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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/142

3:00 p.m., September 12, 1984

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	W. B. Tshishimbi
	H. G. Schneider
	X. Blandin
	M. A. Weitz, Temporary
	M. K. Bush
	T. Alhaimus
H. Fujino	T. Yamashita
G. Grosche	
	I. R. Panday, Temporary
	D. I. S. Shaw, Temporary
	G. W. K. Pickering, Temporary
A. Kafka	C. Robalino
G. Lovato	N. Coumbis
	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
J. J. Polak	
A. R. G. Prowse	
	O. Kabbaj
	M. Camara, Temporary
	J. L. Feito
	A. Lindø
	T. A. Clark
Zhang Z.	

L. Van Houtven, Secretary
K. S. Friedman, Assistant

Also Present

Administration Department: J. B. Kaiser. African Department: J. B. Zulu, Director; J. P. Briffaux, E. A. Calamitsis, F. d'A. Collings, S. E. Cronquist, I. A. H. Diogo, M. G. Fiator, C. J. Hoban, S. N'guiamba, M. Sidibé, A. Tahari. Asian Department: W. G. L. Evers. European Department: L. A. Whittome, Counsellor and Director; P. C. Hole, L. G. Manison, J. Prust, J. P. Reitmaier, P. M. Thomsen. Exchange and Trade Relations Department: S. Mookerjee, Deputy Director; M. Allen, E. H. Brau. Fiscal Affairs Department: E.-A. Conrad. Legal Department: G. P. Nicoletopoulos, Director; P. L. Francotte, W. E. Holder, S. A. Silard. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; B. R. Hughes. Treasurer's Department: D. Williams, Deputy Treasurer; D. Berthet, D. Gupta, T. B. C. Leddy, T. M. Tran, G. Wittich. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. El-Khouri, L. Ionescu, W. Moerke, G. E. L. Nguyen, D. C. Templeman. Assistants to Executive Directors: H. Alaoui-Abdallaoui, J. R. N. Almeida, R. L. Bernardo, M. B. Chatah, Chen J., L. E. J. M. Coene, G. Ercel, D. Hammann, N. Haque, H. Kobayashi, A. Koné, M. Lundsager, E. Olsen, E. Portas, D. J. Robinson, A. A. Scholten, Wang C. Y.

1. INTERIM AND DEVELOPMENT COMMITTEES - ARRANGEMENTS

The Chairman commented that steps were being taken to strengthen security at headquarters for the coming meetings of the Group of Twenty-Four, the Development Committee, and the Interim Committee, mainly to ensure that only authorized persons entered the building. The procedures might cause some inconvenience, but he hoped that there would be full cooperation in following them.

The Secretary remarked that under the special security procedures described in detail in Administrative Circular 84/25 (9/14/84), pedestrian and vehicular access to the headquarters building would be tightened. Some delays in entering the building might well occur, and Executive Directors could help to limit them by giving the reception desk advance notice of any visitors to the building during the period September 19-23. The reception desk would then be able to minimize the delay in permitting outsiders to enter. Vehicles entering the garage would be checked more thoroughly than in the past.

All staff members in the building would be required to display identification passes on their person at all times, the Secretary explained. The guards would be empowered to stop anyone in the building who was not displaying proper identification. The delegates would be free to move around the building when they wore the meeting badges issued upon registration. Other visitors would receive passes from the reception desk that also would have to be displayed at all times.

Mr. Kafka said that he was confident that there were good reasons for the additional security measures and that all Executive Directors would support them fully.

The Executive Directors took note of the security arrangements for the forthcoming meetings.

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:

> This staff report, as well as the highly informative report of recent economic developments, shows the results not only of the consultation itself but also of a preparatory staff mission in February 1984, which was devoted entirely to increasing the knowledge and understanding of the staff of the workings of the planning and decision-making mechanism of the Romanian economy

and included visits to major industries, export organizations, etc. The Romanian authorities appreciate the special effort made by the staff to enhance mutual understanding and see in this a valuable basis for close cooperation between Romania and the Fund over years to come.

For the first time in the last four years, the Article IV consultation with Romania is not accompanied by use of Fund resources by the country. As the staff rightly emphasizes in its appraisal, Romania has made an impressive turnaround of its convertible current account position, from a deficit of $2.4 billion in 1980 to a steady surplus both in 1982 and 1983. And there are strong indications that the forecast higher surplus for 1984 will be achieved; the convertible current account surplus in the first half of 1984 represents 57.1 percent of the target for the whole year. In comparison, the surplus for the first half of last year represented only 46.2 percent of the whole year result. Romania was able in this period to reduce substantially its gross and net external debt, a unique performance among the debtor member countries.

All this was achieved by maintaining during the entire period a growing GNP (Table 4), although the growth was smaller than in the 1970s. This growth trend clearly indicates that the country has overcome its most difficult moments and that recovery is under way.

Obviously, such a tremendous adjustment could not be brought about without a great deal of sacrifice. Imports had to be cut, but much of this could be accommodated by other changes; for instance, the investment program, which had been very dynamic in the 1970s, had to be reconsidered in the light of more expensive energy and of shrinking export markets; smaller exports required smaller imports of raw materials and intermediate goods; and the country's sophisticated industrial capacity was able to play a more appropriate role in import substitution. All things considered, Romania's total non-oil imports were reduced by only 21 percent between 1981 and 1983. I would not think, therefore, that the reduced level of imports has put the country's potential for future expansion in jeopardy. Nevertheless, as Table 43 shows, the negative trend in convertible exports and imports was clearly reversed in the fourth quarter of 1983. The data for the first semester of 1984 show that the improvement has continued. Non-oil convertible exports have increased during this period by 8.6 percent over the comparable period of 1983, and non-oil convertible imports have increased by 12.5 percent.

Perhaps some projected growth rates for 1984 are ambitious. For example, GNP in constant prices is projected to increase by 7.3 percent in 1984, more than double the 1983 rate. However, one should not forget that this projection is based mostly on a projected strong recovery of agricultural output, after its decrease in 1983 because of a continued drought that affected most of Eastern Europe. Very recently, it was announced that the already completed harvest of wheat, rye, and barley was the largest in the country's history, with wheat output being 40 percent higher than in 1983. There are indications that the forthcoming harvest of corn also will be very good too.

But if, finally, the GNP growth proves to be one, or even two, points less than 7.3 percent, it will still constitute a very good economic performance. It should be observed that a smaller growth rate would not be incompatible with the planned performance of the various components of the economy, as the Romanian planners follow the practice of providing for a large "planned reserve" (3.6 percent of GNP in 1984), which could absorb a smaller growth rate.

One major policy area on which I want to comment is the Romanian authorities' approach toward future borrowing abroad. Traditionally, Romania has had a conservative approach to borrowing abroad. It was only after joining the IMF and the World Bank that an active borrowing policy was initiated. Unfortunately, this was soon followed by the world economic recession of 1979-80, higher costs for energy imports, sharp increases in interest rates, shrinking world trade, and accompanying restrictions on Romanian exports. As a consequence, Romania's external debt position deteriorated very sharply in just two years (1979-80), mostly by increases in short-term debt. Thus, although the net indebtedness of the country was not very high in relation to GNP or exports, the maturity schedules of the debt made the country very vulnerable to an adverse change in attitude by its creditors. While much has been said since 1981 about the decrease of lenders' confidence in Romania's creditworthiness, it should be stressed that the authorities' confidence in international lenders was also greatly shaken. Also contributing to their present prudent attitude toward new borrowings has been the very high cost--high market interest rates and excessive spreads required by banks--associated since 1980 with international credits. These spreads vary with the credit rating of the country. And the authorities are unhappy that despite their strong adjustment, Romania's rating on international markets is still much lower than the country deserves. The authorities feel that the time has come for the banks to look more at the country's series of positive achievements since 1981 than constantly to cast doubt on the sustainability of its adjustment process.

I note a certain tendency on the part of the staff, too, to underrate adjustments made and to emphasize remaining shortcomings. For instance, in the section on price reform, the staff seems to take as its optimum model that higher costs of imports should be reflected pro tanto in higher prices of the products into which the imported materials are incorporated. The Romanian system is intended to avoid that by making price increases difficult, thereby putting pressure on enterprises to cut down on the use of imported materials and to reduce costs generally. The price policy can also cut profits of the enterprises concerned and lead to reduced tax payments by them; in short, it seems to have many of the effects that a higher degree of competition--which Romania lacks--would have had in economies organized on capitalist lines. Nevertheless, the authorities remain firmly committed to the cost-plus principle, and their pricing system is flexible enough to allow price increases whenever other means for offsetting higher production costs are exhausted.

Finally, I have three smaller comments.

First, the staff expressed uncertainty about the authorities' intentions regarding incomes policies, because the increase in real average net remuneration in 1984 will be higher than the planned increase in productivity. I do not see an inconsistency between the Government's intentions and the staff's statistical observation. General increases in remuneration are not granted every year in Romania. For example, the current increase was the first one since 1981; it started in September 1983 and was put into effect sector by sector during the next 12 months, until August 1, 1984. It was meant to cover 1982-84. Therefore, the difference between the observed growth in productivity and the actual average increase in remuneration would provide only a partial compensation for the sharp decline in real incomes in 1982 and, to a smaller extent, in 1983.

Second, on page 4 of the staff report it is said that although foreign reserves increased in 1983, their level at end-1983 was $179 million below the target stipulated in the 1983 program. Board members will no doubt recall that the projected increase for international reserves had assumed the purchase before end-1983 of the last two tranches of the 1983 program under the stand-by arrangement. Those two purchases, in the amount of about $190 million, could be made only in January 1984, after the failure to meet the target had been waived by the Board.

Finally, I want to refer to the possible resumption of borrowing from the World Bank. On page 1 of its report the staff observes that such a resumption would be contingent on agreement between Romania and the World Bank on debt reporting. I have learned, however, from the World Bank's regional division dealing with Romania, that the country has already entered in the normal reporting procedure of its external debt, as of April 1984, and that there are no pending problems that would stand in the way of future borrowing by Romania from the Bank.

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 only tentatively.

The staff had indicated certain deficiencies in the development of the economy in 1983, Mr. Zhang continued. But it had also said that considerable progress had been made, 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 to the equivalent of 5.5 percent of GNP, a record matched by few debtor countries.

The present report raised significant broad 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 rate, devaluing the rate, and pegging it to a basket of currencies would significantly affect the external position. In fact, those measures had apparently had little or no effect. The external current account had improved because of the authorities' decision to cut imports following the general intensification of trade restrictions abroad, the stagnation in Romania's principal markets, and the fall in exports. There seemed to be no justification for the staff conclusion that the usefulness of the devaluations 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 centrally planned economies recognized 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 knew 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. Moreover, since it involved the determination of priorities with respect to the various social sectors and the distribution of income, it ran the risk of compromising certain basic economic and social principles. Given those considerations, the Romanian authorities' decision to slow the pace of price adjustments was acceptable.

The corrective measures normally applied in market-oriented 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. The Fund's insistence on a large number of policy details placed an unnecessary constraint on nonmarket member countries 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 costs involved. Moreover, because the general instability of the world economic situation made it impossible to forecast future interest rates and the demand for Romania's exports with any great confidence, the balance between the advantages and disadvantages of further large-scale borrowing was not obvious.

As to Romania's plan for 1984, Mr. Zhang said, it was difficult to assess the importance of the discrepancies between various output targets the staff had noted. The staff's doubts about the attainability of the targets for agriculture seemed somewhat exaggerated. The staff apparently felt that those particular 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." Presumably the staff felt that increases in prices received by individual producers 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 when harvests were good. In any event, assessments of effective price changes should take into account a number of factors such as weather conditions, changes in the scope of collective farming, and the availability within the agricultural sector of fertilizers, fodder, consumer goods, and equipment.

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. Moreover, the staff apparently expected Romania to achieve far more than the increased flexibility in the export sector and greater attention to world prices in setting domestic prices that were supposed to make devaluations work in market economies but by no means always did so.

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 total foreign exchange transactions, and its role was limited 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, 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 clear-cut 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 in any event clearly been in Romania's own interest. Indeed, she had stressed that failure to implement such reforms could undermine the effort to achieve a sustainable balance of payments position.

The present medium-term prospects for growth and balance of payments sustainability were a cause for concern, Ms. Bush commented. Apparently the authorities either were not convinced that changes in relative prices were useful in encouraging exports and investment, or, having 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. In that connection, it was important to note that, as the staff had remarked, even in an essentially planned economy, the quality of policy decisions could be enhanced when data on the relative profitability of firms and sectors were available. Accordingly, the staff suggestion to improve the value and price data for exports and imports, direction of trade statistics, and the domestic price series was clearly 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, they would not allow the effects of 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 to be fully passed through to domestic prices. The results of that decision should be offset to some extent by productivity increases, selective tax relief for enterprises, and reduced price ceilings in the peasant markets. While price changes were admittedly politically sensitive, the efforts to increase productivity were certainly welcome, and limitations on price increases might encourage greater productivity; the allocative function of relative prices should not be undermined. As the staff had noted, if prices were to play a role in resource allocation in the medium term, more flexibility would obviously be needed in setting prices as well as 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, as 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 exports needed to achieve the convertible 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. 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 the staff report was drafted.

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, hinder 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 remarked. Although there had been a sizable increase in imports, the level of imports was still relatively low, and a further pickup 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 on to those 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 when they faced 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 detract from the consistency of fiscal policy planning. 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 1980 level, Mr. Grosche remarked. In that context, the assumed improvement in the oil balance seemed overoptimistic, 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 substantial 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. For instance, presumably the cumulative decline of about 45 percent in the volume of imports from the convertible area in 1980-83 should have adversely affected industrial production, which had traditionally made the main contribution to net output. At the same time, 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 had apparently had the same effect 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 various 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, as 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 to $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 to make every effort to reduce the country's foreign debt, Mr. Coumbis said, and then planned to continue their efforts in the future. They intended to cut the debt 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. While 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, 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. In that connection, it was important to note that there were substantial differences of opinion between the staff and the authorities; for instance, the rate of increase of GNP in 1983 and 1984, the role of prices in the economy, and the possible effects on Romania's development effort during the adjustment period. He wondered whether those differences did not indicate that the staff and the Executive Board should carefully re-examine their usual policy recommendations for 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 and that 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, it would be unwise to try to reduce total debt so rapidly that profitable investments would not be undertaken, further 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 new strategy would require 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 attempt to stabilize all domestic prices.

Commenting on specific aspects of policy, Mr. Clark noted that, while the recovery of non-oil exports in 1984 was encouraging, the experience of 1983 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. There should be some reduction in convertible currency oil imports in coming years following the agreement by the U.S.S.R. 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.

Referring to structural policy, Mr. Clark said that he welcomed the introduction of a system of wage determination based more closely than hitherto on productivity developments. However, the authorities' forecast of an 8 percent increase in labor productivity in 1984 seemed optimistic. He wondered whether there were yet any indications of the effectiveness of the new wage system. The discussion on pages 8 and 9 of the staff paper underscored the limitations imposed by Romania's institutional arrangements on the country's exchange rate and price policies. 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. Would that arrangement not affect the response to exchange rate changes? Apparently the exchange rate did not directly affect producing enterprises. Profitability was an important target for those enterprises. Perhaps the limitations on the effectiveness of exchange rate policy could be mitigated by an adjustment of the tax and profit target regime applied to exporting enterprises. The staff had noted that none of the effect of price and exchange rate changes was passed on to suppliers--a situation which had caused problems in other Eastern European countries. Consequently, the response to such changes had to come through the central plan. However, it was unrealistic to expect that modifications to the central plan would take account of the complex implications for the whole economy of price and exchange rate changes. That 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 the exchange and pricing systems of centrally planned economies were in need of improvement, which must be accompanied by measures to ensure that those systems send signals that could be transmitted effectively. Moreover, 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 useful.

Indeed, 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 under way." 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 the effects of the depreciation of the exchange rate to be fully passed through to domestic prices, 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, it was difficult to know the precise level at which to fix prices, 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, experiencing negative effects on productivity, incentives to produce, and tax payments. The authorities apparently felt that there was some room in the economy to cut costs by reducing the use of imported materials. 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. Accordingly, 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 goal of rapidly reducing 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's resorting to financial markets in order to ease the import constraint.

A further comment on the so-called statistical shortcomings in Romania would be helpful, Mr. Blandin commented. The inconsistencies between the data on the growth of output and on 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 to a single large cut.

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 once 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. For instance, 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 continued, 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 staff's pricing proposals were a major part of the structural adjustment needed to achieve medium-term economic recovery, Mr. Shaw remarked. Energy prices had been gradually increased, but they were still well below world levels, and the failure to raise natural 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 to consolidate it a number of structural adjustment measures would have to be introduced, 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 in Romania's economic data, Mr. Shaw commented. There was a considerable lag in the availability of data on the national accounts and trade, including volume and price data, and trade with the nonconvertible area in particular. If confidence in the Romanian economy was to be restored, 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.

Mr. Lindå said that the authorities were to be commended for their strong adjustment efforts in 1981-83. Their record was matched by only a few other debtor countries. 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. Lindå 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 one of the objectives 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 ongoing 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, increased energy efficiency, and, most important, administrative restraints on imports, Mr. Prowse said. 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 convertible area, did not suggest 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 reinforcing 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. The decline in trade with the convertible area 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, however, 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 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 in 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 those price increases had caused in Romania, the authorities had decided during 1983 to keep prices virtually stable, and consumer prices had since remained essentially unchanged. The Fund's recommendations concerning the exchange rate and prices had thus lost much of their force. The authorities' decision to cancel the stand-by arrangement had been due in part to the realization that having decided 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 had the ability to improve 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 by 100 percent, and the production of an even more important crop, maize, was estimated to rise by 50 percent.

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 significant potential difficulties in maintaining adequate supplies of spare parts.

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 Director noted. 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 would, if used for productive purposes, permit more rapid growth of imports, thereby paving the way for an improved export performance and helping to stabilize the current account surplus, the Director remarked. 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. The amount of $500 million a year in 1985-89, over and above the figure in the official scenario, had been used for presentational purposes; the staff did not know for certain whether Romania could actually borrow that amount. But additional capital inflows of approximately that magnitude 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 was often a rate in force before the start of the relevant plan period.

The authorities believed that the present exchange rate was appropriate, the Director noted. 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. One of the reasons for the authorities' reluctance to unify the rates was the difference in the rates for the convertible and nonconvertible areas that would result.

The staff representative from the European Department remarked that the authorities' attention had been drawn 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 the exports of a particular sector. The authorities had noted that the targets were applied and adjusted in a sufficiently flexible manner to prevent such a contraction.

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, although 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 further increase in the 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; nor was it 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 in 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 1981-83, which was matched by few debtor countries. However, they also noted that the improvement had been brought about largely 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 the 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 also focused on the following: 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:

1. The Fund takes this decision relating to exchange measures of Romania subject to Article VIII, Section 3, in concluding the 1984 Article XIV consultation with Romania and in the light of the 1984 Article IV consultation with Romania conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Comprehensive restrictions on the making of payments and transfers for current international transactions are maintained by Romania in accordance with Article XIV. The multiple currency practice of Romania resulting from differential exchange rates for its currency with respect to commercial and noncommercial transactions is subject to approval under Article VIII, Section 3, and the Fund urges Romania to eliminate this practice as soon as possible. Moreover, the Fund encourages Romania to continue its efforts to reduce reliance on bilateral payments arrangements

with other Fund members and welcomes the removal of restrictions on the making of transfers of balances under a remaining bilateral payments arrangement.

Decision No. 7806-(84/142), adopted
September 12, 1984

2. CHAD - OVERDUE FINANCIAL OBLIGATIONS

The Executive Directors considered a staff paper on the status of Chad's overdue financial obligations to the Fund (EBS/84/193, 9/7/84).

Mr. Alfidja considered that the Executive Board had been wise to send a new staff mission to Chad to discuss possible ways in which the authorities could eliminate their overdue financial obligations to the Fund. The staff had had the opportunity to meet not only with the Chadian authorities but also with representatives of the regional central bank (BEAC) and other interested parties. The staff's analysis in EBS/84/193 confirmed, as he had stated during the previous discussion on Chad (EBM/84/115, 7/27/84), that the authorities were struggling to revive the economy and restore the public administration after the highly destructive war. Their efforts had been hampered by the shortage of financial resources. Despite a significant increase in government revenue owing to progress made in centralizing government operations and to the good performance of the cotton sector, receipts in 1984 were likely to amount to only CFAF 12 billion compared with the initial projection for expenditure of nearly CFAF 38 billion. In the absence of corrective measures, the deficit would have amounted to CFAF 26 billion, with no resources available to finance it. In order to reduce the imbalance, the wage bill had been cut by more than 60 percent, as civil servants had received only half their pay and military personnel less than one fourth; appropriations for supplies and materials and central government services had been halved; no appropriations for investment had been made; and outlays for security had been kept to a minimum.

Despite the exceptional circumstances of Chad, the authorities were committed to maintaining good relations with the Fund and had fully cooperated with the staff mission, Mr. Alfidja said. The authorities had indicated that the expected increase in cotton profits in 1984 was already committed to improving productivity in the cotton sector. They had shown great interest in the staff proposal to enable Chad in effect to make partial and temporary use of its SDRs held by the BEAC. That option was being carefully studied by the Government and the BEAC, and management would soon be informed of the outcome of the consultations among them. He agreed with the staff conclusion on page 11 that Chad's economic and financial rehabilitation required the financial and technical support of individual external donors and the international community at large.

Mr. Prowse commented that he too believed that it had been helpful to send an additional mission to Chad. Some progress had apparently been made toward solving the problem of Chad's overdue financial obligations.

In theory Chad could use its reserve tranche or the SDRs held for it by the BEAC; in fact, however, Chad could use its reserve tranche only by placing an equivalent amount in CFA francs with the BEAC or by borrowing from the BEAC. The Government's financial position was still precarious despite the substantial measures recently introduced. The authorities probably would not be able to mobilize sufficient domestic counterpart funds to use the reserve tranche, and they had in addition already received the maximum permissible credit from the BEAC. As the staff had noted, it would be inappropriate to urge the BEAC to alter its regulations to accommodate the temporary need of an individual member.

Chad's option to use its SDRs also posed problems because the CFAF equivalent of the SDRs held by the BEAC were kept in a blocked account in keeping with the requirements of membership in the regional central bank, Mr. Prowse observed. However, the BEAC officials seemed favorably disposed to the proposal under which the BEAC would release temporarily--without establishing a precedent--the CFAF counterpart of Chad's SDR holdings up to an amount equivalent to its obligations to the Fund through end-1984. The details still had to be worked out, but a BEAC ministerial meeting was to be held in September, and the Board of Directors of the regional central bank was due to meet in October. The Fund Executive Board's formal consideration of the Managing Director's complaint under Rule K-1, scheduled for October 1, 1984, should be postponed until the BEAC Board of Directors had met, by which time the Fund would have a better idea of whether or not the proposed solution would work.

However, the proposed option would not eliminate the underlying problem--namely, Chad's continuing inability to meet its financial obligations to the Fund--and the member might well need to exercise a similar option in 1985, Mr. Prowse went on. A lasting solution to the problem still had to be found. The staff should give further thought to the problems facing member countries whose reserve assets were held by a regional central bank.

The staff representative from the African Department, responding to a question by Mr. Nimatallah, said that the proposed solution could probably be implemented within one or two weeks after its acceptance by the BEAC Board of Directors. The staff would have a better idea of the likely outcome after the September BEAC ministerial meeting.

Mr. Blandin considered that the staff report showed that the Executive Board had acted appropriately in postponing any final action on Chad's overdue financial obligations until after the return of the latest staff mission. The report provided a clearer picture of the situation in the country and contained a proposal that would permit Chad to meet its obligations to the Fund through end-1984 and that confirmed the benefits for Chad of membership in the regional central bank. There was a good chance that the overdue obligations would be eliminated soon after the next meeting of the BEAC Board of Directors--which would have to approve the solution proposed by the staff--and the coming meeting of the finance ministers of the French franc area would help to pave the way for that outcome. In the circumstances, the Fund Executive Board's consideration of the Chairman's complaint under Rule K-1 should be postponed until after the meeting of the BEAC Board of Directors.

The staff report clearly showed that the economic situation in Chad was still very difficult, Mr. Blandin commented. The authorities' efforts to rebuild the public administration and to revive the economy would greatly benefit from technical assistance by the Fund.

Mr. Nimatallah agreed that the Executive Board had acted wisely in sending an additional staff mission to Chad, although a more complete staff report would have been useful. For instance, he wondered why the BEAC could not extend additional credit to Chad, particularly as the BEAC had sufficient foreign exchange. The solution favored by the staff--namely, the provision by the BEAC of the CFAF equivalent of Chad's SDR holdings with the BEAC--seemed practicable and would enable the country to meet its obligations to the Fund through the end of 1984. A further comment on the precise steps needed to implement that proposal and on the Chadian authorities' attitude toward it would be helpful.

The Executive Board's formal consideration of the Managing Director's complaint under Rule K-1 should be postponed to give the Chadian authorities sufficient time to eliminate the overdue obligations, Mr. Nimatallah stated. The staff should explore with the BEAC authorities a possible mechanism that could be triggered when a BEAC member needed to meet its financial obligations to the Fund. Member countries' overdue payments to the Fund were still a cause for concern, and the Executive Board should take a further look at the problem in the near future.

The Chairman suggested that the Executive Board could meet during the 1984 Annual Meetings to examine the progress toward implementing the solution proposed by the staff.

Mr. Nimatallah considered that a meeting of the Executive Board during the 1984 Annual Meetings to receive a progress report on Chad's overdue financial obligations would be helpful.

Ms. Bush said that she wondered whether the staff had any indication of the likely reaction of the BEAC Board of Directors to the staff proposal. A meeting of the Fund Executive Board during the 1984 Annual Meetings to consider a progress report might well be helpful, especially as the Executive Board had decided to wait until October 1, 1984 to consider the Managing Director's formal complaint under Rule K-1 in order to be able to take into account the outcome of the BEAC ministerial meeting scheduled for late September.

Mr. Blandin said that in light of the coming discussions among the BEAC authorities and member countries, the Executive Board should meet during the 1984 Annual Meetings to consider a progress report on Chad's overdue financial obligations.

The Chairman remarked that it seemed best to hold a further discussion on Chad during the 1984 Annual Meetings and, for the time being, to keep the October 1, 1984 date for the consideration of the complaint under Rule K-1. The Executive Board could conceivably select another date after considering the staff's progress report on Chad.

Ms. Bush said that the progress report should describe the Chadian authorities' response to the staff proposal for eliminating the country's overdue financial obligations.

The staff representative from the African Department commented that the BEAC-related solutions, excluding the use of the CFAF equivalent of Chad's SDR holdings, would involve an upward revision of the ceiling on credit from the BEAC to Chad. A decision to that effect would have to be taken by the BEAC Board of Directors. The BEAC officials believed that the present arrangements, including the ceiling on credit to individual member countries, had worked well, and they saw no need to change them in order to meet the temporary need of an individual country.

Mr. Nimatallah commented that the Fund was in an uncomfortable position: a member country with overdue financial obligations had sufficient foreign exchange to make the necessary payments, but could not do so because of the arrangements of a regional central bank. The BEAC should help to solve the problem, even if the ceiling on its credit to Chad had to be raised temporarily; available foreign exchange could be used as a guarantee of the loan repayment. A possible mechanism to ensure that BEAC members could meet their financial obligations to the Fund should be explored with the BEAC authorities.

The Chairman remarked that the relationship between the Fund, regional central banks, and their individual member countries should be further explored as a separate issue.

Mr. Alfidja commented that the Chadian authorities were meeting with BEAC officials. A further Executive Board meeting to consider a progress report would be helpful.

The Chairman commented that overdue financial obligations to the Fund were a serious matter, and the Chadian authorities would no doubt recognize that the Executive Board was greatly interested in learning of their progress in eliminating their overdue payments.

Mr. Prowse agreed that a further Executive Board meeting to consider a progress report would be helpful. On previous occasions Executive Directors had expressed an interest in having the staff examine the relationship between the Fund and currency unions and their members. He wondered whether the staff had made any progress in that area. That general problem should be kept separate from the particular issue of Chad's overdue financial obligations.

The staff representative from the Treasurer's Department responded that the staff had learned a great deal more about the operation of the BEAC during its latest visit to Chad. However, the mission had concentrated on possible solutions to Chad's particular problem and had not dealt with the broader issue of the relationship between the Fund and currency unions in general.

The Director of the Legal Department added that the staff had given some thought to possible ways of reconciling the requirements of membership in a currency union and the obligations of membership in the Fund. The staff would be willing to produce, if the Board so desired, a paper on the general subject some time after the particular problem of Chad's overdue obligations had been solved.

The Chairman remarked that the staff would wish to continue examining separately the problem of Chad's overdue financial obligations to the Fund as well as the more general question of the relationship between the requirements of membership in a currency union and the need for member countries to meet their obligations to the Fund. He proposed that Executive Directors should meet during the 1984 Annual Meetings to consider a progress report on Chad's situation.

The Executive Directors accepted the Chairman's proposal.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/84/141 (9/12/84) and EBM/84/142 (9/12/84).

4. RELATIONS WITH GATT - CONSULTATIONS WITH CONTRACTING PARTIES - FUND REPRESENTATION

The Executive Board approves Fund representation at the consultations with the CONTRACTING PARTIES to the GATT on Korea, Portugal, Bangladesh, and the Philippines to be held in Geneva in the week of October 29, 1984 as set forth in EBD/84/238 (9/7/84).

Adopted September 12, 1984

APPROVED: July 3, 1985

LEO VAN HOUTVEN
Secretary