorded in the August 1983 staff report (SM/83/173) and reflected in the September 14, 1983 Board discussion (SM/83/173, Supplement 2). The February 11, 1983 letter of intent (Appendix III to EBS/83/54) paragraph 11 also contains the undertaking that the unification of the two rates will "be completed in the course of 1984."

In sum, pace the February fact-finding mission, we still lack basic knowledge on how the Romanian economy performs and the economic policies of the Romanian authorities. The limits of our policy dialogue with Romania were underlined by the President's reported 1983 decisions to adopt targets of eliminating Romania's indebtedness to the West and of price stability: the first of these targets could be considered to eliminate the need for Fund resources, the second to nullify the main thrust of our efforts to reform the domestic economy.

2. Romania's Unique Position

The problems outlined above militate against further financial Fund involvement with Romania. However:

a. To a considerable extent, our lack of knowledge of the Romanian economy reflects a dilemma which has remained unresolved since Communist countries have joined the Fund. This is how does the Fund perform its traditional role of promoting external and internal adjustment in a centrally-controlled economy where the authorities are reluctant to share their knowledge or control about how the economy works? The conflict between a member state's right to determine its economic system and the Fund's right to impose conditionality highlighted in such a case has never been satisfactorily resolved. In this sense, some of the problems outlined above are not new, but rather inherent in the Fund's relationship with a Communist country, and therefore do not justify an ending of Fund involvement with Romania. This is particularly the case in view of:

b. Romania's unique position as the "licensed dissenter" of the Eastern bloc, symbolized by Romania's prospective attendance at the Los Angeles olympics. This is likely to predispose industrialized countries

and particularly the U.S. to view sympathetically any further application for Fund resources by Romania despite failings in its economic system. The fact that the Board's adverse reaction in September 1983 to a possible breakdown in the program was directed at both the Romanian authorities and the staff probably partly reflected this underlying political reality.

For these reasons, it is in my judgement unrealistic to rule out Fund involvement with Romania even if the difficulties outlined above, in our knowledge of and influence on the Romanian economy, persist. Whether further Fund program(s) with Romania would be justified would depend at least initially on Romania's current account position and the question of need.

II. Current Account/Need

1. Formal position

The December 20, 1983 letter of intent, paragraph 4, records the Romanian intention to request a new one-year stand-by arrangement. At the conclusion of the latest mission on May 29, Minister Gigea indicated the Romanian authorities were not at the present time considering the further use of Fund resources.

2. Fund attitude

The Fund's response to any request for the additional use of resources by Romania would be conditioned by:

- Decisions on the continuation/phasedown of enlarged access (Mr. Hauvonen's note of May 11 refers) and

- The Fund's liquidity position.

3. Latest balance of payments projections

The Romanian authorities latest convertible currency forecast--handed to the May mission--are attached in Table 1. These show:

a. A current account surplus exceeding US$1 billion in 1984 and rising to US$1.5 billion in 1989 based on annual trade surpluses approaching US$2 billion.

b. External debt falling rapidly from US$7.9 billion in 1984 to US$2.9 billion in 1989.

c. A fall in reserves in 1985 (partially reversing a US$0.1 billion increase in 1984) followed by a slow increase in subsequent years with a large jump in 1989.

It is presumably on the basis of these projections that the Romanian authorities:

- no longer seem so immediately interested in a Fund program, and
- have reportedly recently refused various offers of credit.

It would not appear attractive to enter into a program with Romania on the basis of such projections. The only justification for such a program would be the US$60 million fall in reserves in 1985 in a country where reserves have historically been inadequate (this would leave reserves at around 1.7 months of convertible goods imports). However, such a justification would appear highly tenuous in a country where imports are tightly controlled and therefore reserves do not play their Western role. In any case, it is probably unlikely that the Romanian authorities would approach the Fund for a further program merely to avoid a small rundown in reserves. The remainder of this note therefore assumes some deterioration--potential or actual--from the projections in Table 1.

4. Likely changes to authorities' projections

In the staff's view, the authorities' projections in Table 1 are optimistic in several respects:

1. The sharp turnaround postulated in short-term credit extended from a net outflow of around US$500 million a year in 1982-83 to rough balance in 1984-85 followed by credit extensions of around US$300 million a year in subsequent years.

2. The recovery postulated in non-oil imports volumes leaves those in 1988 still about 25 percent below the average level of 1980-81 despite rising domestic demand and exports to 1988.

3. Equally, the postulated expansion of oil exports by 22 percent in volume terms by 1988 seems inconsistent with the permitted 2 percent growth of oil imports.

4. The general growth of non-oil exports.

At the risk of overschematization, I think it is worth distinguishing two variants under which Romania could seek Fund assistance.

Variant 1 involves a small deterioration (of say US$0.5 billion) in Romania's capital account position, perhaps because of the need to extend more credit to sell Romanian exports. Following tradition, the Romanian authorities achieve their trade balance targets. 1/ This deterioration, while not threatening the achievement of persistent current account surpluses of more than US$1 billion, leads the Romanians to seek further Fund assistance.

1/ Conceptually, it makes little difference if some of the deterioration is on the trade or services account, though given Romania's history, the former would seem less likely. The key requirement is that the sustainability of Romania's current account position is not questioned.

Variant 2 involves a much more serious deterioration in Romania's balance of payments position, which threatens the sustainability of their adjustment. The most likely version of this is a continued decline/stagnation of Romanian exports such that trade balance targets could no longer be met by import compression without unacceptable affects on the domestic economy. It would probably be heralded by indications of some crisis in the domestic economy. As it became obvious Romania could not meet its current account targets and repayment obligations, foreign credit would dry up and Romania would be obliged to approach the Fund.

There are, as yet, no firm signs of Variant 2 emerging. In my view, at least in the short-term, Variant 1 is much more likely. The Fund's response to a Romanian request for assistance under these variations is discussed below.

5. Fund response: Variant 1

Romania is:

a. Still running a substantial (more than US$1 billion) current account surplus; and

b. Its external debt is being reduced rapidly, but

c. It is in difficulties meeting its existing debt repayment obligations.

Essentially, the problem in banking terminology is one of liquidity not solvency; Romania, while fully able to meet its repayment obligations given sufficient time, is not able to do so on the current repayment schedule.

There would appear three possible Fund responses to Romania's request:

1. A refusal to entertain a new stand-by,

2. A classical stand-by in the sense the Fund promised resources against a further deterioration in Romania's position, or

3. A Fund program.

Response 1, (no) has considerable merits. The problem is essentially that Romania's creditors (particularly Western banks) are seeking to be repaid too fast. While Romania would obviously wish to avoid rescheduling, a de facto spreading out of its liabilities from 1985--and to a lesser extent 1986 and 1987--to beyond 1988 by new credits would remove Romania's problem. It is not clear that the Fund has a role to play in this process (e.g., Venezuela). The Fund is not in the business of providing repayments for Western banks or providing residual gap finance, particularly in a country which had been rejecting other offers of finance. The balance of payments need in such a case would be demonstrably weak. The general lack of Romanian cooperation on domestic conditionality would strengthen this view.

Response 2 (classical stand-by) I see as having considerable disadvantages. The basis of such a stand-by arrangement is normally agreement that the main economic policies of the country are appropriate. Given the current state of our cooperation on policies with Romania, we would hardly be able to offer such an assurance. Equally, I doubt whether the Romanians would be interested in such an arrangement.

The arguments for Response 3 (yes) are essentially those against Response 1. The Romanians would no doubt argue that it would be difficult

for them to raise funds in the market without a Fund seal of approval, particularly after so many years of close involvement with the Fund. The low level of Romanian reserves could, if required, provide sufficient justification to pass the criterion of need. Romania's unique political position as described above could lead to strong pressure for a further program.

The issues raised are of wider import. Romania is ahead of the pack in seeking a rundown in its external debt, but presumably some others will (eventually) follow. Does the Fund have any role in securing a satisfactory timescale for the repayment of debt for a country in such a position? If the Fund is seen solely as a provider of temporary balance of payments assistance, interpreted narrowly, the answer would appear no. On the other hand, some of the Fund's main constituents might see the Fund as having some role in "managing" the repayment of the West's assets in a Communist country like Romania.

Table 2 further illustrates this problem. Fund resources are being repaid at around US$0.2 billion a year in each of the key years 1985-87. As a result, outstanding Fund credit declines from 12 1/2 percent of all debt outstanding at end-1984 to 7 1/2 percent at end-1987. This trend is reversed if credit from the World Bank is included: debt to international institutions rises from 32 1/2 percent of total debt at end-1984 to 43 1/2 percent at end-1987.

Any presumption that the Fund should be repaid at the same rate as other creditors would undermine the temporary nature of Fund assistance. But if it were decided that Fund assistance were appropriate to facilitate

Romania to move its debt repayment onto a more acceptable timetable, Table 2 could be used to suggest an appropriate range for Fund assistance. Clearly, a prerequisite for additional Fund lending would need to be further credits from other sources to prevent the Fund providing residual finance. Given that the other debtors (except the World Bank) were reducing their net indebtedness, an upper limit to Fund gross advances would be Romania's scheduled repayments to the Fund--around US$180 million in 1985. At end-1984, the ratio of Romania's debt to the Fund and debt to commercial banks was around 1:3. 1/ Assuming a "gap" of US$500 million to be financed in 1985, and on the (highly unfavorable) assumption of no alternative sources of finance (e.g., governments), if these proportions were to be continued, US$125 million additional Fund resources should be matched by US$375 million new credits by the banks. For the Fund, this would involve lending around 23 percent of Romania's quota; for the banks, re-lending slightly less than 50 percent of the scheduled 1985 repayments.

The case for an additional Fund stand-by for Romania is that it would facilitate a reordering of Romania's debt repayment schedule. As such, its role would be primarily catalytic. It should in my view be accompanied by a guarantee of sufficient credits from banks to overcome the whole of the 1985-87 hump. I would recommend a one-year program with Fund assistance between 20 to 30 percent of quota as the appropriate range, with 30 percent (around US$160 million) the maximum. Whether such a stand-by would be preferable to the refusal of assistance is primarily a

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1/ The actual ratio calculated for end-1984 is 1:3.29; the projections in Table 1 show this falling to 1:3.06 at end-1983.

matter for political judgement in the context of the Fund's liquidity position. Such a program, in my view, is unlikely to contain much meaningful domestic content, though this is discussed further below in Chapter III; Chapter IV examines possible performance criteria.

6. Fund's response: Variant 2

Under this variant, with a crisis at least incipient in the Romanian economy, Romania is forced by the shortage of alternative credits to seek Fund assistance. Since Romania has already achieved external adjustment, the problem is essentially that domestic adjustment has not been sufficient to sustain the external adjustment effort. Attention is therefore focused on the domestic economy and domestic reforms. The size of any program would need to be determined in the light of Romania's need and the reforms that could be agreed. The next section examines the possible approaches to improving the performance of the Romanian economy.

III. Domestic Economy: Possible Reform

1. Current Romanian Economic System

a. Planning

Economic activity in Romania is governed by a series of plans: a physical plan, a financial plan, an investment plan, a labor force plan, and an export or external plan. While the Romanian authorities have emphasized to the staff the importance of profitability in influencing both investment and earnings (under the new wages law), we simply do not know the relative importance of the various plans described above.

While the process of planning has been described to the staff, the criteria

which govern the formulation of the plan remain a mystery. For example, the staff were told that the main criterion for appraising investment projects was the "social need for consumption."

b. Enterprise autonomy

Nor do we know the extent of enterprise autonomy. The process of formulating the plan begins at the enterprise level, but we have no means of assessing the relative importance of enterprises in the final product. While we have been told enterprises have considerable freedom, for example, in their utilization of excess profits, the extent of enterprise autonomy is probably severely limited by the multiplicity of plans outlined above. We do know, for example, that investments of more than a certain size require higher approval which is only given if surplus capacity in the industry concerned does not exist and that banks audit all enterprise expenditure as it takes place to ensure conformity with the relevant regulations. And enterprises have little or no autonomy in price setting.

c. Prices

Prices are set centrally by the Price Committee. All price changes appear to require approvement by this Committee. We lack comprehensive information on the structure of Romanian prices. We do, however, know that certain domestic prices such as energy prices appear generally low. And assessment of investment projects involving foreign exchange at domestic and foreign shadow prices often produces different results to be resolved by "judgemental factors." We also know that prices do not perform the equilibrating role that they perform in Western economies.

For example, an enterprises' response to an external shock--e.g., the increase in the price of an imported input--would be first to increase productivity, then reduce profit margins and only very much as a final resort consider applying for a price increase. As a result, there appears to have been little pass through of successive devaluations into the final product price of products with import content. Equally, price setting in foreign markets seems essentially passive with few enterprises suggesting a price reduction in response to a devaluation. Indeed, by law, Romanian enterprises are required to sell at the prevailing world market price though occasionally, e.g., in fertilizers, Romania has been accused of dumping.

d. Taxation/profit transfers to the budget

Whatever enterprise autonomy may exist may also be effectively diminished by the tax system and profit transfers to the budget. Tax rates are set by the industry central, with the approval of the relevant Ministry and the Ministry of Finance. There appears to be a considerable variation in enterprise tax rates within the same industry, with centrals able to set (in advance, though not apparently change during the year) widely different enterprise tax rates. There is some evidence that both enterprise tax rates and transfers to the budget vary directly and more than proportionately with enterprise profits, thus potentially nullifying any incentive effects of higher profitability.

e. Summary

In short, we lack knowledge of the key determinants of the Romanian's economy. We do not know:

- How plans are formulated

- How they interact

- How much autonomy enterprises have

- How prices are centrally set

- How wages are determined

- How investment is determined

- How taxation of profits and profit transfers is determined.

We do know that

- Some prices vary considerably from international prices

- Enterprise autonomy, e.g., on investment is circumscribed

- Competition between enterprises in the same industry is limited as enterprise investment is not approved when there is spare capacity

- The system is effective in limiting imports.

f. Assessment of previous reforms

Given our state of knowledge, we have little more than a presumption that the reform measures that were taken under Fund programs over the past few years have worked in the right direction. Devaluations should encourage exports provided physical plans permit some transfers to exports, and that prices/tax rates/profit transfers are not changed to nullify their impact. If Romanian exporters are passive price takers, the process could, however, take a long time--until potential exporters realized it was now profitable to export, and plans were ultimately modified. The Romanian authorities, admittedly with their own axe to grind, have repeatedly told us that devaluations have little effect and that other (more direct actions) are more efficacious. Equally, increases in,

e.g., energy prices toward world market levels should lead to more efficient energy use. But since we have been mainly talking about producer prices and not final product prices, and we do not know the structure of taxation/profit transfers concerned, this is far from certain. The Pearce World Bank report attributes the improvement in Romania's energy balance to a whole range of measures of which price rises is only one. Equally, it is doubtful whether shortening of depreciation schedules and raising the cost of capital--whose effects could be negated by price/tax changes--are anything like as important as approval or rejection of investment projects. [Indeed, if one assumes the planners have ordered things to their satisfaction prior to any Fund intervention, it would be entirely logical for them to seek to negate any measures imposed by the Fund.]

Quoi faire?

2. Reform

There seem to me two principal approaches to improving the Romanian economic mechanism--systemic reform and a sectoral approach.

a. Systemic reform

This is following the Hungarian model, in itself a strong argument against in the Romanian perspective. Its essentials are:

(1) More flexible prices reflecting supply and demand, elimination of subsidies with increasing decentralization of price setting.

(2) Enterprise autonomy to respond to these prices.

(3) Primacy of the financial plan over physical plans with the latter reduced to an indicative role (with the exception of intra-Comecon trade which needs careful integration).

(4) Enterprise responsibility for their decisions, with inefficient enterprises ultimately closed down.

(5) Greater uniformity of enterprise tax rates and profit transfers to the budget.

(6) The imposition of credit ceilings on the household and enterprise sector (separate unless and until financial intermediation develops) to control overall demand in the economy. (Allocation of these ceilings raises important issues.)

(7) Establishment of instruments of macroeconomic management (instruments of monetary and fiscal control, e.g., to deal with liquidity overhang, perhaps import controls until exchange rate is fully able to adjust exports and imports).

This program of reforms is ambitious in the Hungarian context. In the Romanian context, it would appear a nonstarter. It is difficult to envisage a domestic crisis of sufficient depth to force the current Romanian regime to embrace such comprehensive reform--with its implied decentralization of power both over price control and enterprise activity. Indeed, it is doubtful whether such a reform policy would work without a long period of transition from the present highly-centralized Romanian economic structure. Moreover, such reforms would need a wide body of political support to survive as their most likely immediate result would be economic disruption and a sharp surge in inflation.

It is possible to envisage a variation of the "Hungarian model" which might be more attractive to the Romanian authorities, under which prices were still determined centrally by the Prices Committee, but once so determined, enterprises were free to respond without central control. But such a system would remove one of the main advantages of market mechanisms-the automatic adjustment of prices. And the benefits for more efficient resource allocation would only accrue to the extent that the Romanian authorities forebore or were prevented by the Fund from administering prices in contradiction to market mechanisms. This would appear an extremely inefficient and unattractive compromise system; at best only a temporary expedient on the road to decentralized price fixing.

b. Sectoral reform

The alternative to systemic reform is an attempt to improve the functioning of the Romanian economy on a sectoral basis. This is admittedly an area where the Fund has little expertise, and assistance from the World Bank would undoubtedly be required. The aim of such an exercise would be to take an in-depth analysis of key sectors of the Romanian economy to try and improve the functioning of these sectors. Candidates might be agriculture, machine-building, chemicals and oil. At the end of the analysis, a series of recommendations would be agreed--with appropriate quantitative performance criteria (e.g., input/output ratios) between the Romanian authorities and the Bank/Fund to improve the performance of the given sector. Implementation of these recommendations for sectoral reform could provide the basis of both project-lending by the Bank--if

viable new projects were identified--and more general Fund balance of payments assistance. Clearly this would be helped if the sectors had a considerable export content.

The advantages of such an approach would be that it did not attempt to reform the current Romanian economic system of centralized planning. The attempt rather would be to improve current planning of the given sector by detailed examination of the plans and expert dialogue. Systemic changes would only be proposed where they were clearly necessary for improved sectoral performance. The disadvantages are that this deviates from the Fund's traditional macroeconomic approach to imbalances and has little direct relevance for the external imbalance. There is also no disposition currently from the Romanian authorities to accept this degree of involvement in their domestic economy--e.g., from the World Bank.

A possible alternative, with more direct relevance to the Fund's role of temporary financing of external payments' imbalances, would be to attempt a detailed assessment of Romania's external plan. This would involve examination of Romania's main export products/sectors 1/ and attempting to assess the measures proposed by the Romanian authorities to meet the export plans. Clearly this would require consultation with World Bank experts, as well as outside experts in the markets concerned. Again, the result of these consultations would be agreement on a series

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1/ In 1983, the five most important export sectors to nonsocialist countries were machinery and equipment, industrial consumer goods, fuel minerals raw materials and metals, chemical fertilizers and rubber, and foodstuffs. The 11 products where exports were worth more than US$100 million were gasoline, diesel oil, heavy oil, steel rollings, chemical fertilizers, furniture, tractors and spare parts, ready-made textile clothes, timber, aluminium ingots and rollings and knitted textiles. Source: 1984 Economic Memorandum.

of measures--with performance criteria--to improve export performance by sector with perhaps some agreed revision to the external plans. Permitted imports would then be determined by the planned trade surplus. The aim of such an approach would be to reduce Romania's reliance on import curbs to meet its debt repayment, by providing a series of concrete measures to improve export performance. Such measures would provide detailed underpinning for export targets as a performance criterion (see Chapter IV below).

The advantage of this approach is that again the Fund would be working within and not against current Romanian economic mechanisms directly to promote balance of payments adjustment while strengthening the international trading system. The disadvantages are that the Fund would be involved in detailed work in a field where it lacked expertise; mistakes could certainly be made. In addition, the Fund could become embodied in trade disputes, e.g., accusations of dumping.

3. Assessment of reform

(a) Variant 2

The above approaches are all effectively tailored to Variant 2--ensuring the sustainability of external adjustment in a situation where this is threatened. All would require a period of several years to have any significant impact. An incipient crisis in the Romanian economy would be required before the Romanian authorities would accept any of these approaches. Even then, I think it implausible that the current regime would accept the loss of power implicit in the systemic reforms described above required to make their economy more market-oriented. It

would, in my view, be counterproductive for the Fund to attempt to impose such reforms. We are therefore forced to work within the existing system. It is impossible for us to attempt to improve the efficacy of the whole system. Despite their manifest disadvantages, I would therefore recommend we attempt to improve the workings of key export-oriented sectors of the Romanian economy in collaboration with the World Bank. I would also favor an attempt to assess Romania's export plans, as underpinning export targets. One advantage of this sectoral approach is that we should start talking to the more important decision-makers/planners in the Romanian economy. At present, we suffer from the singular disadvantage of dealing largely with the analysts rather than the key decision-makers of a centrally-planned economy.

b. Variant 1

Under Variant 1, the sustainability of external adjustment is not threatened; what would be the appropriate domestic content of a catalytic program if one were favored? My preference would be for no domestic content, or the minimum possible content if this is considered not acceptable. The logic of a program under Variant 1 is that the Fund is providing an umbrella for Romania to receive sufficient new credits for its debt repayment to be moved onto an acceptable timescale. In a sense, no further adjustment measures are required in that existing adjustment is sufficient but existing debt repayments too fast. Repayment

of the Fund's temporary finance would be guaranteed by Romania's existing adjustment effort plus its record of achieving trade targets. Such a bold approach runs counter to the Fund's doctrine of conditionality. Equally, it could be considered difficult to justify given the tenor of the Board's January discussion stressing the need for further structural adjustment. If some domestic content were considered essential, the main possibilities would appear:

(1) A continuation of the existing policy of exchange rate devaluations and selected price increases designed to promote more efficient resource allocation. The problem with this is that we have no assurance it has any effect in the current Romanian system. Indeed, unless we convince planners of the need for our proposed measures, I would presume they would take steps to offset the effects, to return to the status quo ante.

(2) Some involvement of the World Bank. While the extent of such involvement would necessarily be limited by the short duration of the program, it might be possible for the Bank to prepare some appraisal for example of Romania's investment program and perhaps for the release of some funds to be tied to measures recommended under this appraisal. The modalities of such an arrangement would need careful exploration with the Bank.

(3) An analysis of peasant agricultural markets. These appear the only legal "free" markets in Romania. In 1983, limits on prices were reduced leading probably to less production and more self-consumption on

the farm. There seems to me a strong a priori assumption that an increase in prices would be likely to produce overall economic gains, both in increased production and more marketing.

In the context of a one-year program for perhaps 25 percent of quota, our bargaining position with the Romanian authorities on domestic measures is unlikely to be strong. Their opposition to further price increases is bound to be tenacious, in view of the President's aim of price stability. While it would be possible to use the lack of domestic measures to refuse a program, this hardly seems necessary in view of the much stronger arguments of balance of payments need that could be used to the same end. It might be possible to provide for some input from the World Bank even for a short-term program. Another possibility is further price measures, including perhaps a small increase in prices on peasant markets. In my view, all such domestic measures will inevitably be largely cosmetic.

IV. Performance Criteria

1. Variant 1

If a program were agreed under this variant, the main aim of performance criteria would be to secure the external position. Hence criteria on a quarterly basis as in 1983 relating to

(i) Reserves

(ii) The convertible trade surplus.

(iii) Short-term debt 1/

1/ To prevent the agreed level of exports being financed by excessive short-term credit.

would seem appropriate. I would also favor a quarterly convertible export clause. The modalities of such a clause would need discussion with the Romanian authorities. It should probably:

1. Either exclude exports financed on credit or provide a separate limit for export credit to prevent exports being "financed away."

2. Be based on export values rather than volumes. No volume data exist and value data would reduce the incentive to dump.

3. Exclude oil given Romania's large reprocessing role.

It would need to be set with some margin below Romania's external plans (perhaps on a cumulative basis) so that quarterly fluctuations like in the first quarter of 1984 would not trigger a breach. This note has overschematized the issue of balance of payments need into Variants 1 and 2: there is clearly some danger that Romania could slip from Variant 1 to Variant 2 with the sustainability of large current account surpluses in question and reflected in exports falling well below target. The maintenance of a catalytic Fund program in such a situation--which would no longer be securing necessary adjustment--would clearly be inappropriate. A performance clause relating to exports would trigger a needed review in such a situation, with cancellation of the program if sustainability of the current account position were questioned. Both quarterly trade and export performance clauses would require improved quarterly trade data. On grounds of general orthodoxy, ceilings for the growth of net domestic assets would probably also be required, though it is doubtful whether these have much effect in the Romanian situation.

2. Variant 2

All the performance criteria suggested above would be appropriate. In addition, quarterly export targets could be underpinned by detailed analysis of the external plan. Further performance criteria could only be decided in the light of the detailed sectoral analysis. While some money would no doubt have to be released at the beginning of a program, it would be desirable to link release of the majority to the implementation of agreed measures in the sectors, to avoid a repetition of the 1983 experience in relation to the four "studies."

V. Conclusion/Implications for Current Relations with Romania

Fund relations with Romania have been difficult. We have not solved the dilemma of how to deal with a centrally-planned economy. In part, this is because the Romanian authorities have not chosen to share with us their knowledge of the workings of their economic control system. Equally in part our approach to domestic imbalances is to seek appropriate macroeconomic policies against a background of a functioning market-oriented economic system. This systemic and macroeconomic policy approach is perhaps inevitable given the Fund's prime concern with temporary balance of payments funding. But it does not mesh well with an economy centrally-planned on nonmarket criteria.

Given our lack of knowledge of the Romanian economic system, it is difficult if not impossible to devise satisfactory economic reforms to apply in Romania. The possibilities outlined above show this clearly:

view whether the current Romanian regime would accept systemic reform into even a quasi-market oriented regime a la Hungary. It is also doubtful whether this would work. Hence the best of the bad lot is some form of reform of key sectors in collaboration with the Bank.

Happily we are not yet forced down this unsatisfactory road. The Romanian authorities' latest balance of payments projections show no prospective need for Fund resources. They also show a considerable margin before an unsustainable external position would be reached--with current account surpluses exceeding US$1 billion in each of the next five years. The staff have good grounds in thinking these forecasts optimistic. But some slippage--provided it did not bring into question the sustainability of the adjustment--could easily by accommodated by new credits. If it were thought politically expedient, a minimalist Fund program--for a maximum of perhaps 30 percent of quota--could act as an umbrella for such new credits. I do not think we coud expect such a program to have much substantive domestic content.

In my view, this is an appropriate juncture to review Fund relations with Romania. While we may still harbor doubts about the sustainability of Romania's adjustment effort--achieved as it has been by import compression--we should no longer be guided by these doubts which have so far proved groundless. Romania no longer has a program with the Fund and has not (yet) asked for a new one; indeed the latest indications are that this is not under current consideration. Given our record of relations with Romania, this is a development we should welcome. In the event of a deterioration in Romania's balance of payments position from current

projections, we should encourage the Romanian authorities in the first instance to approach the banks for new credits. We might also suggest Romania approaches the World Bank. This implies that we should encourage Romania to become more self-reliant by limiting our visits to annual consultation missions and eschewing further fact-finding missions which are inevitably seen as preparatory for a new program.

In short, our present relations with Romania represent a carryover from the close involvement of the program era. There is now a good prospect that a substantive Fund program with Romania will not be required in the foreseeable future. Fund relations with Romania should now be based on this prospect.

Table 1. Romania: Official Medium-Term Balance of Payments and Debt Outlook, 1984-88

JR 6/25/84:15

(In convertible currencies)

	1984	1985	1986	1987	1988	1989
	(In millions of U.S. dollars)					
Payments flows						
Current account balance	1,030	1,200	1,310	1,380	1,470	1,520
Trade balance	1,750	1,850	1,890	1,890	1,890	1,910
Exports	6,480	6,780	7,240	7,720	8,260	8,830
Imports	-4,730	-4,930	-5,350	-5,830	-6,370	-6,920
Services, net	-720	-650	-580	-510	-420	-390
Of which: Interest payments	(-750)	(-700)	(-600)	(-520)	(-380)	(-325)
Capital inflows	215	220	470	450	450	450
IBRD 1/	115	100	200	200	200	200
Commercial banks	100	--	50	50	--	--
Medium- and long-term	--	--	--	--	--	--
Short-term, net	100	--	50	50	--	--
Other	--	120	220	200	250	250
Medium- and long-term	200	140	200	200	200	200
Short-term, net	-200	-20	20	--	50	50
Capital outflows	-1,190	-1,296	-1,450	-1,572	-1,637	-1,153
Amortization of medium- and long-term debt, total	-1,120	-1,385	-1,250	-1,372	-1,337	-753

	[illegible]	100	200	200	200	200
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Medium- and long-term	--	--	--	--	--	--
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Amortization of medium- and long-term debt, total	-1,120	-1,385	-1,250	-1,372	-1,337	-753
On debt incurred by end-1983	-1,120	-1,285	-1,195	-1,267	-1,182	-543
Of which: Commercial banks	(-471)	(-783)	(-639)	(-740)	(-677)	(-255)
On inflows after 1983	--	-100	-55	-105	-155	-210
Credit extended, net	-70	89	-200	-200	-300	-400
IMF, net	44	-183	-238	-238	-160	-113
Purchases	190	--	--	--	--	--
Repurchases	-146	-183	-238	-238	-160	-113
Change in gross reserves (increase -)	-100	59	-92	-20	-123	-704
Stocks (end of year)						
Convertible external debt	7,895	6,550	5,530	4,370	3,335	2,910
Of which:						
To commercial banks	(3,258)	(2,475)	(1,886)	(1,196)	(519)	(264)
To international institutions	(2,560)	(2,313)	(2,103)	(1,895)	(1,750)	(1,644)
Gross reserves	758	699	791	811	934	1,638
Of which: Foreign exchange	(625)	(566)	(658)	(678)	(801)	(1,505)
		(In percent of current receipts)				
Debt service ratios						
Including IMF repurchases	28.6	30.6	26.4	25.3	20.9	12.4
Excluding IMF repurchases	26.6	28.1	23.4	22.5	19.1	11.2

Source: Staff calculations based on projections provided by Romanian authorities.

1/ Including estimated disbursements for any new projects.

Table 2. Romania: Fund and Bank Credit Outstanding as a Percentage of Total Debt 1983-1989 (End-Year)

	1983	1984	1985	1986	1987	1988	1989
Use of Fund credit: total outstanding	947	991	808	570	332	172	59
As a percentage of:							
Medium- and long-term debt	11.3	13.0	12.9	11.0	8.4	6.0	2.4
Total debt	10.8	12.5	12.3	10.3	7.6	5.2	2.0
Outstanding credit to international institutions (Fund and World Bank) 1/	2,620 1/	2,560	2,313	2,103	1,895	1,750	1,644
As a percentage of:							
Medium- and long-term debt	31.3	33.7	36.9	40.6	47.7	60.9	68.2
Total debt	29.9	32.4	35.3	38.0	43.4	52.6	56.5

Source: Staff calculations based on projections provided by the Romanian authorities.

1/ Includes US$90 million outstanding to BIS at end-1983 but to be repaid in 1984.

Office Memorandum

TO : Mr. Whittome

DATE: June 13, 1984

FROM : Ekhard Brehmer EBr 6/13

SUBJECT : Romania - Failure to Unify Noncommercial and Commercial Exchange Rates

ETR reminded us that the deadline for eliminating the remaining multiple currency practice subject to approval under Article VIII will expire on July 1, 1984 (see SM/83/173, 8/5/83, para. 2 of proposed decision). This practice results from the failure to unify the non-commercial exchange rate (lei 14.2 per US$1 on June 4, 1984) and the commercial rate (lei 21.8 per US$1).

I proposed to Mr. Mookerjee and he agreed that in the case of a failure to unify the two rates by that date we should mention in the Staff Appraisal of the forthcoming Staff Report that we would not recommend a continuation of this multiple currency practice because of the absence of any clear intention of the Romanians to remove this practice.

During the last consultation discussions we have reminded the Romanians of their obligation to unify the two exchange rates. Nevertheless, it would be fair if you would indicate to Mr. Polak the above problem and that he would in the case of no action on the part of the Romanians face a similarly embarrassing situation on this issue as he did in the January 1984 Board meeting.

cc: EED

1) Talked to JJP

2) Talked to EB & asked for a draft message to be prepared for me to send to Bucharest

LAW 14/6

INTERNATIONAL MONETARY FUND

7/5

Mr. Whittome,

Mr. Brehmer asked if you could let him know how recently you heard about the Romanian bank credit and where you heard about it. Evidently Ms. Bush asked him this question.

Lynne

The answer is the Ld. Journal [illegible]

Could EB or Jim Russell then Pelletier - ask for [illegible]

Mr Brehmer

Office Memorandum

MEMORANDUM FOR FILES June 11, 1984

Subject: Telephone Call from Mr. Pelletier, Manufacturer's Hanover Trust, June 7, 1984

Mr. Pelletier said that he had heard that Romania had turned down an offer of a government guaranteed bank credit to buy basic commodities. The maturity offered was about three years and the amount involved "substantial." He could not reveal the name of the country involved but I took it to be the U.S., nor did he know to which Romanian institution the offer had been addressed. He said that margins on such loans were typically "razor thin."

Mr. Pelletier said that Barclay's Bank (as international agent) was currently distributing the 1984 Economic Memorandum to all signatory banks to the rescheduling agreements. They were also circulating copies of the Fund staff reports of August and December 1983--the latter including the letter of intent. He said this was in line with the "Information Covenants" of the 1983 rescheduling agreement and was also intended to explain to creditors the reasons for the cancellation of the stand-by.

Mr. Pelletier is sending me a copy of the 1984 Economic Memorandum.

J. Prust

cc: Mr. Brehmer
Mr. Hole
Mr. Reitmaier
Mr. Thomsen

Mr. [illegible], This is the [illegible] information we have [illegible] Mrs. Burke [illegible] got in [illegible] promised to check [illegible] and [illegible]
[illegible]

INTERNATIONAL MONETARY FUND

12/vi

TO : Mr Whittome Thanks cc: PGH

FROM: Peter Hole

Romania

You may be interested in the first paragraph of the attached note.

One can only speculate on whether the timing of the offer was too close to the COMECON summit, or whether there is a blanket veto on dealings with banks.

PH

Mr. Hole

Office Memorandum

MEMORANDUM FOR FILES June 11, 1984

Subject: Telephone Call from Mr. Pelletier, Manufacturer's Hanover Trust, June 7, 1984

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Mr. Pelletier is sending me a copy of the 1984 Economic Memorandum.

J. Prust

cc: Mr. Brehmer
Mr. Hole
Mr. Reitmaier
Mr. Thomsen

APR 20 1984

Dear Mr. Dumitrescu:

On behalf of the Executive Board and staff, I wish to welcome you into the International Monetary Fund as Alternate Governor for Romania.

Sincerely yours,

William B. Dale
Acting Managing Director

Honorable Florea Dumitrescu
Alternate Governor of the International
Monetary Fund for Romania
Banca Nationala a Republicii
Socialiste Romania
Bucharest, Romania

CC: MD
DMD
MR. POLAK
EHR
SEC
MR. COLLINS

MDennison:mc
April 19/84

cc: EB
EED

Mr. Polak April 19, 1984

The Secretary

<u>Alternate Governor of the Fund for Romania</u>

This will acknowledge and thank you for your memorandum dated April 18, 1984 advising the Fund of the appointment of Mr. Florea Dumitrescu, Governor of the Banca Nationala a Republicii Socialiste Romania, as Alternate Governor of the International Monetary Fund for Romania.

CC: MD
DMD
MR. POLAK
EUR
~~SEC~~
MR. COLLINS

MDennison:mc
April 19/84

IMF OFFICIAL CABLE

RCV: @1IM/1.04775 LINE: 1

RECEIVED
IMF CABLE ROOM

0744 EST
440385 FUND UI

605420

1984 APR 19 AM 8:12

QSW71 IN 19/07:41 OUT 19/07:43

ORIG: MR. WHITTOME
CC: MR. HOLE

21627 CENBNK CE

cc: PCH

APRIL 19, 1984

EUROPEAN DEPT.,
INTERFUND

'N : WHITTOME/HOLE

LETTER RECEIVED TODAY DATED 21 MARCH FROM DR.BETHKENHAGEN OF DEUTSCHES INSTITUT FUR WIRTSCHAFTSFORSRHUNG IN BERLIN REQUESTING MEETING APRILH24 IN FUND WITH STAXF?RESPONSIBLE FOR HUNGARY, ROMANIA AND POLAND. HAVE TELEXED HIM TO?CONTACT EUR DIRECTLY.

BEST REGARDY,

MOUNTFORD

21627 CENBN? CE

4?0385 FUND UI

TIME: 07:47 04/19/84 EST
CONNECT TIME : 93 SECONDS

CS

4880

Office Memorandum

INTERNATIONAL MONETARY FUND

488071

TO : The Secretary 1984 APR 19 PM 12:35 DATE: April 18, 1984

FROM : J. J. Polak OFFICE OF THE SECRETARY

SUBJECT : Change of Governor of the National Bank

The Romanian authorities have requested me to notify the management of the Fund of the following change in their government:

Since March 16, 1984 Mr. Florea Dumitrescu became Governor of the National Bank , replacing Mr. Rauta. Accordingly Mr. Dumitrescu will now become the Alternate Governor for the Fund.

ORIG: SEC (MRS. LONG)
CC: MD
DMD
MR. POLAK
EUR
SEC
MRS. DJEDDAOUI
INST
MR. COLLINS

RECEIVED INTERNATIONAL MONETARY FUND
1984 APR 19 PM 2:51
COMMUNICATIONS DIVISION

Office Memorandum

April 13, 1984

MEMORANDUM FOR FILES

Subject: Romania

Minister Gigea asked me to meet with him this morning. He said that the consultation mission was very welcome and he said that if they wished to meet with other enterprises or banks he would be pleased to arrange it. I said that I thought it would be useful if this idea was taken up.

He then said that he would be attending a meeting in Paris on May 3 to be held in the Bankers Club at the Rue Lafayette due to begin at 1700 hours. He would much like a French speaking Fund representative who could play the same role as Mr. Brehmer played in New York. Having talked with Mr. Brehmer I wonder whether Mr. Prust should not be given this task.

Lastly he raised the question of Romanian staff members and I said that Mr. Brehmer would always be pleased to interview suitable candidates and describe the sort of qualifications that we would be looking for. Gigea said that Gheorghe Grigorescu, presently attending Institute Course 1984-VI would be one of the candidates. I said that we would interview him while he was in Washington.

L.A. Whittome

cc: Mr. Brehmer
Mr. Hole

Mr. Whittome

cc: EB

Office Memorandum

cc: [illegible]

HBJ

TJB

TO: Mr. Whittome

April 11, 1984

FROM: Ekhard Brehmer EB 4/11

SUBJECT: Romania - Working Luncheon with Manufacturers Hanover Trust Co.

On April 10 Mr. Prust and I attended a luncheon given by the President of Manufacturers Hanover Trust Co, Mr. Taylor, in honor of Minister Gigea. I attach a list of those who attended.

In his long tour d'horizon, Mr. Gigea gave a rather rosy picture of recent developments and immediate prospects. He asked banks to "show understanding for, and to cooperate with, Romania" but remained vague as to what he actually wanted them to do. He noted that Romania was still in a "quarantine" period as far as access to new credit was concerned. The Minister confirmed that Romania does not intend to enter into a new stand-by arrangement with the Fund in 1984. Any new arrangement eventually agreed at a later stage should, in his view, be for a shorter period and a smaller amount than its predecessor. The Minister stressed Romania's intention to maintain close contacts with the Fund.

Mr. Taylor invited me to say a few words about the Romanian situation. I recalled that the last stand-by arrangement, which was cancelled on January 31, 1984 (with SDR 285 million undrawn), was successful insofar as it helped bring about (1) a solution of the arrears problem; (2) debt rescheduling agreements with banks and governments; (3) an impressive transformation of the convertible current account position into large surplus; and (4) significant structural price reform measures, which I briefly explained. I also drew attention to the fact that the large improvement of the convertible current account position was due to drastic cuts in imports through 1983 which were prompted by falling convertible exports and was viewed by the IMF staff as an obstacle to satisfactory economic growth. In order to re-establish export growth Romania needs a recovery of imports and in this connection additional import financing would be helpful. I pointed out that the cancellation of the recent stand-by arrangement should not be taken as a bad sign. Despite this cancellation and the absence of any negotiations for a new arrangement, the Fund staff will remain in contact with the Romanian authorities. One contact would be in the form of the forthcoming Article IV consultation. The tasks for the immediate future for the Fund staff include an assessment of short- and medium-term prospects, the sustainability of the external position, and the effects of the recent structural price reform measures.

The ensuing discussion was brief. Mr. Clark (Citibank) said that, according to his experience, cancellation of a Fund program normally indicated a major problem; Romania should come to an agreement on a new arrangement as soon as possible. The Minister invited me to answer by saying "audiatur et altera pars." I explained that the main reason for the cancellation was that more time was needed to study the effects of the structural price reform measures before Romania could formulate new measures. I said that in any new negotiations, if they were to take place, the question of need and burden sharing with the banks would unavoidably be raised.

Following the luncheon, Mr. Pelletier (Vice President in charge of Romania, etc.) told us that the banking community, at least in New York, is still showing a very reserved attitude vis-à-vis Romania. (This contrasts with more upbeat statements that he made to Mr. Prust about a month ago). However, several European banks have reopened very modest credit lines for Romania in the first quarter of 1984. Mr. Pelletier was in Romania last week and had two things to report. First was a request by the Deputy Chairman of the Romanian Bank for Foreign Trade for a so-called "club" loan of medium size (perhaps about US$150 million and involving seven or eight banks). This request was made only to a representative of Barclays Bank and not mentioned directly to Mr. Pelletier, which he found surprising, as well as the fact that it had not come from Mr. Eremia, the Bank's Chairman. Mr. Pelletier thought that the indirect method of approach reflected the reluctance of Romanian officials to be seen to be breaching the continuing prohibition by the political leadership of large new foreign borrowing.

The second aspect of Mr. Pelletier's Bucharest visit was that the Romanians had refused to provide more than the briefest statement to the rescheduling agent (Barclays) or the reasons for cancellation of the Fund stand-by arrangement. The intention was to circulate such a statement to all the banks involved in the reschedulings. Pressures on them to come up with something better were continuing. This attitude on the part of the Romanians was unhelpful and compounded a communication problem. Many banks do not understand, and had in fact misinterpreted, the reasons for the cancellation of the stand-by arrangement. A contributing factor had been some inaccurate reporting in the Wall Street Journal. In particular, he thought that there was little appreciation by bankers of the difficulty Romania could have in establishing balance of payments need for future stand-by arrangements with the Fund. Mr. Pelletier wondered whether there was not something more that the Fund could do in "selling" the cancellation to the banking community. I did not hold out any hope that there was.

I dont see anything that we can do which is not likely to lead to yet more difficulties & misunderstandings

Attachment

cc: Mr. Hole
Mr. Prust

[initials]

April 10, 1984; 12:00 noon

270 Park Avenue, 50th Floor

Luncheon for Mr. Petre Gigea, Minister of Finance of the Socialist Republic of Romania

Attendance List

Minister Gigea
Hon. Mircea Malitza, Ambassador of Romania to the United States
Nicolae Eremia, Chairman of the Romanian Bank for Foreign Trade (RBFT)
ader Rapanu, Commercial Counselor, Embassy of Romania
Sergiu Contineanu, RBFT N.Y. Rep.
Vladimir Soare, U.S. Area Manager, RBFT

Chase Manhattan Bank:	John Minneman, Vice President
Chemical Bank:	Paul McCarthy, Vice President
Citibank:	George J. Clark, Executive Vice President
European American Bank:	Michael Rassman, Executive Vice President
EXIM Bank:	Thomas E. Moran, Vice President
International Monetary Fund:	E.O.C. Brehmer, Assistant Director James Prust, Senior Economist
Irving Trust Company:	Hunter Brown, Vice President
Marine Midland Bank:	Thomas Donovan, Sr. Executive Vice President
rgan Guaranty Trust Co.:	Charles Stanton, Vice President
Manufacturers Hanover Trust Co.:	Harry Taylor, President, MHC Bruce F. Henderson, Senior Vice President and Deputy General Manager Fulvio V. Dobrich, Senior Vice President Stephen Pelletier, Vice President

cc: Pl copy to HBT

INTERNATIONAL MONETARY FUND 2 JB

April 2, 1984

Mr. Whittome:

I attach for your information a summary of the mission's findings regarding the working of the Romanian economic system. I have also sent a copy to Mr. Polak, who showed great interest in this matter. I find this preferable to giving him the minutes.

cc: Mr. Hole cc: EB

Why do you have to give either?

4/2

E. Brehmer Br 4/2

CONTAINS CONFIDENTIAL
INFORMATION

Romania - Study of Economic Mechanism

April 2, 1984

(Staff visit: February 22 to March 2, 1984)

I. Introduction

This will ? be dynamite for an [illegible] ED in the future.

A staff team consisting of Messrs. Brehmer, Prust, Reitmaier (all EUR), Ms. Puckahtikom (ETR), and Miss Windsor (RES) as secretary, visited Romania from February 22 to March 2, 1984. This visit was the first of its kind to improve the staff's understanding of the working of the Romanian economic system with particular reference to its responsiveness to the recent structural price reform measures, especially the devaluations. The staff team talked to a number of large enterprises engaged in different sectors (tractor production, machine building, garments, tourism, and wine); to several of the relevant "centrals," namely the organizations bearing supervisory reponsibility for the branches in question; to specialized ministries and foreign trade enterprises; and to representatives of the Ministry of Foreign Trade, the State Planning Committee, the State Committee for Prices and the Ministry of Finance. The production firms visited had a large export surplus and they therefore did not constitue a ~~fully~~ representative sample of firms. The following four chapters summarize the results of the discussions.

The first impression of the mission was that an exchange rate change could be effective even in a system of planning practiced by Romania. However, its effects are likely to be noticeably more circumscribed as a result of various obstacles than in other types of economies. In addition, several questions remained unanswered concerning, inter alia, the use and role of profits, investment planning and financing, the role of interest rates and of taxation. A lack of statistical information also makes it difficult to come to firmer conclusions at this stage. Future missions to Romania will explore these questions further.

II. The Establishment, Adjustment, and Execution of Plan Targets

Plan targets are set annually. Some interviewees mentioned the existence of complementary plans on a quarterly and monthly basis and this probably represents a general practice. Annual plans are part of the five-year planning process. However, the representatives of the State Planning Committee said that there is now a tendency to plan targets for shorter periods ahead and that a more flexible approach to planning than in the past has been adopted designed particularly to take account of the needs of the foreign trading sector. There has also been an increased use of indicators and targets in current prices in the recent past. Normally, plans incorporate some reserves of raw materials and spare capacity.

The annual plan, on the evidence of most enterprises interviewed, has four common elements. These are: (1) an economic plan which in some cases includes only volumetric targets but in several cases also value targets; (2) a financial plan, expressed in current lei values, in which profit targets, the most important indicator of the plan, are derived from revenue and expenditure projections; (3) an investment plan, covering new and replacement investment; and (4) a labor force plan, covering employment and earnings.

Some enterprises described the foreign trade plan (notably for exports) as a component of the economic plan; others referred to it as being in a category by itself. Foreign trade targets are specified for both exports (i.e., floors) and imports (i.e., ceilings) at the national level and all the way down to the individual production units. Most enterprises said that their trade targets were specified both in foreign and domestic currency. They also said there were separate targets for convertible and nonconvertible trade which were expressed in U.S. dollars and rubles, respectively. However, one enterprise (the wine producers) said that it had only a single export target expressed in lei. The exchange rate used in formulating the local currency targets is not necessarily that in force during the plan period, but may be the rate prevailing on some previous date. For instance, the exchange rate underlying the 1984 plan, pending possible revisions, is the commecial exchange rate in effect on December 31, 1983. Although there are separate targets for imports and exports, the representatives of the Ministry of Foreign Trade said that, at least in the recent past, the ability of branches, enterprises, etc., to import the planned amounts was dependent on their achieving their own export targets. Exports are thus viewed as a financing item for imports rather than as an independent variable.

Interviewees spoke variously of June and September as the months in which discussions concerning the plan for the following year started. Almost all emphasized that planning proposals emanated from the enterprises rather than the reverse. From there they worked upward via the special ministries (which aggregate the proposals) to the state planning authorities for final approval, ultimately by the Grand National Assembly.

Regarding the adaptation of the plan to changing circumstances, the general principle is that any entity may only modify plan targets for itself and for subordinate bodies on condition that its own aggregate ("synthetic") targets are not modified. For example, a ministry may revise targets for centrals under its control as long as performance for the Ministry as a whole remains in accordance with the plan. If the latter condition were not to hold, approval for any plan revisions would need to be sought from higher authorities. This would be granted only if justified by "objective" factors, e.g., a drought in agriculture.

Most interviewees cited the following as possible (but not mutually exclusive) responses to an unexpected rise in demand for exports: first, to raise productivity; second, to raise output by such means as working extra shifts; and third, to reduce supplies to the domestic market. The latter, however, was subject to discussion between the various bodies concerned and for essential items minimum supplies had to be guaranteed to the domestic market thereby, other things being equal, imposing an upper limit on what could be exported. To shift supplies from the domestic to the export market the tractor company interviewed said that it could modify the schedule for delivery of tractors domestically in agreement with the Ministry of Agriculture in light of higher export demand. Interviewees in the textile sector said that where increased output required increased imported inputs, the latter could be obtained through a revision of the import program or, alternatively, through increased use of "lohn" operations whereby a foreign buyer provided the raw materials for processing in Romania.

i.e., to market or divert output ?

Regarding the effects of a shortfall in export demand from planned targets, there was apparently only limited use of price reductions to enhance competitiveness and sales. Only the textile and tourist sectors mentioned this as a possible response. Any price cutting was subject to the constraint that sales remain profitable. While an unexpected slack in export demand could lead to higher domestic sales, there was no automaticity in this reaction.

The impressions gained by the mission on the effects of a shortfall from targets for foreign trade were perhaps distorted by the fact that all enterprises interviewed had substantial exports, which had generally grown satisfactorily in recent years, and a substantial surplus on external trade; their direct import expenditures were also very low. A different impression might have been gained from enterprises whose trading position was less favorable. An important point for further investigation is the following: if enterprises are effectively bound by trade balance targets and if imports are needed in export production, how is it possible to avoid a cumulative contraction of trade following an initial downturn in export sales?

There was some discussion of the question of how damaging the recent compression of imports had been to the level of domestic and export production. The answer officially provided by the Ministry of Foreign Trade was that the effect of declining imports was offset by intensified import substitution. However, the scale of the decline in imports has been such that this is unlikely to be the whole story, and this impression was partially confirmed by statements of officials from the State Planning Committee.

The mission had only rather brief discussions of investment planning. Representatives of the State Planning Committee said that investment projects were selected on the basis of social need. They also had to be efficient. There was insufficient time to explore the operational meaning of these two terms. Investment in projects with a substantial foreign trade component is appraised using shadow prices (world prices) as well as domestic prices. These two techniques sometimes produced different answers, in which case final decisions are made in light of other judgmental factors.

III. Foreign Trade--Transactions and Pricing

Foreign trade transactions are conducted exclusively by foreign trade enterprises (FTEs). The relative foreign exchange receipts and payments for foreign trade of the FTEs are effected through the Bank of Foreign Trade and converted to or from local currency at the commercial exchange rate. FTEs normally act as agents of the producing enterprises or in some cases on their own account. The trading and financial arrangements between the FTEs and the producing enterprises appear to depend on the nature of the activities and could vary among sectors. For instance, in the agricultural sector, FTEs act mainly as agents, except in a small area involving exports of bulk commodities such as wheat, where the relevant FTE acts on its own account. For the tourism sector, only one FTE is authorized to negotiate group contracts with foreign tourists on its own account. On the other hand, imports of the tourist sector fall under the quota of the Ministry of Tourism and are carried out by various specialized FTEs which also import for other sectors.

Export prices of the FTEs are normally those set in the world market and are little influenced by the FTEs' actions, suggesting that Romanian enterprises act usually as pricetakers in world markets. Exporting by FTEs can only be undertaken at prices that permit a profit. Only the tourism and textile sectors mentioned a lowering of foreign prices as a means to gain a competitive edge.

Pricing arrangements between the FTEs and producing units seem fairly straight-forward. When the FTEs act as agents, the price received by the export producing enterprise is the foreign currency price of the exported good converted to lei at the commercial rate, less the FTE's commission. The price paid for imported goods by the producing enterprise to an importing FTE is normally the local currency equivalent of the foreign price (also converted at the commercial exchange rate) plus the FTE's commission. Under this type of arrangement, fluctuations in foreign currency prices and variations in the exchange rate would be directly, if not immediately, felt by the importing and exporting units.

In the tourism sector, and presumably in other areas where the FTEs act on their own account, the internal pricing arrangements appear more complex. As explained by the representatives for the tourism sector, the financial contract between the FTE and the individual producing enterprise is concluded annually in terms of lei, and specifies, among other things, the export volume (in this case, the number of tourist arrivals), and the fee structure that the FTE agrees to pay for the services of the producing enterprise. The contract is based on certain price and exchange rate assumptions which may not materialize. Any gain or loss resulting from the invalidation of the assumptions would, in the first place, affect only the FTE and not the individual producing enterprise. The degree and the speed of the price pass-through to the producing enterprises may not be uniform, and could depend on noneconomic factors. For the tourism sector, the producing units eventually were granted a 10 percent increase in their fee schedule following the 1983 devaluation, which was partially intended to cover the rise in the cost of their imports.

IV. Effectiveness of Devaluation

Even though the effects of devaluation cannot yet be measured, the general impression is that devaluation could be effective in the Romanian system of planning. This impression could have been influenced by the fact that the interprises visited are substantial net exporters. However, all enterprises interviewed also indicated that the devaluation has been but one of a number of factors that have assisted their performance. These other factors include productivity-raising measures, improvement in product quality, and introduction of new products. High export prices in relation to comparable domestic prices also provide a powerful incentive to exporters. Regarding export supply response in the short-term, only one sector (tourism) suggested that a devaluation could immediately raise export volume. Other producing sectors indicated that the stimulus to export volume from a devaluation would only be felt after a lag, i.e., after the devaluation-induced profits had been used to finance investment in new capacity and product development. Reflecting all these factors, the full effects of the recent devaluations cannot be quantified at this stage, although reportedly non-oil exports showed year-on-year increases in the last two months of 1983 and in January 1984 when they rose by 3 percent to 4 percent.

The overall effects of the devaluation are likely to be more limited than in market economies for three main reasons. First, the system of price determination does not appear to be sufficiently flexible, thus preventing a full-fledged adjustment in the level and structure of domestic prices designed to induce the intended shift in resources. Second, there are no assurances that offsetting domestic measures would not be introduced, which would dilute the effectiveness of the devaluation that might have been achieved so far. Finally, certain features built into the Romanian economic system appear to constitute an obstacle to fully attaining the intended effects of the devaluation. These three aspects are discussed in more detail below.

In 1982 the price equalization system was abolished which shielded Romania from price fluctuations abroad. Since then, FTEs and producing enterprises have, on the whole, obtained local currency prices on direct exports and paid at world prices converted at the commercial exchange rate for imports. The devaluations in 1983 and January 1984 have therefore been accompanied by corresponding increases in prices in local currency terms. But this response appears to have been confined to direct foreign trade transactions, and it seems that a further pass-through of price increases to the rest of the economy has not occurred and may not occur in reasonable time. Firm conclusions are not possible at this stage, as detailed price statistics have not yet been made available to the staff, and also because the discussion of this subject was often not clear. Nonetheless, there are indications that as a matter of policy adopted in 1983, domestic sale prices of exportables have not generally been raised, supply prices of intermediate inputs to the tradeable sectors have not been adjusted, and final domestic prices of importables have, with few exceptions, remained unchanged.

The Romanian authorities considered both undesirable and avoidable a general upward adjustment in the price structure at this time. They emphasized that substantial price adjustments already took place in 1981-82, and the standard of living of the population has been so adversely affected that similar substantial price adjustments could not be allowed. Indeed, one of the plan targets for 1984 is to limit inflation to a rate of only about 1 percent. Despite the pressures stemming from the devaluations, further price increases are nonetheless considered avoidable for several reasons. The reason most often cited is that devaluation-related cost increases should and could be absorbed by improved productivity; for 1984, the plan target is to reduce unit costs by 5-6 percentage points. Significant labor productivity measures have already been taken with the result of considerable shifts of workers to new jobs; increased emphasis is being placed on job training. Moreover, for certain sectors, there is scope for a further reduction in profit margins. Unprofitable activities are being phased out or redesigned. Finally, for firms supplying essential goods in the domestic markets, certain tax relief is available, thus obviating the need to raise prices.

Another question that remains unanswered concerns the possibility of the authorities introducing new measures to offset the spontaneous effects of the devaluation. For example, discretionary changes in taxation could be effected to "shave off" extra profits earned by enterprises as a result of the devaluation with a view to ensuring "normal" profits in the particular economic sector; the apparent benefit from higher profits could be counteracted by a reduced provision of investment financing from other sources, i.e., the budget and the banking system. The depreciation of January 1984 (which has not been taken into account in the original 1984 plan) as well as other changes in the exogenous assumptions would lead, according to the Romanian authorities, to some modification of the plan targets and indicators, e.g., for investment and costs. However, without details of the modifications under consideration, at this stage one could merely speculate on the direction and importance of their overall impact on the tradeable sector.

There is also need to explore the extent to which the existing economic system could already hinder the effectiveness of the devaluation. On first impression, there are several weak areas that should be further examined. First, under the planning system, with rigid plan targets for both export and domestic sales, the export sector may not have full flexibility in responding to the devaluations. Despite added incentives for export sales, firms may not have adequate scope in shifting sales from the domestic market to exports, as the domestic market must be guaranteed certain minimum supplies of essential commodities. Thus, in these instances increased export sales must come from additional production. The latter is in turn limited by the degree of unused capacity, unless the plan indicators are revised accordingly to provide for a higher level of inputs and expanded capacity. Second, under the taxation system, there appears to be bias against enterprises/sectors that are relatively more profitable, e.g., the export sector after a devaluation. In particular, the rates of net production tax vary among enterprises and by producers, and appear to be inversely dependent on profitability. This progressive tax structure could reduce the incentives to export that are intended by a devaluation, and also artificially maintain uneconomic activities. Finally, under the system of centralized economic management, there could be undue lags and uncertainties affecting decisionmaking. For producing enterpises, of particular concern are the decision lags in obtaining approval for the use of added profit for investment.

V. Profits, Taxation and the Financing of Investment

Among the most important indicators of an enterprise's performance is its profitability. Profits play a growing role as a source of investment financing, and financial rewards to workers and management are to some extent linked to actual profits relative to the target level specified in the financial plan of the enterprise. 1/ With direct subsidies to enterprises now much reduced, the avoidance of losses has become important for the survival of an enterprise--or at least the group of enterprises which form an industrial "central." But it should be recalled that the authorities retain indirect control over enterprises' financial results through various means, including their control over input and output prices.

The information given on the use of profits remained unclear in some important respects. The Romanian representatives stated that

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1/ Different accounts were given of the importance of this linkage: some enterprises said that up to 50 percent of any excess of profits over plan targets could be devoted to staff bonuses while others mentioned much lower percentages.

Surely this must be a nonsense figure for a society that has as its basic principle a narrow range of money incomes plus largely frozen differentials.

profits are normally devoted to (a) payment of the net production tax (where applicable), (b) profit transfers to the budget, (c) financing of investment and working capital, (d) payment of individual staff bonuses, and (e) general benefits to the labor force (e.g., housing, health care, training). In particular, the determinants of enterprise transfers to the budget and the development of such transfers over time needs to be explored further.

The net production tax, although paid out of profits, is not a profit tax, but rather has as its base the value of net production, defined as the difference between gross production and material expenditure (presumably including depreciation). Net production, therefore, comprises the salary fund, taxes on the salary fund, 1/ interest payments, and profits, thus resembling the concept of value-added in SNA terminology.

Differing rates of net production tax apply to different industrial branches, each organized under the supervision of an industrial ministry. In 1983, tax rates for industrial branches ranged from 10 percent of net production value for the metallurgical industry to 31 percent for the chemical industry; the energy sector as well as non-productive services are exempt from net production tax. Within an industrial branch the overall tax liability (established on the basis of net production and the applicable tax rate) is distributed down to centrals, enterprises, and even individual products, apparently to a large extent on the basis

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1/ Taxes on the salary fund consist of an income tax of usually 16 percent (in the case of one enterprise interviewed, 15.5 percent) and social security contributions of a further 16 percent. After this deduction of tax at source, there is no further direct taxation of labor income derived from the socialist sector. Personal incomes in the nonsocialist sector are subject to a progressive income tax.

of profitability. Thus, at the same level of net production, a highly profitable enterprise would tend to pay net production tax at a higher rate than a less profitable one; furthermore, each enterprise's final tax liability would also depend on the urgency of other claims on its profits, especially the need for investment funds. The industrial centrals appear to have wide discretion in assessing the tax to the enterprises under their authority, subject to the requirement that the overall tax liability of the industrial branch (ministry) is met. The representatives of the textile sector made reference to enterprises with low profitability being subject to a zero rate of net production tax, compared with a rate of 25 percent for the Ministry of Light Industry as a whole, which supervises the textile sector.

There appears to be an inconsistency between the stated net production tax expressed as a percentage of net production (e.g., 16 percent for an enterprise of the machine building industry) and the stated share of the same tax in profits (e.g., 13 percent for the same enterprise). Given the usually high weight of the salary fund (labor cost) in the value of net production, a tax of 16 percent on net production, would naturally absorb a share of profits far in excess of 16 percent. Quite apart from this problem, the taxes on the salary fund and on net production overlap to a large extent, with the salary fund (and the taxes imposed on it) representing the main part of net production itself.

The determinants of profit transfers from enterprises to the budget were even less transparent than those of the net production tax. The rate of such transfers has changed substantially in the last decade or so. While in the early 1970s it amounted to no less than 30 percent of profits, this rate fell to a minimum of 10 percent now. Profit transfers to the budget have, in part, the character of repayments of budget funds received earlier for investment purposes. However, there appears to be no formal rule requiring the repayment of such funds similar to the repayment of a bank loan. It remains to be seen whether the recent introduction of an interest-like capital charge on new budget financing of enterprise investment will ensure a treatment of such funds more closely resembling banking practice. Other profit transfers to the budget seem to represent a residual after other legitimate profit uses have been met. The whole subject of enterprise payments to the budget, including the net production tax, needs to be clarified further.

In the case of deviations of actual from planned profits, the transfers to the budget were explained to serve a buffer function, absorbing a relatively higher share of "overplan" profits but also suffering disproportionate declines in case of a profit shortfall. However, this latter statement appears to be contradicted by the assertion that payment of the net production tax, has first claim on the enterprise's profits.

The importance of profits for the ability to justify and finance investment projects was emphasized by all Romanian representatives. In some cases, up to 50 percent of profits are available for investment purposes. The aim pursued by many enterprises, and achieved by some, is to generate as far as possible enough profits to meet their normal investment needs and to rely for this purpose as little as possible on bank credit or budget funds. 1/ One enterprise said that it followed a

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1/ Independently of the source of financing, investment projects of all types need to be approved within the framework of the investment plan.

policy of taking out only short-term bank credit in order to bridge financial requirements which temporarily exceeded its self-financing capabilities. Other enterprises rely on bank credit as a normal source of investment funds.

Depreciation funds are the financial source for most routine investment including the gradual modernization of plant and equipment. Depreciation funds are accumulated by enterprises in their own accounts with the Investment Bank in accordance with prescribed depreciation schedules. The accumulation of depreciation funds for a capital good ends with its complete writedown.

While emphasizing their policy of self-financing investment, most enterprise representatives also mentioned that truly large investment projects, including the creation of new enterprises, were, as a matter of course, financed from the budget. It was not apparent, where the line between small and large projects was drawn. For this and other reasons, the financial relationship between the state and enterprises in the area of investment financing (including the effect of the newly introduced capital charge) as well as the effect of recent interest rate increases would require further investigation.

Mr. Brehmer March 28, 1984

L.A. Whittome

Romania

Have you told Treasurer's that we now don't expect to negotiate a new stand-by in 1984?

cc: Mr. Hole

Mr. Brehmer March 21, 1984

L.A. Whittome

Romania

Thank you for your "thinking aloud" note on Romania. Please copy it to all those concerned with Eastern Europe and in particular to Mrs. Junz and Messrs. Hole and Boorman.

I agree that we can always justify "need" if we wish to. The question is should we wish to? Several of the lines of argument you put forward could be applied with equal force to Brazil, Nigeria, etc., etc., and we should think twice (at least) before using them. As for building-up reserves we are caught with the awkward precedent of Hungary but I guess in neither of these two countries is it a really valid argument. Both economies are subject still to such a variety of controls that they can continue (as they have for many years in the past) to live with what for other types of economy would be very low levels of reserves. Perhaps we can argue that Hungary is really loosening up its system to a degree that Romania is not even contemplating but I wonder whether that is really correct.

As regards the changes you suggest (prices etc.) I would suspect you have identified one main problem area and it is possible for us to believe that a freezing up would not violate the basic tenets of socialism. The trouble is that the Romanians might not agree. I am sure that the short complete paragraph on page 8 is accurate and I suspect that it would still be accurate if you were to drop such words as, for instance, "fully".

This leads me to wonder how realistic it is to expect meaningful changes in the field of price setting. I presume that it is price controls that are the main instrument and that price subsidies via the budget play a relatively minor role. Can the Romanian system absorb any real degree of price freedom? What would we expect the results to be on the price index? (surely calamitous). If a move were made in this direction would not drastic action (even a monetary reform?) have to be taken to absorb surplus liquidity? etc.

As to the suggestion that we pin ourselves to performance clauses or exports I see its attraction and JJP has talked around the point with me before. But we shall need ex-ante to know a lot more about the way in which Romanian export prices are set, and about the present position as regards dumping. We shall also need to be unusually accurate in estimating the growth of Romania's market for the particular commodities that Romania exports. But I agree that we should contemplate moving in this direction unless someone has a better idea--in a field where any ideas seem sparse.

cc: Mrs. Junz
Mr. Boorman
Mr. Hole

INFORMATION COPY

INTERNATIONAL MONETARY FUND

Mr. Whittome:

Attached is the paper on Romania you requested last week. It is now superseded by events. But it may prove useful should the Romanians change their mind.

E. Brehmer EBr 3/20/84

Mr. Whittome

DRAFT/EBrehmer
3/20/84:7

Romania - Possible Stand-By Arrangement for 1984-85

1. Introduction

To come to a final position on important issues related to a new stand-by arrangement for part of 1984 and part or all of 1985 is made difficult by the fact that the staff does not have the basic information to determine the economic prospects for 1984 and 1985 and is not yet in a position to fully assess the effects of the structural price reform measures adopted under the past stand-by arrangement. A new stand-by arrangement with Romania should aim at ensuring greater viability of the balance of payments position. This objective, which was not attained under the recent arrangement, requires sustained policy actions by the authorities and should be achieved not only by re-establishing ~~sustained~~ growth of non-oil exports but also by doing everything to restore the confidence of foreign creditors.

2. The problem of need

To justify conclusion of a new stand-by arrangement with the Fund, the question whether or not Romania has a balance of payments need has to be answered first. Official 1984 forecasts of December 1983 show that Romania is now striving to attain another large convertible current account surplus (US$0.9 billion) for the third year in a row, which is designed to match approximately the envisaged large net capital outflow influenced by continued large debt amortization payments. Without further Fund drawings reserves would be largely unchanged. Thus, from a purely numerical point of view, there does not appear to be a balance of payments need for a Fund program in 1984. Since any new stand-by arrangement would run well into 1985, balance of payments prospects for that year also need to be taken into accouant. On the basis of longer-term forecasts of July 1983, the expected sharp rise in debt repayments in 1985 will lead to a fall in reserves of US$200 million to only US$500 million, although a further large convertible current account surplus is expected. Taking 1984 and 1985 together, a weak case for need can be made from a numerical point of view. But this depends very much on whether new capital inflows exceed estimates which appear to be on the somewhat pessimistic side.

The determination of need based solely on balance of payments forecasts is incomplete on two grounds. First, the forecasts do not take account of inequalities in burden sharing between the Fund and other creditors. Fund credit should be accompanied by an increase in the inflow of new capital. While a small increase is forecast from 1983 to 1984, no further increase is foreseen between 1984 and 1985 according to the longer-term forecast. Any attempt on our part to persuade the Romanians to accept new rescheduling agreements would be in conflict with Romania's repeatedly stated ~~original~~ intention not to seek further debt reschedulings and would thus be damanging to the regaining of confidence on the part of foreign creditors which seems to be slowly coming about. But the Fund could insist on the full utilization by Romania of existing credit offers abroad, which may well be higher than the forecast inflow of new credit from abroad. Second, the forecasts do not take account of the existing shortage of imported inputs essential for export production, which in itself constitutes a factor of balance of payments need.

"insist" perhaps, but could we [illegible] check

[illegible] but [illegible] of the [illegible] so [illegible] will [illegible] we have stand-bys?

All this is a fair & reasonable if we could really believe it. But we can't. [illegible]

Romania could use part of any new purchases from the Fund to finance a much greater rise in convertible imports than is officially forecast for 1984 in order to remove the shortage of imported inputs essential to the export industries. This shortage was, in the view of the staff, a serious obstacle to export growth in 1982-83. Convertible imports (including declining oil imports) are officially predicted to rise less in 1984 (6 1/2 percent) than nominal GNP (8 percent). This is expected to bring the level of imports to only US$4.9 billion, far below the previous peak in 1980 (US$8 billion) and even below the 1983 plan target (US$5 billion). To remove the supply constraint on the export side and thus to better ensure sustained growth in exports, imports could reasonably be permitted to grow at, say, twice the forecast rate in 1984 (13 percent), the extra increase adding US$300 million to the estimated 1984 import bill. Taking account of the positive effect on exports of the additional imports and the envisaged removal of important obstacles to the effectiveness of the recent devaluations (see Section 3 below), the forecast convertible current account surplus would be, say, US$150 million lower than originally forecast.

Could one not argue that there should be a net positive effect?

Second, it is also suggested that Romania use another US$150 million of the new purchases from the Fund for the twice-postponed objective of raising gross convertible reserves. Although Romania has lived with low reserves for many years, this rebuilding may be important for the strengthening of creditor confidence after the severe loss of such confidence in 1981-82 and prior to the expected sharp upturn of debt amortization payments in 1985, which on the basis of existing longer-term forecasts is envisaged to be partly financed by the afore-mentioned rundown ~~rundown~~ of reserves.

What has happened to [illegible] rebuilding?

All told, the above measures to establish viability of the balance of payments (through higher imports and reserves) could require new drawings from the Fund of approximately US$300 million (or about 50 percent of new quota). If realized, a program in this amount would bring ceteris paribus Fund holdings of lei to about 330 percent of new quota by the end of 1985.

Romania's balance of payments need would, of course, be reduced should new credits from abroad in 1984 exceed the estimated total of US$720 million. There is some likelihood for this to happen. Both from talks with Minister Gigea and commercial banks it appears that Romania's credit standing is improving slowly. Government credit lines are now open with Belgium, Canada, France, Germany, the United Kingdom, and the United States (amounting according to staff estimates to no less than US$100 million), and commercial banks also seem to look at Romania more favorably although Romania has not made any great effort to put this to a test, probably partly because of its policy of gradually reducing foreign debt. Given the uncertainty about future capital inflows, there may be a case for exploring the possibility of a stand-by arrangement in the original sense of the terms in which drawings would only be made if capital inflows and/or reserves fell short of some pre-agreed indicative targets. This might give the Romanians the assurance they need while safeguarding proper use of Fund resources.

but we could be accused of manipulated

3. Approaches to improving economic efficiency and to attain balance of payments viability

Under the Romanian system of central planning, only profitable firms are permitted to produce. But this does not necessarily mean that profitable firms are also efficient firms. This does not need to be the case as under the Romanian economic system domestic prices (which are in principle determined on a cost-plus basis) are fixed in a way which can assure profitability to firms that are inefficient but whose production is considered important. At the same time, under this system profits of efficient firms can be, and most probably are, held down so as to avoid their exceeding a "normal" level. Therefore, as long as profitability reflects only the "quirks" of the price system rather than prices based on real (international) market conditions, there is bound to be a high degree of inefficiency in the economy and the profitability under this system cannot be looked upon as a useful guideline for adjustment.

In light of this, any improvement of economic efficiency in Romania and attainment of balance of payments viability will have to rely on further structural price reform measures. Romania has already carried out significant modifications of the relative price structure in 1981-83 but not to the point of removing all the price distortions. Recently Romania has not even permitted the 1983 and January 1984 structural price reform measures to be fully reflected in an increase in domestic prices which may have created new distortions in the price structure.

The staff has very little statistical evidence of the present degree of distortion in the relative price structure and is not yet in a position to determine all the main causes of the distortions and the relative weight of these causes. Budget subsidies no longer seem to be a major cause, as they have been cut drastically in 1980-83. (There are, however, some indications of an upturn in subsidies in 1984.) But the widespread differentiation of the rates of taxation of enterprises as well as in their planned rates of profits do appear to be an important cause for price distortion. This differentiation tends to penalize products and firms with relatively high profits and favor firms and products with low profits or firms with high costs. Other price distorting factors are protectionist measures and preferential treatment of firms in the framework of price setting. The whole area of price distortions and their causes needs close examination as a precondition for the start of the negotiations of a new stand-by arrangement.

While the Fund cannot ask Romania to replace its system of centrally planned price and profit determination by a free market system, it can ask for changes in the existing system of price determination in order to make it work in a way which ensures greater economic efficiency and balance of payments viability. To this end the staff proposes (a) the removal of what it considers to be some of the main causes of price distortions; (b) the removal of the identifiable institutional obstacles to the devaluations; and (c) the full incorporation of the effects of the devaluations into the structure of domestic prices. The proposal under (c) is a sine qua non as it represents a request to the Romanian authorities to catch up with the fulfillment of their obligations under the 1983 program with the Fund rather than a new condition. Since, however, fulfillment of this condition involves a major resetting of prices in Romania and goes against the major policy objective of keeping domestic prices stable, the proposed conditionality would in fact be much more onerous to the Romanians than it might look to the staff or to the Executive Board.

a. Removal of price distortions

The Romanian authorities should be committed to reduce all budget subsidies to enterprises further; they amounted to lei 5.8 billion in the 1983 approved budget against lei 61 billion in 1980. In addition, rates for

net production tax (which in the enterprises interviewed ranged from zero to 30 percent of profits) and profit transfers to the budget (which in the firms interviewed ranged from 10 to 30 percent) should be unified. It will probably be very difficult to agree with the Romanians on the removal of protectionist measures for certain industries and preferential treatment of certain firms in the process of price determination but a reasonable objective could be the removal of deliberate biases to rates of profitability between different sectors. Whether all this could or should be done in the space of a one-year program could remain open to further review and negotiation.

b. Removal of obstacles to the effectiveness of the devaluation

It is suggested that the highest priority be given to exports by allowing shortfalls from the plan targets (for enterprises) for domestic sales in favor of exports, should foreign demand permit such a switch. Exporting firms benefiting from a devaluation should be given immediate approval for investment in new capacity, product development, and modernization once their devaluation profits are realized. They should also be assured of supplementary financing through the banks or the budget.

c. Incorporation of devaluation effects into price structure

To help enhance the effectiveness of the devaluations (and other structural price reform measures) of 1983 and January 1984, it is suggested that the effects of these measures on import costs (and other costs) be fully passed on to final prices and that the benefits of higher export prices in terms of lei, which so far were only permitted to accrue to the direct exporter, be passed on to all firms involved in the production for exports. Very rough calculations of the staff indicate that these measures would raise domestic prices by 5 percentage points, even allowing for some moderating effects on prices emanating from the Romanian rationalization measures. Part of this price adjustment should be made a precondition for the first drawing under the new stand-by arrangement.

The staff is skeptical whether Romania would allow enterprises to become financially autonomous and fully responsible for their profits. Romania is not prepared to accept progress in enhancing the freedom of decision making on the part of enterprises with respect to the setting of prices and determining investment.

4. Performance criteria

As an innovation the staff suggests a floor ~~on~~ for non-oil exports to the convertible area as quarterly performance criteria under the new stand-by arrangement. This should help prompt the Romanian authorities to give greater priority to exports. The absence of this performance criterion in the 1983 program enabled several Directors to make statements to the effect that virtually all performance criteria had been met, thereby giving the wrong impression that Romania performed well in the field of foreign trade. The new performance criterion may also prevent Romania from cutting imports too drastically, thereby hampering the growth of exports. Failure to meet the export targets should trigger a review about the possible remedial action. The staff is aware that imposition of an export target might induce Romania to resort to increased counter trade measures or to dumping. However, on balance, the staff could prefer a quantified export target as a performance criterion rather than a more vaguely constructed review clause on export performance. The point would be to focus attention on exports from the start: not too much could be expected to come from a midyear review of possible remedial measures. Of course, if there were good reasons, failure to meet an export target could be subject to a waiver.

For precautionary reasons the staff suggests retaining quarterly targets for convertible trade surpluses as performance criteria.

An increase in gross international reserves in convertible currencies should be a performance criterion. The question is whether we need in this respect performance criteria or indicative targets for the quarters of the program period.

The staff suggests dropping the annual ceiling on new external debt in convertible currencies in a maturity range of one to five years, which was very generous in 1983 (US$500 million). The staff suggests that the ceiling on short-term debt in convertible currencies be retained and raised to US$600 million, although the share of short-term foreign debt in total convertible foreign debt has remained minimal in 1983.

The ceiling on net domestic assets of the banking system should be retained, although this ceiling is less important in a centrally planned system than in a free market economy.

Office Memorandum

March 19, 1984

MEMORANDUM FOR FILES

Subject: Romania

Mr. Polak phoned to say that the Romanians had formally told him that they would not wish to enter into a further stand-by with the Fund in 1984. It is possible that in the second half of 1985 they might wish for another stand-by in order to help meet heavy debt maturities which fall due around that time.

L.A. Whittome

cc: Mr. Brehmer
EED

also Mr. Polak

(done)

Office Memorandum

TO : Mr. Brehmer

DATE: March 13, 1984

FROM : L.A. Whittome

SUBJECT : Romania

I have a suspicion that the Romanians will soon again be asking under what conditions could we envisage another stand-by. Would you please let me have a brief which must cover the question of need, the approaches that might best promise an improvement in economic efficiency and a sustainable improvement in the balance of payments and also the question of performance criteria.

cc: Mr. Schmitt
Mr. Hole
Mr. Boorman

MAR 12 1984

INTERNATIONAL MONETARY FUND cc: EB FRED

March ~~10~~9, 1984

TO : THE MANAGING DIRECTOR

FROM: WILLIAM B. DALE

SUBJECT: Romania--Study of Economic Mechanism (back-to-office)

This was clearly a useful mission in the realm of understanding the workings of centrally-planned economies.

(1)

Office Memorandum

TO:	The Managing Director The Deputy Managing Director	March 8, 1984
FROM:	Ekhard Brehmer E.B. 3/8/84	
SUBJECT:	Romania - Study of Economic Mechanism	

A staff team consisting of Messrs. Prust, Reitmaier (all EUR), Mrs. Puckahtikom (ETR), Miss Windsor (RES), and myself returned this week from a 10-day visit to Romania ending March 2. This visit was the first step on our part to seek a better understanding of the working of the Romanian economic system with particular reference to its responsiveness to the recent structural price reform measures, particularly the devaluation. The mission talked to representatives of large enterprises engaged in a number of sectors (tractor production, machine building, garments, tourism, and wine); to several of the relevant "centrals," namely the organizations bearing supervisory responsibility for the branches in question; to specialized ministries and foreign trade enterprises; and to representatives of the Ministry of Foreign Trade, the State Planning Committee, the State Committee for Prices and the Ministry of Finance. Each of the production firms visited was registering a large export surplus. The sample of firms was not therefore fully representative and in particular did not include enterprises with a high import quota.

The first impression of the mission was that an exchange rate change could be effective even in the system of planning practiced in Romania. However, its effects are likely to be noticeably more circumscribed as a result of various obstacles than in other types of economy. In addition, several questions remained unanswered in the field of profit use, investment planning and financing and the role of interest rates and of taxation. A lack of statistical information also makes it difficult to come to firmer conclusions at this stage. Future missions to Romania will endeavor to explore these issues further. However, progress in this respect will remain slow given the difficulties of communication.

I informed Minister Gigea about the very preliminary findings of the mission. The Romanian representatives did not attempt to elicit from the staff team views about the possible elements of a future program with the Fund. During the final meeting Minister Gigea stated that his authorities did not at present wish to discuss a new program with the Fund but may reassess their position at a later stage partly in light of the effects of the recent measures.

In line with the request by several Executive Directors at the January 23, 1983 Board meeting, I submitted to the Romanian authorities a detailed request for additional information in the field of domestic

prices, foreign trade, and taxes and levies on enterprises. The Romanian representatives promised to respond to this request in the near future. The Director of the State Committee for Prices promised to provide in the future quarterly data on producer and consumer prices which so far have been made available only annually.

cc: Mr. Whittome
Mr. Finch
Mr. Collins
EED

—> MD 3/8

Office Memorandum

MAR 9 1984

TO: The Managing Director
The Deputy Managing Director

March 8, 1984

FROM: Ekhard Brehmer E.B. 3/8/84

SUBJECT: Romania - Study of Economic Mechanism

A staff team consisting of Messrs. Prust, Reitmaier (all EUR), Mrs. Puckahtikom (ETR), Miss Windsor (RES), and myself returned this week from a 10-day visit to Romania ending March 2. This visit was the first step on our part to seek a better understanding of the working of the Romanian economic system with particular reference to its responsiveness to the recent structural price reform measures, particularly the devaluation. The mission talked to representatives of large enterprises engaged in a number of sectors (tractor production, machine building, garments, tourism, and wine); to several of the relevant "centrals," namely the organizations bearing supervisory responsibility for the branches in question; to specialized ministries and foreign trade enterprises; and to representatives of the Ministry of Foreign Trade, the State Planning Committee, the State Committee for Prices and the Ministry of Finance. Each of the production firms visited was registering a large export surplus. The sample of firms was not therefore fully representative and in particular did not include enterprises with a high import quota.

The first impression of the mission was that an exchange rate change could be effective even in the system of planning practiced in Romania. However, its effects are likely to be noticeably more circumscribed as a result of various obstacles than in other types of economy. In addition, several questions remained unanswered in the field of profit use, investment planning and financing and the role of interest rates and of taxation. A lack of statistical information also makes it difficult to come to firmer conclusions at this stage. Future missions to Romania will endeavor to explore these issues further. However, progress in this respect will remain slow given the difficulties of communication.

I informed Minister Gigea about the very preliminary findings of the mission. The Romanian representatives did not attempt to elicit from the staff team views about the possible elements of a future program with the Fund. During the final meeting Minister Gigea stated that his authorities did not at present wish to discuss a new program with the Fund but may reassess their position at a later stage partly in light of the effects of the recent measures.

In line with the request by several Executive Directors at the January 23, 1983 Board meeting, I submitted to the Romanian authorities a detailed request for additional information in the field of domestic

prices, foreign trade, and taxes and levies on enterprises. The Romanian representatives promised to respond to this request in the near future. The Director of the State Committee for Prices promised to provide in the future quarterly data on producer and consumer prices which so far have been made available only annually.

cc: Mr. Whittome
Mr. Finch
Mr. Collins
EED

Office Memorandum

TO: The Managing Director
The Deputy Managing Director

March 8, 1984

FROM: Ekhard Brehmer E.Br 3/8/84

SUBJECT: Romania - Study of Economic Mechanism

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cc: Mr. Whittome
Mr. Finch
Mr. Collins
EED

MEMORANDUM

To: Mr. Marin

February 22, 1984

From: Ekhard Brehmer

Subject: Romania--Data Request by IMF Mission

To enable the Fund staff to analyse the effects of the structural price reform measures taken under the stand-by arrangement (concluded in mid-1981) and to improve our analysis of the Romanian economy in general, it is important that the following information be made available by the Romanian authorities as soon as possible:

1. Domestic prices

a. The producer price index and the consumer price index on a monthly basis retroactive from December 1982.

b. Quotations of domestic lei prices for important bulk products (iron ore, steel, wheat, cement, aluminium, fertilizer, cotton textiles, glass, edible oil, wine, meat, gasoline, heating oil, etc.) for January 1980 and January 1984 in order to measure the effect of the structural price reform measures on the domestic price structure. The analysis would be greatly facilitated if lei prices of representative items of manufacturing production, e.g., railroad cars, tractors, and knitwear could be included for the same dates.

c. Quotations of U.S. dollar prices applicable to Romanian trade in the commodities and manufacturing items listed under item 1.b for the same two dates in order to see the effect of the structural price reform measures on prices relative to those abroad. To make the international comparison possible, we need the representative leu/U.S. dollar export rates for these product categories for January 1980.

2. Foreign trade data

Annual data for export unit values and import unit values for non-oil trade with the convertible area, total and according to the export and import categories in Tables 8 and 9 of the 1983 Economic memorandum, retroactive from 1980 and through 1984 (forecast year). We also need to have the same commodity breakdown expressed in U.S. dollars on an annual basis for 1983 and 1984.

Starting from the first quarter of 1982, we need quarterly data for unit values and U.S. dollar values for export and imports (excluding oil), total and by main export and import categories.

3. A breakdown of industrial production for 1980 and 1983 in order to help us analyse the effect on the industrial production structure emanating from the unification of the commercial exchange rates and the devaluations. Please, also indicate which of these production categories experienced a net appreciation or a net depreciation as a result of the exchange reform measures from 1981.

4. For each of the main taxes or levies on enterprises, please provide:

a. The tax base

b. The tax rates and rates for profit transfers in effect in the years 1980-84.

MEMORANDUM FOR FILES

February 24, 1984

Subject: Conversation with Mr. Dobrescu, Director of the Department of Foreign Trade in the Ministry for Agriculture and Food Industries, on February 23, 1984 (lunch)

During the conversation the following bits of information emerged:

1. There are four foreign trade enterprises active in the agricultural sector; one (Agroexport) is directly responsible to the Ministry of Foreign Trade, while the others are subordinated to the Ministry of Agriculture and Food Industries.

2. Food is not subject to taxes at any level of production or distribution, with the only exception of wine, which is taxed, but not at the producer stage. Income from private farming is subject to a progressive income tax.

3. Depreciation charges, which are treated as costs of production, have recently been raised.

4. Profits are allocated (in unknown proportions) to (a) a fund for self-financing of new investment projects, (b) a fund for the payment of bonuses and premiums to the workforce, (c) the repayment of bank credit (this should not come out of profits, but may have been misunderstanding), and (d) a remainder which is to be transferred to the budget.

5. Every investment project must be approved within the investment plan; approval for replacement investment is typically easier to obtain than that for new investment.

6. When asked about the effect of an exchange rate depreciation, Mr. Dobrescu said that it helped exports and that this effect had been strengthened by the new incomes policy introduced in late 1983 that linked a higher proportion of earned income to the profitability of the enterprise.

Jurgen Reitmaier

cc: Mr. Brehmer
Mr. Prust
Ms. Puckahtikom

INTERNATIONAL MONETARY FUND

Romania - Fact Finding Mission

Meeting No. 1
10:30 a.m., Wednesday, February 22, 1984
Ministry of Finance
Bucharest

Romanian Representatives	Fund Representatives
Ministry of Finance	Mr. Brehmer
	Mr. Prust
Mr. Dan Stelian Marin, Director	Mr. Reitmaier
Mr. Petre Mada	Ms. Puckahtikom
Mr. Traian Munteanu, Senior Economist	
Mrs. Aura Gereanu, Senior Economist	

After opening remarks by Mr. Brehmer and Mr. Marin, the Romanian representatives presented a draft program for the staff visit. It was agreed to proceed with the visits to economic units essentially as planned, but to leave the details of the subsequent program for later discussion.

1. Request for price data

With a view to calculating changes in relative prices within Romania and vis-à-vis world markets, Mr. Brehmer asked for absolute prices for important commodities for 1980 (i.e., before the measures of the stand-by arrangement took effect) and for 1983 or, if possible, for January 1984. The Fund ought also to receive monthly statistics of consumer and wholesale prices. In addition, in order to analyze the effects of the measures taken under the recent program, Mr. Brehmer asked for time series of export and import unit values, on an annual basis broken down by main commodity groups, and, if possible, on a quarterly basis for the non-oil totals. Incidentally, this request had recently been endorsed by the whole Executive Board, including Mr. Polak. It was agreed to put the data request in writing.

2. Export procedures and export financing

During the subsequent, very preliminary discussion of these topics, the following information emerged:

a. All foreign trade is effected through foreign trade enterprises (FTEs);

b. About 70 percent of Romanian tractor production is exported, with a high proportion going to the convertible area, including the United States;

c. The Romanian Bank for Foreign Trade (RBFT) is the only government department engaged in export promotions (the meaning of this statement remained somewhat unclear). It refinances in domestic currency the medium- and long-term trade credit extended in foreign currency by FTEs. According to the interest rate schedule that came into effect on January 1, 1984, these refinancing credits carry an interest rate of 10 percent. Short-term trade credit of up to one year is extended by the producing enterprises which also carry the exchange risk for such transactions. (Producing enterprises can obtain credit for working capital purposes from the National Bank.) The foreign exchange risk for longer-term transactions is carried by the FTEs, which otherwise act only as agents between the domestic producer and the foreign customer. For its services, the FTE collects commission of between 0.5 and 3 percent of the value of exports.

d. In keeping with the role as agent, the FTE concludes contracts only with the approval of the domestic producer. As a general rule, Romanian enterprises can only begin production once sales contracts are concluded.

e. Ceilings for the refinancing of export credit are established under the quarterly credit plan which balances demand for and supply of credit in the domestic economy.

For more detailed questions on the financing of foreign trade, the mission was referred to the National Bank and the RBFT.

The meeting adjourned at 12:30 p.m.

INTERNATIONAL MONETARY FUND

Romania - Fact Finding Mission

Meeting No. 2
Thursday, February 23, 1984 at
Valea Calugareasca Wine Institute

Romanian Representatives	Fund Representatives
Mr. Dobrescu, Director Ministry of Agriculture and Food Industry Mrs. Brinzaru, Division Chief "Fruitexport" Agri-Foreign Trade Co. Mr. Mihalache, Director, Wine Institute Mr. Lazar, Deputy Director, Wine Institute Mr. Dancea, Director, State Local Inspection of Judetz Prahova Mr. Marin, Director, Ministry of Finance Mrs. Tase, Ministry of Finance Mr. Mada, Ministry of Finance	Mr. Brehmer Mr. Prust Mr. Reitmaier

The Institute has 560 hectares under cultivation of which 26 hectares are for table grapes and the rest for wine. It also produces seeding material. All red Premiat wine sold in the United States is from the Institute. Sixty percent of total production is covered by long-term contracts.

Planning

Initial proposals for plan targets come from the enterprise and take into account the area to be cultivated, investments, and past achievements, usually going back three years.

For each product--grapes, wine, and seeding materials--there are plan targets for output and exports. No distinction is made between convertible and nonconvertible exports. Output and export targets are both set in volume terms and in terms of current lei values. It was said that the greater importance was attached to meeting the value targets. Mr. Dobrescu explained that generally planning in the agricultural sector was done in two stages. Targets were set at the beginning of the year and were adjusted immediately before the start of the harvest of each crop. Only if the modifications on the latter occasion involved some deviation from the "synthetic" targets for the Ministry of Agriculture as a whole would there be any need to modify the national plan. Even these modifications would only be allowed if necessitated by unexpected developments in "objective" factors. This had been done in 1983 when the harvest was depressed by drought. It was noted that the original plans contained reserve funds which could be called upon if performance fell below original expectations. Also, the Ministry would try to compensate for any shortfall in any particular items by raising output elsewhere.

If a production shortfall required a reduction in sales compared with original targets, emphasis would normally be placed on meeting the export target except in the case of essential commodities where supply to the domestic market had to be assured.

Prices and foreign trade

The mission enquired what would be the effects of a rise in costs such as could be caused by the effects of a devaluation on the cost of imports. The answer appeared to be that domestic sales prices were preset in a rather detailed price list. In the short run at least, these could not be changed. The enterprise would, however, try to raise productivity and to shift its production mix to higher quality, higher price items (the assumption seemed to be that the latter would also be more profitable). If these moves were not enough to offset the cost increases, the latter could also be accommodated through a reduction in profits and profit transfers to the budget. Only where cost increases were very large in relation to the scope for raising productivity and/or reducing profits and profit transfers to the budget would increases in domestic sales prices be considered. Similar answers were given in response to the mission's questions about the effect of the appreciation of the exchange rate applicable to wine exports in the wake of the 1982/83 unification of the commercial rate.

Foreign trade enterprises (FTEs) acted as agents only (except in a small number of cases involving bulk items such as wheat). The producing enterprise received the full foreign currency price of an export converted to lei at the commercial rate less the FTE's commission. This had always been the practice.

The mission enquired what would be the effect of a devaluation on production and exports. The initial response appeared to be one of surprise that there should be any effect. It was said that 1984 export targets had been adjusted in value terms but not as regards volumes following the January 1, 1984 devaluation. However, further questioning led to the response that after a lag, during which enterprises realized the effect of the exchange rate change on relative profitabilities, there would be an effect on export volumes. This, however, would be qualified in certain cases by the need to maintain minimum supplies to the domestic market (the consumption fund).

No special arrangements applied for CMEA trade. Prices were subject to bargaining but in principle took account of comparable prices on world markets in the preceding 3-5 years. The rate for the transferable ruble had been set at the equivalent of lei 17.5 = US$1 on July 1, 1983 and had not been changed since.

INTERNATIONAL MONETARY FUND

Romania - Fact Finding Mission

Meeting Nos. 3 and 4
Friday, February 24, at 3 p.m. and
Saturday, February 25, 1984 at 10 a.m.
Ministry of Tourism, Poiana Brasov

Romanian Representatives

Ministry of Tourism
Mr. Nicolae Rosoga, Director
Mr. Ion Voica, Director
Mr. Mihai Badiu, General Director
"Carpati" National Tourist Office
Mr. Eugeniu Ciocalteu, Councellor
Mr. Dumitru Burtea, Deputy Director
"Carpati Brasov" National Tourist Office

Ministry of Finance
Mr. Stelian Marin, Director
Mr. Ioan Petre Mada
Mrs. Auro Gereaau, Senior Economist

Fund Representatives

Mr. Brehmer
Mr. Prust
Mr. Reitmaier
Ms. Puckahtikom

The following areas were covered: the organizational framework of tourism, the setting of plan targets, the relationship between prices negotiated abroad and domestic prices received by local producing units, the effects of devaluation, the allocation of profits and investment financing, and taxation.

Opening the meeting, Mr. Brehmer said the purpose of the mission was to assess the result of structural price reform measures undertaken in the program since 1981. The mission's knowledge about planning in tourism was sketchy, but two features of the sector had been noted. First, foreign contracts were thought to be negotiated by only the Carpati National Tourist Office, hence there was only one foreign trade enterprise. Second, there was a differential between the exchange rate applicable to the individual tourist (the non-commercial rate) and the rate applicable to organized (group) tourists (the commercial rate). At the last devaluation in January 1984, the non-commercial rate had not been allowed to depreciate along with the commercial rate as had been the case previously, and the differential between the two rates had since widened.

Organizational framework

Mr. Rosoga described the organizational framework of tourism as consisting of the Ministry of Tourism, national (i.e., regional) tourist offices, and local tourist enterprises. Only one national tourist office, the Carpati National Office, was authorized to negotiate group contracts with foreign tourists. Generally, national tourist offices (NTOs) were charged to administer fixed assets of the specific localities but were not authorized to conclude foreign tourist contracts, although they could organize trips for tourists already inside Romania for both inside and outside of Romania.

Setting plan targets

Mr. Badiu said that the planning process for tourism started at the level of local enterprises just like planning for any other sectors. For each local tourist enterprise, plannings were made under four separate chapters, incorporating various plan targets and indicators. These were:

1. Economic plan, which specifies the volume of activity, and the target receipts expressed in U.S. dollars for foreign activity, in rubles for activity vis-à-vis the socialist countries, and in lei for domestic activity. The volume would be based on factors such as the assumed level of tourist arrivals, and the estimated occupancy rate of existing capacity.

2. Financial plan, which transforms the economic targets above into lei through the appropriate exchange rate. The balance between income and expenditure yields the target plan profit, which is the main indicator of the plan.

3. Investment plan, which provides for both maintenance and replacement, and new investment requirements. These are governed by the priority of new projects and the availability of resources.

4. Utilization of labor force plan, which must be consistent with the previous three plans, and which specifies the salary fund.

All these four plans are interrelated but overall the financial plan has the overriding importance. The plans of the local tourist offices are then centralized at the level of Judetz, and the centralized draft proposals in turn are reviewed and aggregated by the Ministry of Tourism. The aggregated proposal is next proposed to the state planning office to be coordinated with plans from all other ministries, and revised for internal consistency as well as on the basis of other constraints, such as the availability of foreign resources and on the basis of any other national policy objectives. The national plan is finally translated back to the level of Judetz and to the local tourist enterprise for execution.

The financial plan has three subsections: (1) currency receipts based on foreign tourist activity, i.e., on contracts with partners abroad. This target is exclusively one of the Carpati's national tourist office, since it is uniquely allowed to conclude such contracts abroad. (2) Currency receipts based on additional local spending of foreign tourists, e.g., additional spending of organized tourists or spending of individual tourists. (3) Currency receipts from local purchases of other tourist services.

Mr. Rosoga said that as a result of this exercise, there were separate national plan targets for domestic tourism activity, international tourism activity, and total tourism activity. For 1984, for example, the plan target was to increase the volume of international tourism (in U.S. dollar terms) by 9.3 percent. (Incidentally, this planned increase figure would imply a net tourism receipt of approximately US$115 million compared with the figure of US$125 million provided earlier to the mission in January.) This target assumed: constant exchange rates, constant prices (i.e., the same volume increase as that of value), and some unquantified assessment of prospective foreign demand.

Pricing structure

Regarding the pricing and financial relationships between the NTO and the local tourist enterprises (LTEs), Mr. Badiu stated that these financial contracts were concluded annually in terms of lei, specifying a number of elements. These included the number of organized tourists that the NTO would deliver to the LTE during the year, the structure of fees that the NTO was prepared to pay the LTE for its services, and the penalties for nonfulfillment of plan targets. The fee structure distinguished between origins of tourists accrued directly to the NTO, who sold these receipts to the Bank of Foreign Trade at the prevailing commercial exchange rate. The difference between the lei receipts and the fees payable to the LTE was the profit of the NTO. NTO's receipts on this account represented 98 percent of its total receipts, with the remainder representing commitment fees applicable only to the Intercontinental Hotel in Bucharest. As a result of currency fluctuations over recent years, the NTO had not incurred any significant losses, and has concluded 1983 with a profit without any need for banking credits for the first time.

Devaluation effects

Asked about the effects of devaluations over the last 14 months on domestic pricing, Mr. Badiu said that the contracts of the NTO with the LTE were annual contracts and in principle were not revised during the year; this is in accord with the practice of not revising the plan during the year unless under very exceptional circumstances. However, in 1983, the devaluation in July had initially led to substantial cost increases (relating to the import component) for LTEs, causing them initially to cut back on staff in order to adhere to the profit targets. Under these pressures, the NTO agreed to revise the fee schedule upward by 10 percent in July 1983. Also, as a result of the devaluation, prices for associated services were raised later in the year by 30 percent. Thus it appeared that on balance local enterprises were able to benefit from the devaluation in 1983. Mr. Rosoga considered that the devaluation thus had had a positive (though indirect) effect on international tourism, and should make possible modernization and expansion of facilities.

In connection with the use of devaluation-related profits in general, Mr. Marin indicated that the Ministry of Finance was now receiving various proposals for plan modification in the use of profits and in the state budget, including the issues of the treatment of taxation, as a result of the depreciation in January 1984.

In addition to the devaluation, Mr. Rosoga continued, the profitability of local enterprises had increased in 1983 because domestic tourism had risen at a rate that more than offset the decline in foreign tourism. On the subject of the poor performance of foreign tourism in 1983, it was explained that exchange rate movements were the main contributing factor. Romania's main tourist market was European, especially Germany. With many contracts denominated in European currencies, such as the deutsche mark, receipts in terms of U.S. dollars fell as these currencies weakened against the dollar. Moreover, the decline in tourist demand owing to the world recession which began in 1982 continued through 1983. In particular, the demand from German tourists fell not only for Romania but also for virtually all of Romania's competitors for the German market, e.g., Italy, Yugoslavia, and Spain. Finally, competitiveness may also have been a factor; reportedly competitors had resorted to price cutting techniques, such as special discounts. The present plan targets were to return as soon as possible to the previous rising trend for international tourism, as well as to provide sufficient flexibility for growing domestic demand. Three specific measures to this effect were described: special measures to stimulate demand from organized tourists, special incentives given to foreign agents supplying Romania with bookings, and increased investment to expand and modernize facilities. (Mention was made of some interest by foreign companies, such as Club Med and Club Robinson to expand facilities at the Black Sea.)

Allocation of profits

Mr. Voica stated that on average 10 percent of profit represented contributions to the state budget. This rate was variable among tourist enterprises depending on the enterprise's capacity to invest and the priority of the project. The rates ranged from 0 percent to over 20 percent in some instances. Profits retained by enterprises could be used to meet investment requirement to improve and expand capacity, and an unspecified percentage could be contributed to the staff fund as an added incentive in the form of bonuses. Enterprises had discretion in their use of retained profit, although they must justify their choice, and this justification formed a part of the financial plan of the enterprise. If actual profit exceeded planned profit, enterprises could retain the excess profit if they could demonstrate that it resulted from their own effort. Such retained profit could be used for investment: if such investment was not already under existing plan, it could be deferred. In addition, up to a maximum of 50 percent of excess profit can be used for contribution to the staff fund for bonuses.

While bonuses were related mainly to the level of profit, they were also linked the the various other plan indicators such as the achievement of economic targets, the quality of services, the success in reducing expenditure, the increase in labor productivity, the maintenance of capital, etc. There was a specified weighting pattern for these various elements, although the profit level was the main factor. As a result, staff bonuses could either be positive or negative, and could differ among the individual staff members. For example, for the Carpati NTO, its major indicators were the achievement of the plan targets in U.S. dollars and in rubles, and the fulfillment of the number of Romanian tourists sent abroad.

Taxation

Aside from the profit tax described above, there is also a turnover tax at an average rate of 5 percent applicable only for catering industries. This rate is identical among enterprises. There is no net production tax.

Financing investment

Mr. Voica said once investment was approved, financing would be made available in the form of either bank credit and/or financing from the budget for fixed investment that exceeded the level which can be financed by the enterprise's own resources. Repayments of the state fund for investment began when the investment in question yielded revenue, and were made monthly into the Ministry of Finance's account. (These repayments were not to be confused with the depreciation allowances which are payable into depreciation funds accumulated within the enterprise's own account.)

Responding to the question on the constraint on the introduction in early 1984 of capital charges and the increase in interest rates, Mr. Rosoga said that the effects on the level of investment and the additional financing that might be needed remained to be seen.

Pricing policy vis-à-vis Comecon

There are separate planning targets in rubles for tourist exchange with the Comecon countries. These are on the basis of bilateral reciprocity in terms of volume and the level of tariffs. The reciprocity is not applied strictly, and transactions are negotiated under the framework of a general bilateral balance with specific countries. The exchange rate plays a more limited role in that it is used to value the physical targets.

Import requirements of the tourist sector

Mr. Voica said that all imports of the tourist sector fell under the import quota of the Ministry of Tourism. Actual importing was carried out by specialized FTEs depending on the type of commodities involved. Asked about the effects of the cutback in imports in 1982 and 1983 on the activity of the tourism sector, Mr. Rosoga said that naturally the shortage in general commodities such as energy led to a lower level of tourism operations. No other specific examples were provided, although the general indication was that the sector had not been much affected by the cutback in imports.

On the question of the effect of the differential between the commercial and non-commercial rate, the answer was ambiguous.

INTERNATIONAL MONETARY FUND

Romania - Fact Finding Mission

Meeting No. 5
Monday, February 27, 1984 at 9:20 a.m.
at the Tractor Factory, Brasov

Romanian Representatives

Ministry of Machine Building
- Central for Tractor Production
    Mr. Rizescu, Economic Director
    Mr. Ciobanu, Chief Accountant
    Mr. Mirica, Chief of Planning
    Mr. Butnariu, Chief of Pricing

- Foreign Trade Enterprises
    Mr. Francu, Deputy Director
    Mr. Dimitriu, Chief Accountant

- Tractor Plant, Brasov
    Mr. David, Technical Director

Ministry of Finance
  Mr. Stelian Marin, Director
  Mr. Ioan Petre Mada
  Mrs. Auro Gereaau, Senior Economist

Fund Representatives

Mr. Brehmer
Mr. Prust
Mr. Reitmaier
Ms. Puckahtikom

By way of introduction to the enterprise, the Romanian representatives explained that the plant belonged to a central comprising altogether 12 producing enterprises, a research division, and an FTE. This particular plant had been created in 1925 as an aircraft factory, and production of tractors had only begun in 1946. The present capacity of the plant was 80,000 tractors a year; 30 different types with various options and engines were produced. The enterprise had a labor force of 25,000. Of the total production, 82 percent was exported and 18 percent sold domestically. The principal foreign customers of the Tractor Company were Iran and the Italian Fiat Company, with which a cooperation agreement (counterpurchase contract) had been concluded. In 1983 about 62,000 tractors had been exported, of which 50,000 were sold to the convertible area. The principal domestic customer was the Ministry of Agriculture.

Mr. Brehmer gave a brief overview of the purposes of the IMF and the role the Fund had played for Romania in recent years. He then asked for a review of the planning process in a manufacturing enterprise. The Romanian representatives explained that the annual plan, which in turn was broken down into quarters and months, consisted of (1) a physical plan, which specified the number of tractors, the horsepower ratings of engines, the number of tons for castings and forgings, etc., (2) a financial or economic plan which was expressed in domestic currency, (3) an investment plan detailing the individual investment projects, and (4) a labor force plan showing the number of workers, the salary fund, average monthly earnings and productivity. In addition, there was an export plan containing export targets in physical units and in foreign currency. The formulation of the annual plan (always within the context of the five-year plan) began in September with the drawing up of an enterprise proposal. This proposal was first discussed in the executive board of the plant and then submitted to successively higher levels of authority, i.e., the central, the Ministry of Machine Building and the State Planning Committee. At each review stage, the plan would be analyzed under various aspects, e.g., the demand from the agricultural sector, what options were to be produced, what time pattern deliveries were to follow, etc. Finally, the plan would be adopted. However, the plan was not to be understood as very rigid, but rather as adaptable from period to period in response to changing circumstances.

Mr. Brehmer asked how the enterprise could react to an unexpected increase in foreign demand. The Romanian representatives explained that, while they were not allowed to have stocks on hand, they had some spare capacity. For instance, they could institute a third shift. They could also ask the Ministry of Agriculture to permit them to stretch out deliveries for domestic use. The Romanian representatives stated that in both 1982 and 1983 the respective export targets had been achieved. In response to a question, they added that production had not suffered under an import constraint. They were in general not a direct importer and had therefore not been directly affected by a curtailment of imports. An exception in the past had been their importation of an electrical component from Bosch of West Germany; when this import had to be eliminated, they had begun to produce the same component themselves.

Mr. Brehmer asked whether the export plan distinguished between convertible and nonconvertible exports. The Romanian representatives said that the plan specified separately the long-term contracts within the CMEA. This was, of course, not to say that there were no long-term contracts with other partners, including in the convertible area. The annual increase in convertible exports expressed in U.S. dollars had been 5 percent in 1982, 8 percent in 1983, and was planned to be 10 percent in 1984. The latter figure was based on the exchange rate in effect at the time the plan was formulated (September 1983), and for purposes of the plan, this rate would not be changed. Exports to the nonconvertible area expressed in U.S. dollars had increased by 6 percent in 1982 and 9 percent in 1983.

Turning to the area of price determination, Mr. Brehmer asked what prices were implied by the plan and how domestic prices were set. The Romanian representatives replied that, for domestic sales, list prices were established on the basis of production costs plus profit margin; these list prices were changed only infrequently. Export prices were, of course, set in the market place. The export revenue in foreign exchange was converted at the commercial exchange rate and, after deduction of a commission of 4.5 percent for the FTE, accrued to the enterprise. Mr. Brehmer asked what the price reaction had been to the three devaluations of the lei that had occurred since the end of 1982. In particular, he enquired whether domestic list prices had been raised in response to higher import costs. The Romanian representatives stated that this had not been done; the first response to higher input costs was always an attempt to offset the effect by measures to reduce other costs and/or increase productivity and in the meantime to absorb the cost increase by a lowering of the profit margin. In this particular case, the norms for inputs had been revised down. The situation had, of course, been alleviated by the devaluation gains on the export side. In a brief intervention, Mr. Marin explained that tractor prices had been raised by an average of 16 percent in 1982 leading to a comfortable increase in profit rates; subsequent cost increases could therefore be absorbed for some time. The enterprise representatives summarized the overall effect of the devaluation as follows: higher export revenues had been partly absorbed by higher import costs, but total profits had increased; export production had not immediately been expanded; the additional profits were to be used for modernization of plant and equipment.

Mr. Brehmer asked whether export prices in foreign exchange had been lowered in order to gain a competitive edge. The enterprise representatives said that this had not been done because the enterprise tried to obtain the foreign prices determined in the market. They had, however, improved the non-price elements of competition. Mr. Brehmer concluded that the devaluations had had some effect, although the domestic price response had only been very limited. Mr. Marin added that the devaluations had not been necessary for tractor sales. Already before the unification of the exchange rate, these sales had been effected at the commercial rate. As regards the most recent devaluation, he thought that some industries might have needed it, but not at the rate of 15 percent.

Turning to the question of investment financing and the use of profits, Mr. Brehmer asked whether profits could be used freely for investment purposes. The enterprise representatives said that their financial planning had always provided for a profit, and a profit had always been realized. The use of the profit was first discussed by the board of workers which then submitted a proposal to the general assembly of workers. The following uses of profits could be distinguished: (1) payment of net production tax; (2) repayment of investment funds to the budget; (3) modernization of plant and equipment, possibly within another enterprise under the same central; (4) a contribution to the state budget amounting to about 10 percent of the total profit; and finally (5) a fund for social benefits to the workforce. In case of a shortfall from planned levels, the profit uses at the bottom of this list were the first to be affected. On the other hand, any excess of profits above the plan could be used almost completely for modernization of the plan (development fund).

The investment plan distinguished between own resources and borrowed resources. The enterprise, as a matter of policy, tried to use only own resources, including its depreciation fund and profits. In this context, the shortening of depreciation periods had benefited the depreciation fund, while on the other hand raising production costs. Depreciation funds were accumulated in an account with the Investment Bank. After complete write-down of a machine, no further depreciation was charged for it, even though the machine might continue to be used. In response to a specific question, the enterprise representatives stated that the shortening of depreciation periods would in tendency lead to a more rapid pace of modernization.

Regarding bank credit, the enterprise had only taken out short-term loans, although of course long-term bank credit was also available to them. The recent increase in interest rates had induced them to reduce their stocks and to rely to a smaller extent on bank credit for their working capital. Mr. Brehmer enquired which taxes had to be paid by the Tractor Company. The enterprise representatives explained that as part of the machine building industry their company was subject to net production tax. However, there was no turnover tax on their products so that the producer price was equal to the delivery price. In fact, only one part of the machine building industry--that which produced consumer goods--was subject to turnover tax. The net production tax was assessed on the basis of net production quotas which were established for each enterprise taking into account six different criteria. In general, the level of the tax to be paid depended on the results of the enterprise. For this central, tax rates ranged from 8 percent to 30 percent, averaging around 20 percent; 8 of the 12 enterprises paid net production tax at the 20 percent rate. Net production was defined as the difference between gross production and material input expenditure; it thus consisted of the salary fund, taxes on the salary fund (16 percent of the fund), interest payments, and net profits. The rates of net production tax would differ, for instance, on the basis of the technical endowment of the factory concerned; rates would also be varied to stimulate those enterprises that performed well. The management of the central had a strong influence on the level and distribution of the net production tax payable.

In response to a question on wage bonuses, the enterprise representatives explained that an additional incentive fund of up to 2 percent of the salary fund could be established depending on the performance of the enterprise. Additional wage bonuses would be paid for overfulfillment of the plan, for a reduction in the consumption of inputs, for a reduction in the number of substandard products and for technical or organization improvements.

The meeting closed at 12:15 p.m.

INTERNATIONAL MONETARY FUND

Romania - Fact Finding Mission

Meeting No. 6
on Tuesday, February 28, 1984 at 10:45 a.m.
at the Garment Enterprise and Central
Bucharest

Romanian Representatives

Garments Factory and Central
Mrs. Elena Verona Burtea, General Manager
Mr. Eduard Colgin, Chief Accountant

Con Fex
Mrs. Viorica Sion, Deputy Manager
Mr. Cezar Stoiculescue, Chief Accountant

Ministry of Light Industry
Mr. Ioan Troaca, General Manager

Ministry of Finance
Mr. Stelian Marin, Director
Mr. Petre Mada

Fund Representatives

Mr. Brehmer
Mr. Prust
Mr. Reitmaier
Ms. Puckahtikom

Background

Until 1982 there was only a single Central for the whole textile industry. In 1982 responsibility was divided among three Centrals organized on geographical lines. The largest Central is that for Bucharest and the southern part of the country (the one the mission was visiting), which accounts for about half of all textile production in the state industries. The head of this Central is Mrs. Burtea who is also General Manager of its chief constituent enterprise. In other aspects, too, there is considerable blurring of responsibilities between the Central and the main enterprise in the group under its control.

The textile industry employs 100,000 people, 86 percent of whom are women.

The Bucharest-based Central covers thirteen plants and two additional bodies--a research and development center and a computer center. The latter two bodies exercise their functions on behalf of all three textile centrals. The main Bucharest plant employs 18,000 people and is specialized in the production of woollen garments. Over 70 percent of the output is exported; typically this proportion is somewhat lower (50-60 percent) in other plants.

Planning--targets and implementation

There are five categories of plan targets. These relate to economic, financial investment, and labor force objectives and to the introduction of new techniques; the latter targets are special to the textile industry. Targets are specified in value terms (in lei) and in volume terms, e.g., number of pieces or number of square meters. Export targets (part of the economic objectives) are specified both in lei and in foreign exchange.

If foreign demand exceeds expectations, the response could be through raising output (e.g., by working extra shifts or improving productivity) in the state industries, by raising output in cooperative units, or by reducing supply to the domestic market. Plans as originally drawn up incorporate some reserves of material supplies to be used as needed, which could enhance flexibility in production in response to higher than expected demand. However, if export production risks being impaired by a shortage of raw materials, additional flexibility may be gained by recourse to "lohn" operations. Imports may also be raised in response to demand conditions.

Import quotas in the EEC, U.S.A. and Canada have limited Romania's exports. All quotas are not always fully utilized because of the rapidity of demand and fashion shifts but in many categories exports have been below the levels that Romania would like to, and could, achieve because of foreign import restrictions.

If export demand is less than planned, export prices can be reduced but subject to the constraint that sales remain profitable, although perhaps with a reduced profit margin. Moreover, a shortfall in demand for one item could be compensated by a better than expected performance for another. The size of the domestic market is limited and it cannot be counted on to make up for all of any export shortfall.

Exports of textiles grew rapidly in 1981 (by over 30 percent), fell in 1982, and rose again in 1983. For the period 1981-83 as a whole export growth averaged 10-15 percent annually.

Prices and profits

Domestic prices are established to cover costs of production and a profit margin. In textiles, the latter varies from 7 percent to 30 percent with an average of about 15 percent.

The direct imports of the textile sector are very small but indirectly it imports a large proportion of its raw materials, e.g., 100 percent for cotton and 50 percent for leather. These items are obtained by the textile sector through intermediary enterprises. For example, raw cotton is imported by spinning mills and the textile sector buys yarn from the mills. The price charged by the mills for yarn is set by government decree. In the long run it may be changed to reflect changes in worldcommodity prices but in the short run this would not occur.

The mission enquired about the effects of exchange rate changes on profitability and the reactions thereto and received replies similar to those given by other enterprises. The response to an increase in input prices (for instance, as caused by the effects of devaluation on import prices) could be in the forms of: (1) raising productivity; (2) reducing profit margins; (3) phasing out unprofitable production; (4) raising effective domestic prices by incorporating technical and design changes in new products with new prices; (5) raising domestic prices for existing products explicitly. Item (4) could be done without Central approval (and the issuance of a decree) which would only be given after full analysis had revealed the price increase in question to be unavoidable. The only example given of an explicit price increase was of school uniforms, which rose in price by 30 percent in 1983. There appeared to have been no general price adjustment as a result of the 1983-84 measures.

Any extra profit arising from a devaluation is devoted to modernization investment (the textile sector is upgrading but not expanding its total capacity), to wage and salary bonuses, to higher social expenditures to the benefit of the workforce, and to higher profit transfers to the budget. Increased allocations for modernization is the most important item on this list. However (but apparently not necessarily related to the recent devaluation), there had recently been an 8 percent general salary increase.

Taxation and investment financing

Information provided on taxation was sketchy. Regarding payments of net production tax, two interpretations of what was said seem possible. One is that enterprises with a profit rate (i.e., profit as a proportion of the sales revenue) of below 15 percent pay no net production tax. If profits are above this threshold, net production tax is paid at varying rates up to 20 percent. (Similar to the situation described at the tractor plant, some of this variation in tax rates may be at the discretion of the Central, but this point was not explicitly discussed in the meeting reported here.) The other possible interpretation is that no net production tax is levied on the first 15 percent of profits but is levied on additional profits according to a sliding scale with a top marginal rate of about 30 percent. The latter interpretation would imply that profits are the base on which net production tax is levied, which is not the case. However, this account is identical to the operation of the excess profits tax that existed before a net production tax was introduced.

Profit transfers to the budget were generally equal to about 10 percent of profits. No turnover tax is levied on clothes but is applicable to fabric sales.

Investment in the light industry sector is generally financed from retained profits. Budgetary investment financing is only provided for new plants or very large projects, especially for firms whose profit rate is relatively low. Investment financing is available from banks but its attractiveness has been reduced by the recent rise in interest rates.

INTERNATIONAL MONETARY FUND

Romania - Fact Finding Mission

Meeting No. 7
Wednesday, February 29, 1984 at 10:30 a.m.
at 23 August Enterprise, Bucharest

Romanian Representatives

23 August Enterprise and Central
Mr. Paul Blaer, General Manager

23 August Enterprise
Mr. Petre Predoiu, Chief Accountant and Economic Director

Ministry of Finance
Mr. Stelian Marin, Director
Mr. Petre Mada
Mrs. Lia Tase, Senior Economist

Fund Representatives

Mr. Brehmer
Mr. Prust
Mr. Reitmaier
Ms. Puckahtikom

This plant is the largest of its kind in Romania. It produces locomotives, railroad cars, engines, generators, compressors, and cement plants (on a turnkey basis). Approximately 45-50 percent of production is for export to both the convertible and nonconvertible areas. Romania has by 1984 become virtually fully self-sufficient in locomotives, compressors, and engines. Production is not very dependent on imports: direct imported input (e.g., engine parts and pistons) represents only 1.7 to 1.8 percent of total production while indirect imported input provided from specialized FTEs (ferro alloys) represents 5 percent. Import quota for the plant falls under the allocation of the Ministry of Machine Building, and because the plant has a net trade surplus, it has had no difficulty in obtaining the necessary authorization for its import requirements.

Discussion focused on the distribution of profits, and the effects of devaluation.

Distribution of profits

Mr. Blaer described profit transfers to the budget as being determined as a residual, after all other justifiable uses of profits had been allowed for. In the past, especially in the early 1970s, the rate for the profit transfers had been as high as 30 to 40 percent. More recently, reflecting the investment push for this priority area, this rate had declined to a minimum rate of 10 percent. For profits that are in excess of the plan level, the rate would be 25 percent.

For 1983, the distribution of profits was as follows:

23 percent	- profit transfers to the budget
25-30 percent	- investment requirements
15 percent	- fund for economic development
20 percent	- financing for working capital (including stock financing)
4 percent	- general bonus payments
2 percent	- special bonus payments for overfulfillment of export targets
6 percent	- special fund for social services.

It was further explained that included in the transfers to the budget was a net production tax. This tax was not fixed by formula but was established on a case-by-case basis at the discretion of the Central. The tax rate averaged 15-20 percent, and varied among products in direct proportion to the level of profitability of the product, and hence the average rate varied among enterprises. If the actual cost exceeded the plan cost, then the tax rate would automatically fall to compensate for the decline in profitability. Mr. Brehmer observed that in these circumstances a more efficient enterprise that succeeded in cutting its costs would be faced with a higher tax rate. Mr. Marin argued that the system needed to allow for sufficient flexibility, in that fluctuations in costs/prices beyond the control of the enterprises must be accommodated. In these cases, protection to enterprises through a lower tax burden would be justified.

Effects of devaluation

Mr. Predoiu agreed that the devaluations in 1983 had led to an increase in profitability for the plant, and indicated that the windfall gain related to devaluations in this year amounted to 25 million lei. As for 1984, additional profits were also now expected. In this connection, it was suggested that the cost structure of this enterprise was so favorable that in fact a much lower exchange rate would suffice. The strength of its competitive position was such that for certain lines of products foreign prices at prevailing exchange rates were about four to five times domestic prices. With this advantageous position, the enterprise had been able to offer attractive service packages and very competitive prices for spare parts.

In this regard, Mr. Marin reiterated the present position concerning the use of devaluation-related profits. The estimates of profits to be generated by devaluation of course had not been finalized, but, in a decree to be soon published, special provision had been made for appropriate plan modifications on the basis of proposals now being received from the various ministries. In particular, it was recognized that some enterprises would suffer a net loss from the devaluation and could not insulate themselves from the negative impact. For these enterprises, some form of tax relief might prove necessary. Normally, as profitability declined, the rate of tax would also automatically fall, hence providing for some respite automatically. However, for some enterprises it could prove necessary to modify certain indicators and prices, depending on a detailed analysis of the overall situation of the enterprise in question. In general, however, Mr. Marin emphasized that it was not expected that the devaluation impact on prices in the Romanian economy would be significant. In particular, because of the very low import content of the economy (convertible imports representing only 0.9 percent of the total cost of production), and the fact that the macroplan this year had already provided for some offsetting in the form of a 5 percent unit cost reduction, any initial impact of devaluation on prices would be easily absorbed within the system. Moreover, the structure of the economy was also such that most of the importing enterprises also were exporters themselves, so that for these enterprises the net benefit from devaluation would likely be positive, entailing no need to adjust domestic prices upward.

On investment financing, it was reconfirmed that financing would be provided from retained profits and from reserves of depreciation allowances accumulated in the enterprise's own account held at the Investment Bank. On export performance, it was said that total exports (measured in lei terms, after exchange rate correction) increased by 12 percent in 1983 (about 13 percent for the convertible area and somewhat less than 12 percent for the nonconvertible area). For 1984, the plan targets were to raise exports by 22 percent in total, and a somewhat higher rate for the nonconvertible area (also measured at constant prices and constant exchange rates).

INTERNATIONAL MONETARY FUND

Romania - Fact Finding Mission

Meeting No. 8
Wednesday, February 29, 1984 at 3:30 p.m.
at the Ministry of Finance

Romanian Representatives

State Committee for Prices
Mr. Virgil Pirvu, Director
Mr. Viorel Bisca, Economist

Ministry of Finance
Mr. Nicolae Sadulescu, Director of Taxation and State Incomes Dept.
Mr. Iacob Zelenco, Division Chief in Taxation and State Incomes Dept.
Mr. Stelian Marin, Director
Mr. Petre Mada
Mrs. Lia Tase

Fund Representatives

Mr. Brehmer
Mr. Prust
Mr. Reitmaier
Ms. Puckahtikom

1. Prices

In opening the discussion on Romanian price policy, Mr. Brehmer asked the representatives from the Price Committee whether they had responsibility for both domestic and export prices. Mr. Pirvu replied that their authority only extended to domestic prices; export prices were determined by world market prices, leaving no role for an autonomous price policy. Mr. Brehmer observed that the effect of the devaluation on import prices seemed to have quickly dissipated further down the line from the importing FTE. He wondered whether even enterprises with a high dependence on imports had been able to absorb the ensuing cost increases. In general, what were the policy guidelines governing the impact of rising import prices on domestic prices? Mr. Pirvu replied that the successive devaluations had indeed represented a serious cost pressure leading to exceptional measures at the levels of enterprises' ministries and the economy as a whole. For industries with a low import content (automobiles, light industry, leather, construction materials, machine building), the objective had been to absorb the import cost increases through a reduction of import use per unit of output and through reductions in other cost components. In the case of the only industry with a high import content (steel), the devaluations had coincided with declining world prices for iron ore (by 23 percent in 1983 alone and continuing in 1984). At the same time, ocean freights had also fallen. A decline had also been experienced in the prices of nickel, lead (by 50 percent), and zinc. In these conditions, the metallurgical industry had been able to absorb the impact of the devaluations. Mr. Pirvu conceded that steel output prices had also fallen worldwide but at a slower rate than prices of imported inputs. Romanian exports of steel had gained from the devaluations, although, of course, in prevailing market conditions no increase in volume had been realized. Profit margins of steel mills had fallen in 1983 by 3 percentage points; for a typical steelwork in Galatia, this had meant a halving of profit margins. With regard to expensive special steels, a national program of import substitution ("assimilation") had been adopted. The Price Committee had, of course, been under pressure from enterprises to grant price increases in response to devaluations. Frequently the answer had been to stop production of unprofitable product lines. When asked for examples where price increases had been permitted in response to the devaluations, Mr. Pirvu mentioned prices of non-essential consumer goods imports (e.g., radios, cameras, etc.) which had been raised in 1983 by 10 to 25 percent, depending of course also on the prices of these items in terms of foreign exchange.

The average increase in 1983 for consumer prices had been 5.5 percent and for producer prices 6 percent. In the course of 1983, prices had increased by about 1 percent. The aim for 1984 was to keep prices as far as possible unchanged. When asked about the effect of rising commodity prices expected for 1984, Mr. Pirvu said that only the steel sector was heavily dependent on imports, and that all forecasts called for no, or only a modest, increase in raw materials of this sector.

In response to a question, Mr. Pirvu stated that the potential for productivity increases in Romania was still very large. The plan now aimed for a significant step in this direction. In this context, the new wages policy was an important measure. Inter alia, it had brought a switch from pay on the basis of piece rates for each worker to pay for the output of a group of workers. Since September 1983, all workers, even employees in ministries, were paid according to the performance of their work area or sector.

In all, total costs of industry were planned to decline by 5.2 percent in 1984, following a decline of 2 percent in 1983. Within this total, the wage bill and average salaries would increase by 5 percent in 1984, implying a reduction in other costs of more than 5 percent.

Regarding the procedures for price reviews, Mr. Pirvu stated that comprehensive price reforms were always undertaken at the beginning of the year, but ad hoc price adjustments could also occur during the year if warranted by circumstances. Applications for price increases were only considered if they were justified by genuine cost increases. There was thus no feedback from export prices to domestic prices. Consideration of an enterprise's application for a price increase had to be completed within 30 days. The application was first screened by the local organs of the Price Committee, then submitted through the Central and the relevant ministry to the Price Committee. As a general rule, the initiative for price adjustments came from the enterprise level, not from the Price Committee itself. The central staff of the Price Committee was about 100 persons. The development in aggregate price indices was a performance criteria for the Price Committee, governing the pay of its staff.

In concluding the discussion on price policy, Mr. Brehmer asked what chances there were for a switch to a more flexible price system, now that Romania had abandoned the price equalization system and had pegged the lei to a basket of currencies. Mr. Pirvu stated that the authorities did not want to lose control over prices, differing in this respect deliberately from market economies. Changes in world market prices and in exchange rates were taken into account in a controlled manner. In a centrally planned economy, prices were a basic instrument without which good planning was not possible. The planned targets for the standard of living of the population necessitated a particularly strict policy with regard to consumer prices.

Mr. Brehmer referred to the greater degree of price flexibility introduced by other centrally planned economies (e.g., East Germany and Hungary). Mr. Pirvu conceded that Romania differed in its price policy from these cases, but that these countries' policies were certainly not better than Romania's, considering their extensive subsidization of consumer goods. In East Germany, price subsidies from the budget amounted to 50 to 60 billion marks. By contrast, there were no price subsidies at all in Romania.

In a brief discussion of the data request submitted to Mr. Marin, it emerged that monthly consumer and producer prices were not available and that even quarterly data were not complete. Mr. Pirvu agreed to provide incomplete quarterly data and complete indices on a half-yearly basis.

2. Taxation

A discussion with the representatives of the Taxation Department brought the following clarifications on the net production tax. The net production tax is fixed by law as a percentage of the net production generated under each industrial ministry with rates differing from sector to sector. It then lies in the discretion of each ministry, and further down, its Centrals, to determine how the tax is collected within that particular industry. The criteria applied here are typically the profitability of individual enterprises and product lines. The requirements of self-financing of plant and equipment are also taken into account. While usually having a progressive character, the tax in no case eliminates all incentive to increase profitability.

In response to a question, the Romanian representatives stated that there existed no export taxes but tariffs on imports, a schedule of which would be provided to the mission.

The meeting closed at 6 p.m.

INTERNATIONAL MONETARY FUND

Romania - Fact Finding Mission

Meeting No. 9
Thursday, March 1, 1984 at 10 a.m.
State Planning Committee

Romanian Representatives	Fund Representatives
State Planning Committee	Mr. Brehmer
Dr. Gheorghe Sică, Director, Finance Department	Mr. Prust
Mr. Avram Roden, Division Chief, Synthesis and Coordination Dept.	Mr. Reitmaier
Mr. Constantin Teodorescu, Division Chief, Investment Department	Ms. Puckahtikom
Mr. Stelian Militaru, Economist, Synthesis and Coordination Department	
Ministry of Finance	
Mr. Stelian Marin, Director	
Mr. Petre Mada	
Mrs. Lia Tase	

Dr. Sică said that the planning process was being made more flexible partly to take account of the needs of the international trading sector. In the past, targets had been established for long periods ahead but now the tendency is to plan for shorter periods. Indicators of developments in current prices are increasingly being used.

The Romanian representatives described at some length the measures that had made it possible to maintain a positive rate of economic growth at the same time as imports were being drastically reduced. However, they recognized the dependence of exports and imports and Dr. Sică said that it could not be denied that in certain cases import cuts had had an adverse effect on export performance.

Mr. Brehmer invited a Romanian reaction to the view which he had heard expressed that all the potential benefits of a devaluation could, in a centrally planned economy, be relaized by other means. Dr. Sică replied that he recognized that a devaluation could have beneficial effects but it was important that it remained "under control." The authorities had also taken other measures whose influence on foreign trade developments was at least as great as that of the exchange rate changes introduced. However, the latter could be a useful complement to the former.

Dr. Sică said that plan figures for 1984 had used the exchange rate on December 31, 1983. The plan was now being adapted to the January 1, 1984 exchange rate change and proposals from the enterprises were being awaited as to how this should best be done. Ms. Puckahtikom enquired as to the nature of these changes. Dr. Sică replied that indicators for investment, costs, etc., could be affected.

Mr. Brehmer said that it was the mission's impression that devaluation would improve profitability in the export sector unless the gains were taxed away. Such profits could be a guide to the desirable pattern of new investment for which they would also provide financing. Devaluation could also stimulate export productivity in other ways. However, there may be some lags before these effects were fully worked out. These considerations suggested that use of devaluation as a policy instrument could be reconciled with central economic planning. Dr. Sică replied that it would be difficult to separate the beneficial effects of the recent devaluations from the effects of other measures taken. Devaluations also had adverse side effects on costs.

Mr. Brehmer noted that part of the economy (that immediately involved in foreign trade) was using world prices whereas the rest of the economy was operating at different domestic prices. He wondered, particularly bearing in mind the moves to world pricing currently underway in other socialist countries such as the German Democratic Republic, whether there was not a strong case for moving prices more comprehensively to a world equivalent basis in Romania. Dr. Sică noted, and Mr. Brehmer agreed, that the other socialist countries in question maintained subsidies on important items which was no longer the case in Romania. He noted that price adjustments in Romania in 1981 and 1982 had been very great and said that these could not be allowed to continue in such a way as to have an adverse impact on the population's standard of living. Mr. Brehmer observed that prices had little allocative function in the Romanian domestic economy and were typically below their market-clearing levels. A more efficient allocation of investment could be achieved by greater use of economically efficient prices. This could be done without giving up the basic features of central planning. Mr. Sică replied that world prices could not always be regarded as a reliable guide in setting domestic prices. He did not accept that all Romanian prices were below world levels and cited non-ferrous metals as an example. He accepted that prices had periodically to be revised to reflect changing conditions but this did not mean that prices had to be changed "every day." As evidence of the actual flexibility of Romania's prices, he cited the following retail prices for wine (in lei per liter):

	1980	1984
Medium quality	12.50	21.50
Top quality	14-17	35-70
Champagne	35	67

Mr. Brehmer noted that it was not only the rate of change of prices that was important but their absolute value in relation to comparable world prices.

Dr. Sică said that the main criterion in investment appraisal was the "social need for consumption" and commercial factors had lesser priority. At the same time, any project had to satisfy the criterion of efficiency. Mr. Prust enquired what was done in the case of an investment project that produced goods for both the export and domestic markets at prices that differed between the two markets: which prices would be used? Dr. Sică replied that feasibility studies were carried out both at domestic prices in local currency and in foreign exchange terms at shadow world prices. The latter was particularly important for export-oriented projects. Sometimes these two methods could produce contradictory results in which case other judgmental factors would determine the final decision.

Mr. Brehmer enquired whether any relaxations of the authorities' current emphasis on price viability was to be expected in the future. Dr. Sicā replied that future price adjustments would depend on conditions in the economy. However, all such adjustments would not necessarily be upwards: for example, the price of coffee had been set at a time when world prices were much higher than currently.

INTERNATIONAL MONETARY FUND

Romania--Fact Finding Mission

Meeting No. 10

Friday, March 2, 1984 at 9:30 a.m. at
Ministry of Foreign Trade and International Economic Cooperation

Romanian Representatives

Ministry of Foreign Trade
Mr. Mihail Micu, Director
Mr. Aldea Victor, Economist

Ministry of Finance
Mr. Stelian Marin, Director
Mr. Petre Mada
Mrs. Lia Tase, Senior Economist

Fund Representatives

Mr. Brehmer
Mr. Prust
Mr. Reitmaier
Ms. Puckahtikom

Introducing the meeting, Mr. Brehmer remarked that export performance had been especially weak in 1982 and 1983, and wondered if the sharp cut in imports during this period may have been a contributing factor and whether it was felt that import policies may have been carried too far. In reply, Mr. Micu stated that the weak performance of exports in 1983 was mainly attributable to certain domestic and international factors, but that the cut in imports had not been a factor. Domestically, the poor agricultural production led to a corresponding decline in exportable surplus, while internationally, the recession over the period 1982-83 was responsible for the weak foreign demand for nonagricultural exports. Mr. Micu agreed that in certain producing sectors and during certain periods, imports required for production had diminished. However, the reduction was well under control and was not seen to have undermined export production, since it led to a significant progress in import substitution, especially in important areas such as machinery and equipment. This development made it possible to concentrate the cut in imports on equipment and less on raw materials required for export production. As a result, he concluded that there had been no impact of import cuts on export production. At this juncture, while data on the commodity composition of trade were not yet finalized and the savings created through import substitution could not yet be quantified, he felt nevertheless that on balance the import policies had been successful. It had made possible for Romania to repay its foreign debt as rapidly as intended, citing in particular the sharp decline in suppliers' credits from $2.5 billion in 1982 to approximately $700 million presently. Mr. Brehmer remarked that over time there would be limits to the effectiveness of the policy of import substitution. Mr. Micu agreed that over the longer term there would be overall limits at the national level, but nonetheless he felt that these limits had not yet been reached.

Referring to the unification of the exchange rates since mid-1983, Mr. Brehmer asked whether the net effects on the export sector had now been discernible in the official statistics, and if not, what the current expectations were. In this connection, Mr. Marin said that at the national level there had been obviously a net positive (although unquantified) impact, while at the individual level, certain producers had lost from the effective appreciation, and some others had gained from the depreciation. It was agreed that the net effect of the unification of the rates had been difficult to quantify, since it had been overshadowed by the depreciation which took place at the same time.

Turning to the question of the priorities within the export sector, Mr. Micu explained that generally the policy was to develop all branches of the export sector equally in order to avoid a differential among branches within the economy. However, in the present circumstances, special attention was being paid to those branches that were better able at utilizing the labor force and local resources. The aim was to increase export production with a higher degree local processing, e.g., machine building, transportation equipment, chemical products, and consumer goods. This group of exports accounted for about 58 percent of total exports and had increased satisfactorily over the recent years, both in terms of export share as well as in absolute terms.

Concerning the external sector targets, Mr. Brehmer inquired if they were set for individual branches in industries, and whether separate targets were specified for exports, imports, and/or trade balance. In reply, Mr. Victor explained that separate export and import targets were established on the basis of proposals submitted by producing enterprises which were centralized at the Ministry level. The targets for the various ministries were aggregated and finalized jointly by the State Planning Committee together with the Ministry of Foreign Trade. At the national level, the level of imports had to be balanced against prospective export receipts. Should exports turn out to be below planned level, then the planned imports could not be accomodated. In these circumstances, the policy would be to look for import substitution from domestic production, but at the same time to ensure that all the import requirements of the exporting sector were met. An indirect impact of this policy had been that the process of import substitution had accelerated and there had been a more efficient use of raw materials.

On the flexibility of production for export and domestic sales, Mr. Brehmer observed that some enterprises had advised the mission that there was scope to cut domestic sales in order to satisfy increased foreign demand. He inquired if, as a general rule, the satisfaction of domestic demand was of as high priority as export production targets. Mr. Micu responded that the export sector had top priority in order to repay external debt and to gain the needed resources for imports. Difficult options had been confronted as it was also necessary to fully meet the domestic consumption requirement. In this connection, Mr. Brehmer remarked that it would seem more efficient to allow the export sector to develop independently--irrespective of the availability of imports--in order to achieve balance of payments viability. Mr. Micu agreed that normally this had been the guiding principle, but noted that under the present exceptional circumstances and that there were obligations to restrict imports in order to ensure an appropriate balance of trade. In this connection, Mr. Prust asked if the legally-binding targets for the individual enterprises or sectors were exports, and/or imports, and/or the trade balance. Mr. Micu replied that although the plan targets were specified for both exports and imports, it must be remembered that imports could not be made without adequate exports. Thus, in practice, imports had to be adjusted in accordance with resources available through exports, thus implying that in practice the trade balance would be the legally-binding target for the enterprises or for the sectors concerned. It was emphasized that those sectors that were able to meet or exceed export targets would be provided with sufficient flexibility to obtain the needed imports.

Finally, on export promotion, Mr. Brehmer noted that so far the mission had been informed of general measures that applied broadly to all sectors and not just for export promotion; these were the various rationalizing and cost reduction measures designed to increase labor productivity and to improve product quality. Mr. Micu indicated that one measure directed specifically at the export sector was introduced in September 1983, in the form of improved salary and incentive system to assure a closer linkage between salaries earned and the outcome of export production. This new measure was to apply equally to export producers as well as to the foreign trade enterprises. Mr. Brehmer observed that the effects of these general measures probably would only be evident with some delays. Asked about the role of devaluation relative to these other measures, Mr. Micu said that naturally the devaluation was expected to improve competitiveness, although the impact would be hard to quantify. On the whole, he felt that the most decisive role for export promotion must be assigned to the structural measures--especially the non-price elements to enhance competitiveness, e.g., improved product quality, services, and marketing network.

INTERNATIONAL MONETARY FUND

Romania - 1984 Fact Finding Mission

Minutes of Meeting No. 11
Held at the Ministry of Finance
Friday, March 2, 1984 at 10:30 a.m.

Romanian Representatives	Fund Representatives
Ministry of Finance	Mr. Brehmer
	Mr. Prust
Mr. Gigea, Minister of Finance	Mr. Reitmaier
Mr. Marin	Ms. Puckahtikom
Mr. Mada	

Mr. Brehmer summarized the task of the mission and briefly described the meetings that it had had. Mr. Brehmer continued that the mission had noted with satisfaction that all enterprises interviewed had reported that they would reap some benefit from the recent devaluation. However, these enterprises all had substantial exports and a positive trade balance. A different picture might have emerged if there had been time to interview firms that had a less favorable external trading position, for example, firms in the steel industry. All enterprises interviewed had also said that devaluation was only one of a number of factors that had assisted their perøformance. These other factors included productivity-raising measures, improvements in product quality, and the introduction of new products. Only one sector (tourism) had said that a devaluation could produce an immediate gain in export volume. Other sectors had said that the stimulus to export volume from a devaluation would only be felt after a lag, i.e., after the additional profits from a devaluation had been used to finance new investment. The mission understood that a considerable part, up to 50 percent, of extra profits resulting from a devaluation could be used for investment.

Mr. Brehmer went on to say that the mission had also noted several factors that tended to limit the effectiveness of a devaluation. Only firms exporting directly benefited from a devaluation and there was no increase in prices paid for intermediate goods supplied by other domestic firms to the export sector. In addition, the mission had the impression that there was not too much flexibility in shifting sales from the domestic market to exports. Mr. Gigea interjected to say that there were no limits on export sales and Mr. Marin added that exports could always be increased if production could be increased commensurately. Mr. Marin acknowledged, though, that certain minimum supplies of essential commodities needed to be guaranteed to the domestic market. Mr. Brehmer said that the mission was not suggesting that domestic sales and export targets were absolutely inflexible but only that there appeared to be scope for more flexibility.

Another limiting factor on the effectiveness of a devaluation, Mr. Brehmer continued, was the time lag between the earning of additional profits and their use in financing new investment. The mission also wondered whether some of the apparent benefit from earning higher profits might not be counteracted by a reduced provision of investment financing from other sources, i.e., the budget and the banking system. Mr. Gigea agreed that it would be desirable to avoid offsetting cuts in these financing sources.

Mr. Brehmer said that the mission had observed that rates of net production tax were differentiated by enterprise and by producer and were sometimes inversely dependent on profitability. He wondered whether any thought had been given to introducing a unified proportional rate of taxation. Mr. Gigea replied that it was common practice for tax systems to incorporate some element of progressivity. Mr. Reitmaier noted that, although this was so as regards personal taxation, it was typically not the case as regards corporate taxation. After some further discussion, Mr. Gigea agreed with Mr. Brehmer's proposition that taxation changes should not be used to "shave off" extra profits earned by enterprises as a result of a devaluation.

Returning to the question of pricing policy, Mr. Brehmer noted that domestic price adjustments had been minimal in 1983; this was perhaps in reaction to the large price rises in the immediately preceding years. However, for whatever reason, strict control was being maintained on domestic prices. Pressures on prices, for example, those stemming from devaluation-related increases in import costs, were being resisted by productivity measures, by reducing profit margins, and by granting relief from net production tax. Mr. Brehmer felt that these moves could undermine the boost to the relative profitability of exporting that a devaluation was intended to give and could also unnecessarily prolong the life of activities that a devaluation might render uneconomic. Mr. Brehmer continued that in a centrally planned economy domestic prices had no allocative function. However, the combination of flexible international prices (that had been in effect in Romania since the abolition of the price equalization system) and fixed domestic prices could frustrate the purpose of a devaluation with resultant losses of welfare for the population if exports did not rise and imports had to be curtailed.

Turning to adjustment measures that might be appropriate in a centerally planned economy, Mr. Brehmer said that the mission had been unable to find alternative measures appropriate within the Romanian system that would yield the same effects as a devaluation. Looking back at the shortfalls from plan targets for non-oil exports in 1982 and 1983, it was difficult to accept the claim that central planning could dispense with exchange rate policy as a means of promoting exports. The mission had not noted any special measures of export promotion other than the devaluation. The other adjustment measures that were being followed would affect the whole economy but would not have any special effect on the export sector. In this context, the mission felt that the official objective of reducing unit costs by 5 to 6 percent in 1984 was highly ambitious despite the scope that no doubt existed for raising productivity and for modernization. Mr. Brehmer referred to the experience of other centrally planned economies in liberalizing prices and shifting resources. The role of profitability in guiding economic decisions had been recognized in these countries, as indeed it had been in Romania since the late 1970s.

In concluding his exposition, Mr. Brehmer informed Mr. Gigea of the data requests that had been made to Mr. Marin.

In reply Mr. Gigea said that he was glad to have the opportunity to meet with the mission. The Romanian economic mechanism was not unchangeable and was capable of further improvement and he was glad that the mission had had an opportunity to review it with critical eyes. Any comments made by the mission would be carefully reviewed. The Government was fully committed to the recently introduced measures and the role the Ministry of Finance had played in introducing them was recognized and appreciated.

Mr. Gigea mentioned four fields in which the Government was acting vigorously: (1) cost reduction; (2) raising labor productivity; (3) quality improvement; and (4) phasing out or redesigning unprofitable activities. Significant labor productivity measures had already been taken in 1984 as a result of which 40,000 workers had been shifted to new jobs. Increased emphasis was being placed on job training. Progress in 1984 was being watched carefully and a big effort was expected from the measures taken at the beginning of the year. Export performance could be reviewed at the time of the next consultation mission. The industrial production target for January had been achieved. Budgetary receipts based on profits (it was not clear whether this meant profit transfers, net production tax payments, or something else) had been 100.5 percent of the plan target in January. A higher rate of growth of investment (2.5 percent) was planned in 1984 than in 1983. Particular priority was being given to raw materials, oil, and agriculture, and reduced priority was being given to housing. There was very tight control on social and cultural expenditures.

Regarding exports, Mr. Gigea reiterated that there was flexibility to adapt to market requirements. For example, the higher the demand for tractors abroad the less would be delivered to the domestic market. The same was true for cars, furniture, and other items. However, for some traditional export items demand was slack and competition was intense. Additional trade representatives had been posted in several countries and special care was being devoted to selection of markets where there was thought to be scope for development.

Mr. Brehmer observed that devaluation had not appeared in the list of recent measures cited by Mr. Gigea. Mr. Gigea replied that it would be necessary to see the figures before judging the effectiveness of the devaluation. However, non-oil exports in January 1984 were 3 to 4 percent above their level of one year earlier. Mr. Gigea expected this favorable trend to be maintained. As regards developments in the domestic economy in 1984, much depended on agriculture. Given the satisfactory precipitation, the prospects were for harvests of wheat and barley that were as good as in 1982.

Turning to relations with the Fund, Mr. Gigea said that he could give no undertakings at the present time about any new stand-by arrangement. The Romanian authorities valued the close relations with the Fund but at the present juncture preferred to take a step-by-step approach.

On the overall payments situation, Mr. Gigea said that all obligations were being met on time and Romania's credit rating was improving. However, the country was passing through what he described as a "quarantine" period and it could be some time before creditor confidence was fully restored. Government credit lines were open with the U.S., Canada, UK, France, Belgium, and Germany: Hermes financing ~~had~~ become would recently available ~~again as of March 1~~. Some credits were being received from commercial banks but commitments from individual banks did not exceed $10 million. Mr. Brehmer noted that the tenor of some recent conversations with bankers who had called on him in Washington also suggested that there had been a change in sentiment toward Romania. For his part, Mr. Brehmer had emphasized in these meeetings that Romania's cancellation of the Fund stand-by arrangement should not be misinterpreted.

Roumanie : des trous dan

III. — *Quelques murmures isolés dans*

De notre envoyé spécial JAN KRAUZE

Economies, économies... C'est le leitmotiv du régime en ces années de crise. Un régime plus solide qu'on ne le penserait, à constater l'étendue des privations et celle du culte de M. et Mme Ceausescu. (*le Monde* du 28 et du 29 février).

Bucarest. – Bucarest s'attend à vivre des heures difficiles. Non pas le Bucarest des palais officiels ou des hôtels de luxe, ni celui des faubourgs neufs, mais celui des rues poussiéreuses où s'effritent doucement de belles demeures surchargées de stuc, celui aussi de ces petites maisons oubliées où vivent de vieilles dames qui parlent un français parfait. Si l'on y tremble, ce n'est pas à cause des difficultés de chauffage, du temps passé à faire la queue dans le froid. C'est pour le bien le plus précieux, le seul qui reste : la culture.

On s'inquiète à double titre : dans la grande campagne d'économies tous azimuts, tout ce qui touche aux activités culturelles semble devoir payer un lourd tribut. Et aussi parce que, craint-on, la « vraie » culture risque de succomber sous les coups redoublés de l'idéologie... et des goûts « petits-bourgeois » prêtés aux dirigeants du pays.

Vrai ou faux ? Les informations les plus pessimistes circulent : les effectifs des orchestres seraient diminués de 40 % et les musiciens priés de *« jouer plus fort »*. Les subventions aux théâtres réduites à la portion congrue (28 millions de lei (1) pour tous les théâtres de Bucarest, contre 30 millions auparavant pour le seul Opéra, qui pourrait connaître de graves difficultés). L'école de ballet de Bucarest serait supprimée, au profit de celle de Cluj en Transsylvanie.

On peut s'étonner que tout cela puisse susciter une telle inquiétude. C'est qu'ici le théâtre – une spécialité roumaine, – l'art, sont considérés comme une bouffée d'air, un peu de couleur dans la grisaille. Du côté des autorités, on laisse entendre qu'il s'agit seulement de mettre fin au gaspillage, de faire respecter là aussi le principe de l'« accord global » et donc de l'efficacité.

Mais comme en même temps on refuse aux théâtres la possibilité d'augmenter leurs prix, il ne reste plus qu'à licencier, en commençant par les machinistes et les maquilleuses. D'autant que certaines subventions extérieures sont refusées par les autorités, comme la contribution de l'Eglise moldave, qui avait proposé un million de lei pour aider le théâtre national de Iassy. Même dans les musées, on s'inquiète de devoir devenir « rentable ».

Un espace de liberté individuelle

A cela s'ajoutent d'autres alarmes. Ne veut-on pas noyer la « vraie » culture dans un flot de folklore, d'amateurisme et de romances dans le cadre du festival permanent « Chanter la Roumanie ». On fait aussi grand cas du discours aux accents réalistes socialistes prononcé en août dernier à Mangalia par M. Ceausescu. Annonce-t-il une offensive en règle contre les intellectuels ? Il semble que le secrétaire général ait piqué une colère après la projection d'un film, *Falaises de sable*, où la vie d'un jeune ouvrier était présentée sous de trop sombres couleurs. Résultat : reprise en main du cinéma, scénarios retirés ; mais là encore, la première alerte passée, les choses pourraient se « tasser », explique un acteur connu.

Tous d'ailleurs ne réagissent pas de la même manière : pour tel intellectuel, qui s'amuse avec brio à dissimuler ses sentiments derrière une succession de paradoxes, tout cela n'a aucune importance. Cette agitation ne concerne en fait, dit-il, que les apparatchiks de la culture, c'est-à-dire tout ce qui ne compte pas...

D'autres prennent les choses avec moins de philosophie, au point de se lancer dans un combat solitaire, et fort risqué. Un poète renommé, Dorin Tudoran, s'est engagé depuis plusieurs années dans cette voie, dénonçant les compromissions et l'arrivisme de certains de ses collègues, et déclarant en substance au pouvoir : d'accord pour laisser à César ce qui est à César – mais pas la culture.

Après ses interventions devant une réunion d'écrivains et la publication de plusieurs de ses écrits à l'étranger, la réponse ne s'est pas fait attendre : exclusion de la revue où il travaillait, impossibilité totale de se faire éditer, tentative de l'expulser de l'Union des écrivains. Il est amer, surtout devant l'attitude de ses collègues intellectuels. *« C'est la jalousie des esclaves envers l'esclave qui s'est libéré. »* Il n'est ni battu ni emprisonné. Simplement impuissant. Et il trouve que la police a fait bien des progrès en subtilité, depuis le temps de la répression pure et dure.

Le tempérament national

Autre exemple – autre solitude – sur des bases un peu différentes : Mihai Botez, mathématicien – spécialiste de prospective, – privé de tout contact avec les étudiants, mais pas de ses possibilités de recherche. Sa revendication à lui, c'est un espace de liberté individuelle, la reconnaissance d'une sorte de statut de libre-penseur. Pas de dissident politique : pour qu'il y ait dissidence, il faut qu'il y ait, même à un niveau très modeste, action collective, groupe.

De cela, il n'est pas question en Roumanie. A cause du tempérament national, pas très téméraire, disent souvent les étrangers, qui, eux, ne risquent rien, de toute manière... Au contraire des Roumains, puisque le simple fait de porter quelques signatures au bas d'un texte tombe aussitôt sous le coup de la loi sur les associations illégales.

Une autre loi – elle porte le numéro 23 – oblige le citoyen roumain à demander une autorisation préalable avant tout contact avec un étranger et à présenter ensuite un rapport dans les quarante-huit heures. La loi, bien sûr, n'est pas toujours respectée, mais l'épée de Damoclès reste suspendue. Avant de braver l'interdit, d'accepter d'être cité, il faut bien mesurer les risques, avoir, quoi qu'on en dise, du courage.

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« Fin de règne ? »

Il y a aussi les Roumains qui pa sent clandestinement les frontière pour se retrouver, particulièreme nombreux cette année, dans l camps de réfugiés d'Autriche. Ce qui émigrent « légalement » ve l'Allemagne fédérale ou les Etat Unis. (A la suite de vigoureus réactions des deux pays, la nouvel loi qui contraint les candidats au d part à rembourser à l'Etat, et en d vises, tous leurs frais d'éducatio n'est pas appliquée. Mais elle n'e pas abrogée non plus...) Enfin il y les Hongrois de Transylvanie, q lorgnent avec envie du côté d'u pays plus prospère, même s'il e moins « indépendant ».

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CC: EB PCH

EUROPE

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tre envoyé spécial JAN KRAUZE

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Même la personne du grand chef, sujet tabou s'il en est, n'est plus épargnée. Et moins encore sa femme, second personnage du pays, dont le rôle ne cesse de croître : elle a en particulier la haute main sur la nomination des cadres et naturellement sur les sciences (doctorat en chimie oblige).

Atmosphère de « *fin de règne* », disent certains, avant d'ajouter : « *mais ça peut durer longtemps* » (M. Ceausescu, à soixante-six ans, en est à sa dix-neuvième année de pouvoir). Certains militaires ou policiers ont-ils tenté de rapprocher l'échéance ? Toutes sortes de rumeurs circulent à Bucarest sur le « complot » qu'aurait ourdi, en janvier 1983, un groupe d'officiers supérieurs et de membres de la Securitate (la police politique).

L'affaire se complique d'autant qu'elle coïnciderait à quelques jours près avec un « accident de chasse » survenu à un frère de lait du colonel Kadhafi, responsable par ailleurs de la sécurité du dirigeant libyen, alors en visite en Roumanie. Seule chose à peu près établie, un certain nombre de colonels ont disparu. Mais ont-ils été seulement éloignés, ou bien fusillés, comme on le chuchote dans certaines chancelleries, ou encore abattus sur place, à la suite d'une trahison, alors qu'ils tentaient de s'emparer de M. Ceausescu ?

Le bel anniversaire de Mme Ceausescu

L'important est que ce dernier est toujours là, et bien là, entouré par un invraisemblable culte qui s'étend aussi, de plus en plus, à madame. Sujet délicat s'il en est, au point qu'on vous conseille gentiment de ne pas trop en parler. Cela peut vous paraître ridicule, explique-t-on avec les meilleures intentions du monde, mais ici ce n'est pas ressenti comme ça, et d'ailleurs ce n'est pas important. Peut-être. Mais comment faire pour ne pas voir ce qui saute aux yeux, à chaque instant, partout.

Comment ignorer que, pour le dernier anniversaire de madame, on a publié quatre-vingts articles, trente-huit poésies, trois livres « hommages », composé vingt-deux peintures ou sculptures, diffusé quatorze émissions de télévision ? Comment oublier cette émission parmi tant d'autres qui nous explique les vertus de l'art roumain contemporain en nous montrant des exemples aussi brillants que M. Ceausescu, cravate au vent, sur fond de moissonneuse-batteuse, M. Ceausescu, jeune comme l'éternité, tenant en ses mains son « sceptre présidentiel », M. Ceausescu toujours, main levée, tantôt la droite, tantôt la gauche, mais toujours pour indiquer la voie à suivre. Ou bien encore, monsieur et madame, jeunes et beaux, sur fond de petits garçons en maillot de corps, savamment disposés par l'artiste en guise de chérubins.

Jusqu'où peut-on aller dans cette voie ? Passé un certain stade il n'y a apparemment plus de limite, et le mieux est peut-être, en effet, de se taire.

Sauf pour constater, par souci d'équité, que, contrairement à ce qu'on prétend parfois, l'ascension du reste de la famille est beaucoup plus modeste. L'un des frères du président, Ilie, s'il a été promu récemment chef du département politique de l'armée, n'est toujours que vice-ministre de la défense. Un autre frère, ancien milicien, serait recteur de l'académie du ministère de l'intérieur. Quant au fils cadet, Nicu, élu récemment secrétaire général des jeunesses communistes, et devenu par conséquent ministre de la jeunesse, il s'est rangé. Finies, dit-on, les frasques de play-boy : Nicu vient de se marier. Le responsable des jeunes communistes a pris pour femme la responsable des Pionniers – l'organisation politico-éducative des enfants de huit à quatorze ans. Le conte de fées peut continuer.

FIN

(1) 100 lei valent 45 francs au cours commercial.

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Roumanie : des trous dans

II. — Vingt-deux millions de fourmis et que

De notre envoyé spécial JAN KRAUZE

Le mythe de l'indépendance de la Roumanie convainc plus certains Occidentaux que les Roumains. Il suppose en tout cas beaucoup d'ambiguïtés et c'est surtout M. Ceausescu qui en profite (*le Monde* du 28 février).

Bucarest. — « *L'efficacité des syndicats se juge à la bonne réalisation du plan.* » Ce n'est pas ici, au siège des syndicats roumains, qu'on aurait mauvaise conscience à jouer les courroies de transmission ou à reprendre des slogans dignes des années 50. C'est le camarade Ceausescu qui l'a dit, dans un tout récent discours, et donc c'est vrai. D'ailleurs son portrait géant trône dans le beau bureau couvert de boiseries de ce responsable de section, ancien secrétaire de parti et haut dirigeant du secteur minier. Il y a aussi le portrait de Madame (Ceausescu), mais plus petit, plus familier, posé sur le téléviseur. Les syndicats occupent le même bâtiment que le ministère du travail, et pendant quelques années les deux organismes avaient le même patron.

Cela fait des années que d'innombrables discours appellent les Roumains à travailler plus et mieux, tandis qu'une cascade de décrets s'appliquent à les y inciter, de gré ou de force. A mesure que la situation économique s'aggrave (les effets de la crise en Occident, évidemment), les appels se font plus pressants, les décisions plus radicales. Toute la Roumanie vit aujourd'hui sous le coup de l'une des dernières en date : la généralisation du système dit de l'« accord global », en octobre dernier. Très complexe, ce système aboutit dans la pratique à deux mesures concrètes : la rémunération au rendement (les travailleurs sont payés en fonction des résultats de l'entreprise, et donc de la réalisation du plan), et — corollaire — la suppression de tout salaire minimum.

Pris à la lettre, ce dispositif pourrait avoir des conséquences extrêmement graves sur le niveau des salaires — d'autant que, dans la grande majorité des cas les travailleurs n'ont aucune influence, sinon purement formelle, sur la marche de l'entreprise. Quant au plan, il est marqué par un tel volontarisme que sa réalisation est hautement aléatoire. Le plan ne prévoyait-il pas pour 1983 une production de bateaux de 842 000 tonnes sur une base de 393 000 tonnes produites l'année précédente; le résultat ne fut que de... 315 500 tonnes. Même chose pour les voitures : production 1982, 89 000 véhicules, plan 1983, 160 000; résultat, 76 900! Naturellement, il s'agit d'exemples limites, mais on n'a visiblement pas fini ici de prendre ses désirs pour des réalités.

Ordre et discipline

Pour l'instant, l'application générale de l'accord global n'en est qu'à ses balbutiements, et ses effets sont [illegible]

par le secteur minier et énergétique et en finissant par les administrations; mais les policiers ont été, semble-t-il, plus gâtés, et plus tôt : 40 % d'augmentation, dès l'automne 1982.

Il est en tout cas un point sur lequel tout le monde, officiels exceptés, est d'accord : le niveau de vie n'a pas cessé de baisser depuis plusieurs années, et surtout la vie est devenue plus difficile. Il y a bien sûr les queues, plus ou moins longues selon les produits et, surtout, selon les régions.

A Bucarest, c'est surtout la viande qui manque (quatre cents personnes, en plein centre, pour tenter d'acheter des lots de viande congelée et de volaille). La situation s'est améliorée récemment pour le lait (même s'il s'agit de lait reconstitué à partir de poudre) et les œufs — on dit que la récente période des « anniversaires » (successivement de Mme et de M. Ceausescu, au mois de janvier) explique ce « mieux ». Dans tout le pays, les seuls produits officiellement rationnés sont l'huile et la farine, mais il y a souvent des difficultés pour le pain.

Dans les rues, on rencontre nombre de gens dont le visage et les vêtements portent les marques de la vraie pauvreté — des vieux en particulier. Les gens plus riches ont d'autres problèmes : le manque d'essence (là aussi, queues interminables), de café, de bananes. Par contre, et contrairement à ce qui se passe en Pologne, on trouve sans grande difficulté la plupart des produits industriels (les meubles par exemple, les vêtements), même s'ils sont souvent de médiocre qualité et très chers.

De rares lumières...

Mais les privations les plus spectaculaires sont celles qui sont imposées par les économies d'énergie au premier chef. Dans les bâtiments publics, on n'allume de rares lumières qu'à la toute dernière extrémité, et les fonctionnaires restent engoncés dans leur manteau : on économise le chauffage. Les rues restent plongées dans la pénombre : au mieux un lampadaire sur deux, en plein centre, beaucoup moins dans les banlieues. Toutes les ampoules de plus de 40 watts ont disparu des magasins, et les Roumains sont priés de débrancher leurs réfrigérateurs l'hiver et de laver leur linge à la main.

De sévères amendes sont prévues pour les contrevenants, mais là encore on aurait tort de croire que ces consignes précises (18 watts pour l'éclairage de la salle de bains), rédigées en langage impérieux et accompagnées de l'habituel martèlement de la propagande, sont respectées.

La consommation d'énergie des ménages ne représente que 7 % de l'ensemble de la consommation roumaine. C'est encore trop : l'objectif

ter le fer dans la plaie, d'autant que M. Ceausescu semble en avoir fait un point d'honneur.

A cet égard, le résultat est brillant, et tout à fait de nature à satisfaire les experts du FMI, dont la Roumanie est membre : la dette globale a baissé ; elle est désormais, selon les chiffres officiels, inférieure à 9 milliards de dollars. Surtout, le solde de la balance commerciale est, pour la seconde année consécutive, nettement positif (173 milliards de lei (1) d'exportations, contre 130 milliards d'importations). Mieux, les opérations en devises ont dégagé un excédent net : 800 millions de dollars pour les échanges avec les pays d'Europe occidentale dont la part dans le commerce roumain a nettement diminué (23 % en 1983) au profit de celle du COMECON (49 %).

Ce genre d'exploit ne se réalise pas sans douleur : si les Roumains manquent de viande, c'est (en partie) parce qu'on en vend de grandes quantités à l'URSS et à l'Irak, pour payer le pétrole. Surtout on a taillé à la hache dans les importations — avant tout dans les équipements et les outillages, en application du principe « *produisons roumain* ». Jusqu'où peut-on aller dans cette voie sans causer trop de dégâts à une économie déjà mal en point, soumise à des directives aussi péremptoires que, parfois, opposées? Déjà, selon

certains observateurs, on a ét[é] loin, plusieurs usines ne trav[aillent] qu'à peine, le manque d'inve[stisse]ments se fait cruellement sen[tir ...] semble d'ailleurs qu'en haut l[ieu on] s'en soit aperçu. Vers la mi-f[évrier] M. Ceausescu a déclaré qu'il [fallait] importer les équipements ind[ispen]sables à la réalisation du [plan] quand il n'y avait pas d'autre [solu]tion. Au ministère du commer[ce ex]térieur, on laisse entrevoir, [pour] 1984 et surtout 1985, une repr[ise de] certaines importations.

Encore un décret

Mais ce n'est pas là-dessu[s que] l'on compte pour améliorer l'[appro]visionnement, guérir une agric[ulture] dont la maladie n'est guère e[xplica]ble dans un pays potentiell[ement] très riche — ne serait-ce qu'à [cause] des célèbres terres à blé de l[a Do]broudja.

Dans ce domaine, après qu[...] de discours et de résolutions [sur la] « révolution agraire », on bra[ndit à] nouveau l'arme secrète : un [...] *tul*, celui-là daté de la fin ja[nvier] qui constitue un catalogue de r[ecom]mandations, d'exigences et d[e me]naces adressées aux paysans p[ropri]taires de lopins privés : c[haque] famille de deux à trois person[nes est] désormais tenue de posséd[er au] moins une vache (ou cinq mou[tons] pour 1983 une production de bateaux de 842000 tonnes sur une base de 393000 tonnes produites l'année précédente; le résultat ne fut que de... 315500 tonnes. Même chose pour les voitures : production 1982, 89000 véhicules, plan 1983, 160000; résultat, 76900! Naturellement, il s'agit d'exemples limites, mais on n'a visiblement pas fini ici de prendre ses désirs pour des réalités.

Ordre et discipline

Pour l'instant, l'application générale de l'accord global n'en est qu'à ses balbutiements, et ses effets sont encore incertains. Au siège des syndicats, on indique que 70 % des entreprises industrielles ont dépassé le plan – en particulier toutes les mines de charbon – et qu'en conséquence les revenus de leurs salariés s'en sont trouvés accrus. Et on ajoute que le but premier de l'accord global est d'instaurer *« l'ordre et la discipline »*.

Les échos recueillis dans la population sont fort différents; ils tournent autour du thème : le système reste parfaitement obscur, mais le résultat est clair : les salaires ont baissé. Le chiffre de 25 % est le plus couramment cité. Il pourrait s'expliquer par le fait que le décret prévoit, au cas où l'entreprise n'est pas en état de réaliser le plan pour des raisons objectives (conditions atmosphériques, manque de pièces importées, etc.), une rémunération égale à 75 % du salaire habituel.

Tout cela peut-il être accepté sans douleur? Quelques mouvements de protestation ont été signalés (dans une usine de camions de Brasov par exemple), mais le problème a été rapidement réglé par des menaces de renvoi immédiat, particulièrement efficaces pour des ouvriers d'origine paysanne dont le revenu est indispensable à la famille restée à la campagne. Des grèves (officiellement, on n'est pas au courant) ont aussi été observées dans les mines du Maramures, et même à Bucarest.

Il semble, à essayer d'y voir clair au milieu de nombre de versions contradictoires, que dans la pratique le pouvoir soit enclin à céder ponctuellement aux revendications ouvrières dans les régions où elles risquent de présenter un certain danger. Officiellement, on indique qu'une augmentation générale des revenus de 10 % a été décidée : elle s'applique progressivement, de l'été 1983 à l'été 1984, en commençant dans les banlieues. Toutes les ampoules de plus de 40 watts ont disparu des magasins, et les Roumains sont priés de débrancher leurs réfrigérateurs l'hiver et de laver leur linge à la main.

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La consommation d'énergie des ménages ne représente que 7 % de l'ensemble de la consommation roumaine. C'est encore trop : l'objectif officiel est de diminuer de moitié ces dépenses. Tous les moyens sont bons : coupures d'eau chaude, de chauffage, raccourcissement des heures de cours et des récréations pour permettre aux écoliers de travailler à la lumière du jour, suppression pendant la semaine des deux chaînes de télévision et interruption des programmes dès 10 heures du soir (sauf le jour de l'anniversaire de M. Ceausescu, évidemment : l'émission a duré jusqu'à 2 heures du matin).

Priorité aux remboursements

Comment a-t-on pu en arriver là ? Le premier responsable désigné est la grave sécheresse qui a frappé cet été l'Europe balkanique (les Yougoslaves aussi en savent quelque chose) et réduit par conséquent la production d'énergie hydroélectrique. Elle a aussi limité la récolte de céréales à *« presque 20 millions de tonnes »* (contre 25 millions prévus par le plan – le plan 1984 est encore plus optimiste : 29 millions).

Mais il y a aussi d'autres raisons : l'impasse dans laquelle s'est engagée la Roumanie en développant une énorme industrie pétrolière au moment où elle était encore un gros producteur et aussi où elle pouvait importer à bas prix le complément d'hydrocarbures nécessaires à ses boulimiques raffineries. A présent que la production est tombée, officiellement à 12 millions de tonnes, la Roumanie doit, malgré tous les efforts d'économie, en importer presque autant au prix fort.

Et il faut, en plus, rembourser de lourdes dettes : après avoir longtemps cherché à retarder les échéances, quitte à user de diverses ruses pour ne pas payer les factures, les Roumains se sont décidés à por-

cc: EB
PCH

EUROPE

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Si le paysan est incapable de remplir ses obligations, ses terres devront être cédées à la coopérative, ou à d'autres paysans. Surtout, faute de vendre à l'État et à la région les quantités de grains ou de légumes requises, il lui sera désormais interdit d'acheter des fourrages et de vendre ses productions sur le marché privé (où les prix ont déjà été strictement limités). Ces exigences tatillonnes sont-elles réalistes — avec tout ce qu'elles supposent de contrôles bureaucratiques, ou de corruption pour y échapper? Ou s'agit-il, comme d'habitude, de menacer beaucoup pour obtenir un peu ?

La campagne roumaine, entièrement collectivisée dans la plaine, en partie privée dans les zones dites de montagne est encore terriblement arriérée. C'est son charme, non seulement en Transylvanie ou en Moldavie, mais même dans les petits villages de la région de Bucarest : on tire l'eau du puits, les carrioles à chevaux s'embourbent, on habite de jolies petites maisons aux couleurs vives, souvent ornées de verroteries, avec parfois des colonnettes plus ou moins droites. Les traditions, mi-païennes, mi-orthodoxes, sont encore bien vivantes. Il y a des bergers, vêtus d'une grosse peau de mouton, et aussi des tziganes, des vrais, qui habitent sous des tentes de toile grossière, en plein hiver. Il paraît qu'ils sont riches...

Tout cela est bel et bon. Mais comment expliquer que la Roumanie, pays européen, plutôt bien doté par la nature, soit encore, quarante ans après la fin de la guerre, un pays « en voie de développement », industrialisé à la hussarde, sans souci du coût économique et humain, ballotté entre les ordres et les contre-ordres ?

Depuis quarante ans, ces paysans, à qui l'on accorde royalement de 800 à 1 000 lei par mois pour les kolkhoziens (le salaire moyen dans l'industrie est de 2 400 lei), sont abreuvés de discours, et priés, comme la « classe ouvrière » restée en fait tout près de la glèbe, d'applaudir des deux mains des dirigeants infaillibles — dont les œuvres complètes s'étalent jusque dans les petites librairies de village. Quand les choses vont mal, quand l'avenir radieux tarde à venir, on demande à ces fourmis de se serrer la ceinture et de travailler plus. Les cigales, elles, continuent à chanter. Et la morale de la fable n'est pas pour demain.

(1) 100 lei valent 45 francs au cours commercial.

Prochain article :

QUELQUES MURMURES ISOLÉS DANS LA FOULE.

INTERNATIONAL MONETARY FUND

TO :

FROM:

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~~tels~~ le Monde of 29/2

page 9 where the "income policy" of Romania is quenced at [illegible] looks hardly effective

LAW

Yes, but if we really want to affect the adjustment process it's here we have to insert our "crowbar" — eventually at least.

HS

cc: FED
BH

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MR WHITTOME, EUROPEAN DEPARTMENT
INTERFUND
WASHINGTON

ROMANIAN MISSION WILL LEAVE BUCHAREST ON FRIDAY, MARCH2.
BREHMER, PRUST, REITMAER, PUCKAHTIKOM AND WINDSON WILL ARRIVEN
IN WASHINGTON AS SCHEDULED.
BREHMER

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CALLED: Mrs. Brehmer

BEING CALLED: Mrs. Prust

SPECIAL DELIVERY CABLE

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EB

Office Memorandum

TO : Mr. L. A. Whittome

FROM : J. J. Polak

SUBJECT : Romania

DATE: February 29, 1984

I understand that Mr. Brehmer will be back from his mission to Romania on Monday March 5. I shall be leaving for Romania on the Wednesday morning thereafter. I would appreciate it if during Monday and Tuesday you could arrange:

(a) a briefing for me by Mr. Brehmer about his trip and

(b) a discussion with yourself on your current thoughts for a new standby arrangement with Romania.

EUROPE

Roumanie

Des trous dans le mythe

(Suite de la première page.)

Cette indépendance, censée excuser tant de choses, combien de fois pourtant n'a-t-elle pas été mise en doute, à mesure que le prestige de M. Ceausescu s'effilochait à l'Ouest, tandis que ses foucades savamment contrôlées semblaient impressionner de moins en moins Moscou. Ainsi personne ne s'est vraiment étonné de voir M. Andrei Gromyko quitter Bucarest, au début du mois, avec en poche un communiqué commun où les thèses originales de la Roumanie sur les euromissiles semblaient singul[illegible]ent affadies. A la veille de cet[illegible]site, les Soviétiques avaient annoncé la livraison à la Roumanie d'un pétrole très convoité ici, et cela, croyait-on alors, à des conditions beaucoup plus favorables qu'auparavant. La cause semblait entendue : Bucarest, étranglé par les difficultés économiques, avait dû baisser publiquement le front.

Erreur, du moins pour ce qui concerne ce fameux pétrole. Quand, après un long détour à travers le dédale des informations et rumeurs contradictoires qui circulent à Bucarest, sur ce sujet comme sur les autres, on peut accéder aux meilleures sources (un haut représentant

dentaux de faire le premier pas en retirant les Pershing. Certes le but ultime reste, dans la thèse roumaine, un désengagement équilibré. Mais en attendant, l'objectif « intermédiaire » ne recoupe-t-il pas à peu près celui de Moscou ?

Pourtant, sur les euromissiles, comme sur des questions plus régionales comme le projet de « dénucléarisation » des Balkans, on s'applique avec soin à cultiver la différence, dans les textes officiels et plus encore dans les commentaires qui ne le sont pas. D'abord en soulignant, avec une pointe de dédain, que la Roumanie ne saurait être mise sur le même plan que les pays frères « orthodoxes ». Et puis en faisant remarquer qu'on ne peut tout de même pas demander l'impossible à un pays doté d'un si puissant voisin. Ce qui revient à dire, si l'on comprend bien, qu'un peu d'ambiguïté et beaucoup de subtilité sont nécessaires pour tenir le cap dans ces eaux bien difficiles, mais qu'à son tour l'Occident doit faire preuve de compréhension.

En même temps, on affiche une totale absence d'illusions à propos du comportement de Moscou : « *Les Soviétiques ne rendent jamais les* d'autant que le contrat ne couvre que la période allant de décembre 1983 (date des premières livraisons) à la fin juillet 1984.

Finesses et ambiguïtés

Les Roumains peuvent donc tenter d'obtenir un supplément pour la seconde partie de l'année. Mais quant à obtenir un contrat rédigé en roubles transférables (une vieille revendication de Bucarest), *« on peut toujours espérer »*, mais visiblement sans y croire, pas plus qu'on ne croit vraiment à une réunion rapide de ce sommet du COMECON, réclamée depuis des années, et avec insistance, par M. Ceausescu pour discuter notamment de la répartition des matières premières et des combustibles.

On comprend mieux alors la réflexion acide faite à Bucarest par M. Gromyko : *« Comme l'hiver est doux ici ; vous n'avez vraiment pas besoin de notre pétrole pour vous chauffer. »* Humour visiblement peu prisé par M. Ceausescu, si on en juge par sa réponse. *« Il fait doux, c'est vrai, mais nous avons tout de même besoin de pétrole... »* De même, ce n'est sans doute pas par excès de charité que les Soviétiques ont annoncé, trois jours avant l'arrivée de M. Gromyko, ces livraisons de pétrole et les autres composantes d'un accord commercial signé en fait en décembre dernier, et surtout qu'ils ont laissé circuler sans les démentir des informations qui attiraient fatalement des commentaires désobligeants pour les Roumains.

A propos des euromissiles, devenus le fer de lance de la politique extérieure de M. Ceausescu, la position roumaine n'est guère plus facile à débrouiller. En dépit des brillantes explications d'un diplomate roumain de haut niveau, on a du mal à se défaire de l'idée que, au moins depuis la fin de l'année dernière, Bucarest a modifié son discours pour le rapprocher des thèses soviétiques. Après avoir dénoncé naguère, avec une égale sévérité, ou presque, l'implantation des Pershing américaines et la présence des SS-20 soviétiques, la Roumanie reproche à présent à l'OTAN d'avoir provoqué les contre-mesures soviétiques. Sans appr[illegible]ver ces contre-mesures (les Ro[illegible]s refusent même d'envisager [illegible]plantation d'euromissiles sur leur territoire, évacué par l'armée soviétique en 1957), Bucarest demande tout de même aux Occi-

plus qu'ailleurs « le style, c'est l'homme ». Et ce n'est certainement pas un hasard si la colossale campagne « pacifiste » organisée en Roumanie depuis plus de deux ans a été tout entière centrée autour d'un slogan très simple, répété à l'infini : *« Ceausescu Pace »*.

Même si les invraisemblables excès du « culte » laissent forcément l'étranger perplexe, il semble bien, sur ce point en tout cas, conserver une certaine efficacité. Nombre de Roumains, et pas seulement les officiels, se demandent par exemple si les Soviétiques ne tenteront pas de remettre la patte sur leur pays en cas de disparition du *« conducator »*.

Encore faut-il, pour conserver cet atout, que la stature internationale de M. Ceausescu soit reconnue périodiquement de par le monde, avant tout en Occident, mais aussi dans le tiers-monde, où la Roumanie est très active. C'est à cela que servent, entre autres, les multiples déplacements de M. Ceausescu à l'étranger, les nombreuses visites qu'il reçoit. Et c'est pourquoi on peut s'attendre à une prochaine visite du président roumain au Canada – pour rendre la politesse à M. Trudeau, qui vient de séjourner à Bucarest, – et surtout, si possible, aux Etats-Unis. Et c'est pour cette même raison que, au-delà de la *« traditionnelle amitié franco-roumaine »*, Bucarest tient tant à recevoir cette année la visite de M. François Mitterrand, prévue pour l'automne 1982, mais reportée alors à la suite de circonstances « fâcheuses », en l'occurrence l'affaire Virgil Tanase (1).

JAN KRAUZE.

Prochain article :

VINGT-DEUX MILLIONS DE FOURMIS ET QUELQUES CIGALES

(1) Le 20 mai 1982, M. Tanase, écrivain, citoyen français d'origine roumaine, avait disparu à l'occasion d'un faux enlèvement. La DST avait eu vent d'une mesure d'enlèvement par les services spéciaux roumains, et avait fait disparaître M. Tanase, avec sa complicité, pendant trois mois. Les informations du service français avaient pour origine les déclarations d'un agent roumain « retourné ».

ROUMANIE : des trous dans le mythe

Le Monde Feb. 28, 1984 W/ cc: EB + POH

I. – Le style, c'est l'homme

De notre envoyé spécial JAN KRAUZE

Bucarest. – Une phrase sèche, douze minutes après le début du journal télévisé. C'était bien assez pour annoncer aux Roumains, le 10 février, la mort de Iouri Andropov. La Roumanie est membre du pacte de Varsovie, membre du Comecon, elle a 1 200 kilomètres de frontière avec l'URSS, et un régime imposé par Moscou au lendemain de la guerre – là comme ailleurs dans cette partie de l'Europe. Mais il ne sera pas dit que la mort du grand chef du camp socialiste puisse impressionner en quoi que ce soit M. Ceausescu. Au même moment, toutes les autres télévisions des pays frères se répandaient en lamentations. Et les voisins bulgares échappaient même à toute comparaison, puisque ce soir là, comme tous les vendredis, la télévision de Sofia, parfaitement reçue à Bucarest, diffusait les émissions de Moscou, en russe.

Le lendemain encore, tandis que l'émetteur de Sofia, redevenu bulgare malgré tout, poursuivait sur le mode lugubre une infinité d'hommages au regretté disparu, Bucarest ne changeait pas un iota à son programme, pour une fois plutôt gai. Pouvait-on rêver plus bel exemple de cette indépendance dont on aime tant se draper ici ?

Naturellement, à y regarder de plus près, les choses sont un peu moins simples. La presse roumaine a publié en première page, le lendemain, la biographie et le portrait « officiels » du défunt, et un message de condoléances (attristées, mais sans plus) de M. Ceausescu. Le jour des obsèques a été décrété jour de deuil national et, bien entendu, le secrétaire général du PC roumain a fait le voyage de Moscou, avant d'envoyer de très chaleureuses félicitations à M. Tchernenko. C'était bien le moins. Mais l'essentiel est sans doute ailleurs : l'étonnant comportement de la télévision roumaine s'explique en fait pour une très grande part par la nécessité impérieuse de respecter, en toutes circonstances, une stricte hiérarchie des valeurs, et donc de rendre compte, d'abord, et longuement, des activités du camarade Ceausescu. Andropov, défunt ou pas, a donc dû attendre qu'on informe en détail les Roumains de l'entretien accordé ce jour-là par leur président à une délégation des syndicats bulgares. *« Ici, ils n'ont qu'un seul dieu »*, commentait un observateur d'un autre pays de l'Est, partagé entre la dérision et l'envie. Cela dit, l'effet produit, en ces circonstances comme en bien d'autres, est remarquable : comment ne pas reconnaître que la Roumanie n'est vraiment pas un pays socialiste comme les autres ?

(Lire la suite page 6.)

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MR WHITTOME,EUROPEAN DEPARTMENT
INTERFUND
WASHINGTON

ROMANIAN MISSION ARRIVED.BREHMER ROOM 1606,PRUST 1603,
REITMAIER 1607,PUCKAHTIKOM 1604,WINDSOR 1609.MISSION WILL STAY
IN BRASOV FEBRUARY 24-27.
BREHMER

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REPLY VIA ITT

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TIME: 11:47 02/21/84 EDT
CONNECT TIME : 113 SECONDS

called: Mrs. Prust
Mrs. Brehmer

EUR
ETR
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Mr. Polak   February 7, 1984

L.A. Whittome

Romania--Fact-Finding Visit

As you will recall, the 1981 stand-by arrangement had among its main objectives the alignment of domestic prices with world prices and the unification of the commercial exchange rate. If memory serves me correctly, these objectives were very much those of the Romanian authorities themselves though we certainly were in sympathy with them for we thought that they would contribute to putting Romania's balance of payments on a sound footing over the longer run. With the termination of the 1981 agreement we now have an opportunity to clarify, with the help of the authorities, the results and relevance of the changes made under that program. This is especially important given that for several months the authorities have argued that further moves in the direction decided upon in 1981 would be either excessive or even irrelevant.

It is urgently necessary that before any new negotiation gets under way we have an informed basis on which to judge the relevance and effectiveness of various instruments which could advance the joint objective of achieving a sustainable external position. My own suggested starting point would be to consider what have been the effects of the measures introduced under the three year stand-by arrangement, especially the complete unification of the commercial exchange rate, the depreciation of the leu and the rise in interest rates. To put the matter bluntly, would the evolution of the Romanian economy have been different if these changes had not been implemented and if so in what way and by how much?

Answers to such questions should allow a joint view as to the relevance of pushing further in these directions. If the wisdom of this approach seemed doubtful then the question arises as to whether there are more effective instruments that could achieve the same objectives and if so whether they are of a nature that the Fund could be involved with and could monitor.

I am aware that there are probably no simple answers to many of these questions but I hope that Mr. Brehmer and his colleagues will be given the help necessary for them to make at least tentative judgments in these areas. I should mention that without the support of Minister Gigea it will be difficult for the staff team to be successful in their task.

You will note that at Mr. Marin's direct request we have sent him a telex intended to help the Ministry organize the meetings that we feel will be essential for our purpose.

The mission is of course not now authorized to discuss a new program with the Romanians.

cc: Mr. Brehmer
EED

Mr. Whittome

2

cc: [illegible]

Mr. Stelian Marin
Director, Ministry of Finance
Bucharest, Romania

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Mr. Polak
Mr. Whittome
Eastern European (files)

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A. As we have agreed in January, a Fund staff team will visit Romania for a period of approximately 10 days, starting on February 22, 1984. The team will consist of Messrs. Prust and Reitmaier, Ms. Puckahtikom, Miss Windsor, as secretary, and myself, and will arrive in Bucharest on February 21 at 3:35 p.m. via Lufthansa flight No 370. We are making reservations at the Intercontinental.

B. The chief purpose of the staff visit is to seek a better understanding of the working of the Romanian economic system with particular reference to two main questions: (1) How responsive is the Romanian economic system in the short and longer term to the structural price reform measures of the type included in the 1983 program under the stand-by, particularly the devaluation, and what are the obstacles to this response? (2) What are the economic measures that are appropriate in the Romanian system to promote a sustainable external position?

C. To explore these questions we would greatly appreciate

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Eckhard Brehmer

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Romania 2

it if we could talk to: production enterprises engaged in both export production and sales to the domestic market, the related foreign trade enterprises (FTEs), related centrals and specialized ministries, relevant units of the State Planning Commission and of the Ministry of Foreign Trade, and the Bank for Foreign Trade. We would want to cover in this way three representative activities--one each in the industrial, agricultural, and tourist sectors. Please feel free to add further institutions, if you believe that his would help our task. We would also like to visit additional enterprises and related FTEs if time permits.

D. At this stage we leave it up to you to allot the time for our various meetings but would greatly welcome it if you would give us some flexibility to lengthen, if need be, certain meetings or to arrange follow-up meetings. To facilitate your preparations for our visit and to give our discussion partners a fair idea of what ground we will cover, I am listing the following questions. The list is

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Romania 3

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What are the consequences of profits falling short of, or exceeding, planned levels? In particular, to what extent are enterprises free to use the profits created by a devaluation? Can they hope for quick approval of additional inputs to expand export production?

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Ekhard Brehmer

INTERFUND

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Mr. Stelian Marin
Director, Ministry of Finance
Bucharest, Romania

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Mr. Whittome
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European (files)

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A. W. Brehmer

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Office Memorandum

cc:

January 23, 1983

To: Treasurer
Internal Auditor
Director, European Department
Director, Exchange and Trade Relations Department
Director, Fiscal Affairs Department

From: The Secretary

Subject: Romania - Stand-By Arrangement - Review

At EBM/84/12 (1/23/84) the Executive Board approved the decision set forth in EBS/83/273 (12/23/83).

BANQUE FRANCO ROUMAINE

S. A. AU CAPITAL DE 40.000.000 F L.B.F. N° 536

20, RUE DE LA BAUME, 75008 PARIS

LE PRÉSIDENT

FEB 8 1984

PARIS, LE 31 Janvier 1984

Monsieur Jacques de LAROSIERE
Directeur Général
INTERNATIONAL MONETARY FUND
100/19th Street NW
WASHINGTON DC (ETATS-UNIS)

Monsieur le Directeur Général et Cher Ami,

Je n'ai pas oublié l'accueil que vous m'avez réservé lors de mon passage à Washington au mois de novembre dernier.

Je vous remercie de cet entretien et de l'intérêt que vous portez à la Roumanie, notre commune préocupation.

J'ai été convié, en ce début de semaine, à l'Ambassade de Roumanie à Paris par M. MANESCU, Vice-Président du Conseil d'Etat roumain c'est-à-dire le n° 2 de l'appareil politique de ce pays. C'est un homme courtois et fin qui connait parfaitement la situation financière et économique de la Roumanie et les problèmes qui en découlent.

Sur ce sujet, il m'a confirmé que la balance des paiements ferait ressortir pour 1983 un excédent de USD 2 milliards. Ce résultat permet à la Roumanie de ne pas demander, à la différence des autres pays surendettés, le rééchelonnement de la dette exigible en 1984. J'ai pu le vérifier car les échéances tombant normalement en ce début d'année ont été honorées à bonne date.

Par ailleurs, le règlement en capital des dettes de 1983 continuera également d'être assuré, celui concernant les dettes de 1981 et 1982 ne devant reprendre qu'à partir de mai 1985.

Quant au paiement des intérêts, il est ponctuellement effectué.

Je vous signale, d'autre part, que la Commission de Contrôle des Banques en France ne recommande plus aux banques de provisionner les créances sur la Roumanie. Enfin, les mêmes banques, dans leur ensemble, n'exigent plus systématiquement la constitution de dépôts par la B.R.C.E. lorsqu'elles confirment des crédits documentaires; les unes n'en demandent pas, les autres se contentent d'un pourcentage variable.

../...

Enfin, je crois savoir que les banques étrangères reprennent le financement d'opérations commerciales avec la Roumanie.

M.MANESCU est bien entendu informé de cette évolution et m'a déclaré que son pays tiendrait les engagement qu'il a pris pour le remboursement de sa dette.

Il m'a parlé également des questions en suspens avec le Fonds Monétaire International dont vous avez bien voulu m'entretenir. Je lui ai indiqué que la Roumanie, si elle voulait consolider et rétablir tout à fait sa crédibilité, devait respecter ce qu'elle avait signé, notamment au Fonds Monétaire International.

Je lui ai toutefois signalé que vous étiez très sensible à l'effort de redressement que la Roumanie a déja réalisé et que vous seriez attentif à toute proposition qu'il pourrait vous faire.

M. MANESCU m'a demandé d'aller le voir à chaque voyage. Comme je dois partir en principe à Bucarest le 14 Février prochain pour quelques jours, je le reverrai donc à cette occasion. Si vous avez un message indirect à lui transmettre, je suis bien entendu à votre disposition. Dès mon retour, je vous ferai part de mes impressions de voyage.

Enfin, M. MANESCU serait très désireux que vous envisagiez de vous rendre vous-même en Roumanie. Je crois que le déplacement en vaut la peine pour prendre la mesure de ce qui a été fait et comprendre beaucoup de choses qui nous échappent.

Veuillez agréer, Monsieur le Directeur Général et Cher Ami, l'expression de mes sentiments les meilleurs. et mes fidèles amitiés

M. Genin

M. GENIN

Office Memorandum

JAN 20 1984

TO : The Managing Director
The Deputy Managing Director

DATE: January 20, 1984

FROM : L.A. Whittome / AW

SUBJECT : Romania

As you will recall, in December the Romanians refused to reiterate their commitment to unify by July 1, 1984 the noncommercial rate (lei 14.1 per U.S. dollar on January 1, 1984) and the commercial rate (lei 21.56 per U.S. dollar on January 1, 1984). Instead we agreed with Mr. Polak on December 16, 1983 that it would be satisfactory if he were authorized by the Minister to tell the Board on January 23, 1984 that the Romanian authorities stand by their commitment. However, Mr. Polak has now told me that this authorization has yet to be provided by the Romanian authorities. The Romanians take the view that their earlier promises stand and, of course, Mr. Polak takes a similar line. We have our private doubts on this matter. If, as is probable, the subject is raised in the Board it would seem best if Mr. Polak were to answer the questions on behalf of the Romanians. Mr. Polak has agreed to do this.

cc: Mr. Collins

INTERNATIONAL MONETARY FUND

Mr. Whittome:

I hope that the attached is sufficient!

(Actually I asked Mr. Jonessen to send this memo to you.)

E. Brehmer 1/19

Office Memorandum

1/Mr
19/1

TO : Mr. Ekhard Brehmer, Advisor, European Department

DATE: January 18, 1984

FROM : Liviu Ionescu, E.D.'s Advisor

SUBJECT: The meaning of the Savings and Consignment House (Bank) in Romania

Regarding our conversation of today, I inform you that under the Romanian law and practice, the "Casa de Economii si Consemnatiuni" (or in a rough English translation, the Savings and Consignment House (Caisse)) is not considered to be a bank. Its role is mainly to attract savings from the households through current and savings deposits. A part of these resources (about 40% in the mid '70s) has been used to extend housing credits to the population. The remainder is made available to the National Bank to finance its own lending operations to the economic units(for which, indeed, the lending rates were increased most recently on January 1, 1984.)

The housing credits are strictly regulated, in the sense that they are extended only to first-home buyers, who buy their homes from the state. These credits are transferable only if the new buyer is also a first-home one. Once that credit is repaid, the owner cannot borrow under a new mortgage.

For additional information on this issue, please see the World Bank country study of 1979 called "Romania - The Industrialization of an Agrarian Economy under Socialist Planning" (pg. 291-292 and 488).

CO ER
ETD

Office Memorandum

JAN 19 1984

CONFIDENTIAL

TO: The Managing Director ✓
The Deputy Managing Director

January 18, 1984

FROM: L. A. Whittome / [signature]

SUBJECT: Romania

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Jan 19 84

Mr. Marin of the Romanian Ministry of Finance visited Washington on January 12-13, 1984. One of the chief objectives of his visit to Washington was to explore the prospects for a new stand-by with the Fund and the way in which conditionality would be applied in the program. We told him that, with a large convertible current account surplus now in prospect for the third year in a row, and given the capital account outlook, Romania would find it difficult to establish the balance of payments need which could justify drawings from the Fund under any stand-by arrangement. We declined to discuss in detail the way in which conditionality would be applied. This would be premature, for any program under a new stand-by cannot be in place before June 1, 1984. We also indicated to Mr. Marin in general terms that any future program is most likely to require further actions designed to improve the economic mechanism of Romania and this would, in the light of past experience, be very difficult to negotiate.

We also told Mr. Marin that better knowledge on our part of the Romanian economic mechanism might facilitate our discussions of future programs and also enable us to judge better than in the past the changes that would be most appropriate in the Romanian economic system to establish a sustainable position. To this end, we have requested that a staff team visit Romania for a ten-day period starting on February 22. Mr. Marin agreed. While such a mission may produce some results, I remain skeptical as to whether the Romanians will permit us to have too close a look at their system and whether they have people capable of explaining its working to us in a candid and analytically useful fashion. Unless this exercise is completed, we should not consider their possible request to enter detailed discussions about a new program. Our position in summary remains, therefore, much as in my memorandum of December 16, 1983: we would prefer not to enter into a new stand-by arrangement with Romania, if this were at all possible, both because of the problem of need and the very strong resistance on the part of the Romanian Government to accept any measures that would "improve" the economic mechanism, because this would be in conflict with the official objective of keeping prices stable and would entail a loss of control by the Government.

to our satisfaction. The sheer sending of a mission should not trigger consideration of a new S.B.A. request

Mr. Marin also requested a postponement to 1985 of SDR 68 million in repurchases falling due in 1984 on the grounds that the present stand-by arrangement with an undrawn amount of SDR 285 million will be cancelled as of January 31, 1984. Our policies do not allow us to agree to this request and our rejection of it may well speed up the Romanians' decision to request a new stand-by arrangement.

cc: Mr. Finch
Mr. Nicoletopoulos
Mr. Brehmer
EED
Mr. Collins

Mr. Whittome

Office Memorandum

January 16, 1984

MEMORANDUM FOR FILES

Subject: Romania - Request for Postponement of Some Repurchases with Respect to Purchases Under the CFF

During his visit to the Fund on January 12-13, 1984, Mr. Marin of the Romanian Ministry of Finance requested that a total of SDR 68.3 million of repurchases with respect to purchases under the CFF, made in May 1980 and June 1981, and maturing in February, May, September, and November 1984, be postponed to 1985 (see attachment). He argued that his postponement would be required in view of the cancellation of the existing stand-by with an undrawn balance of SDR 285 million.

I consulted Mr. Wittich in this matter. He said that since the Amendment of the Articles in 1978 no such postponement of repurchases were permitted by the Fund, even not in severe circumstances. Any credit extended by the Fund has been on the basis of stand-by arrangements which take ~~s~~ account of the amount of repurchases due. Therefore, the Romanian request cannot be accepted. The postponement of the repurchases would, in my view, also aggrevate the situation in 1985, when Romania will experience a sharp increase in its debt repayment obligations.

I informed Messrs. Polak and Ionescu about the staff position on this matter. Mr. Ionescu promised to inform Mr. Marin accordingly.

E. Brehmer 1/17/84

Attachment

cc: Mr. Whittome o/r
Mr. Rose
Mr. Kanesa-Thasan
EED

Romania - Repurchases with respect to CFF purchases.

	Finanţarea compensatorie primită la 21 mai 1980		Finanţarea compensatorie primită la 18 şi respectiv 22 iunie 1981	
20. VIII. 1983	(1)	15.156.250 Achit.		
20. XI. 1983	(2)	15.156.250 Achit.		
20. II. 1984	(3)	$\boxed{15.156.250}$		
20. V. 1984	(4)	$\boxed{15.156.250}$		
20. VIII. 1984	(5)	15.156.250		
17. IX. 1984	(1)		(1)	$\boxed{19.000.000}$
20. XI. 1984	(6)	15.156.250		
17. XII. 1984	(2)		(2)	$\boxed{19.000.000}$
5. I. 1985	(3)	15.156.250		
15. II. 1985	(7)	15.156.250		
17. III. 1985			(3)	19.000.000
5. IV. 1985	(4)	15.156.250		
15. V. 1985	(8)	15.156.250		
17. VI. 1985			(4)	19.000.000
1. VIII. 1985			(1)	19.000.000
17. IX. 1985			(5)	19.000.000
1. XI. 1985			(2)	19.000.000
17. XII. 1985			(6)	19.000.000
17. III. 1986			(7)	19.000.000
17. VI. 1986			(8)	19.000.000

Office Memorandum

2

January 10, 1984

MEMORANDUM FOR FILES

Subject: Mission to Romania

I spoke to Mr. Palmer this morning and explained that we would be sending a small technical nonoperational mission to Romania in February to improve our knowledge of the functioning of the Romanian economy. We wished to keep the mission small and felt that there was no need for an ETR person to go. He did not demur.

Brian Rose BR

cc: Mr. Brehmer
Mr. Hole

cc: EED
EB

IMF OFFICIAL CABLE

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I M F UR WASHINGTON D.C.
ATT. MR.A.WHITTOME
~~DIRECTOR I M F - EUROPEAN~~ DEPARTMENT
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DEAR SIR,

ACCORDING TO OUR UNDERSTATING, IN DECEMBER 1983, I AM INFORMING YOU ABOUT THE FOLLOWING ACTIONS TAKEN ON JANUARY 1, 1984 :

1. DEVALUATION OF THE COMMERCIAL RATE BY 15 PERCENT AGAINST THE BASKET. THE COMMERCIAL RATE IN EFFECT ON JANUARY 1, 1984 IS 21.56 LEI/1 US DOLLAR. THE NONCOMMERCIAL RATE IS 14.01 LEI/1 US DOLLAR.
2. INCREASES OF 2 PERCENTAGE POINTS IN LENDING RATES OF INTEREST AND IN ENTERPRISE DEPOSIT RATES.
3. INTRODUCTION OF A CAPITAL CHARGE (AT RATE OF 7 PERCENT) ON THE UNAMORTIZED AMOUNT OF NEW INVESTMENT FINANCING PROVIDED FROM THE BUDGET.
4. SHORTENING OF DEPRECIATION SCHEDULES ON FIXED ASSETS IN THE MACHINE-BUILDING IN DUSTRY CONSISTENT WITH PARAGRAPH LC OF THE LETTER OF INTENT.
5. INCREASE IN THE DOMESTIC PRODUCER PRICE OF CRUDE OIL FROM LEI 1,100 PER TON TO LEI 1,750 PER TON.

WE ARE LOOKING FORWARD THE STAFF PAPER WHICH WILL BE PRESENTED TO THE BOARD AT THE END OF JANUARY 1984.

BEST REGARDS,
CORNEL IUGA

11239A MIFINR
248331 IMF UR
MMMN
Time: 04:16 01/04/84 ???
Connect Time : 207 seconds

ORIG: EURO
CC: MD
DMD
MR. POLAK
ETR
LEG
RES
SEC
TRE
BUREAU OF STAT.
MR. S. COLLINS