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CONFIDENTIAL

March 8, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Romania - Staff Report for Review Under Stand-By Arrangement
and Approval of Exchange Restrictions

Attached for consideration by the Executive Directors is the staff report for the review under the stand-by arrangement for Romania and the approval of exchange restrictions. Draft decisions appear on pages 26 through 28.

It is proposed to bring the subject to the agenda for discussion on Wednesday, March 30, 1983.

Att: (1)

INTERNATIONAL MONETARY FUND

ROMANIA

Staff Report for Review under Stand-By Arrangement
and Approval of Exchange Restriction 1/

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

(In consultation with the Legal and Treasurer's Departments)

Approved by L. A. Whittome and Subimal Mookerjee

March 7, 1983

I. Introduction

A staff team consisting of Messrs. Mentré, Brehmer, Hole (all EUR), Paljarvi (ETR), Prust (EUR), Ms. Salop (EUR), and Miss Emerson (EUR) as secretary visited Bucharest January 12-28, 1983 to review performance under the stand-by arrangement, to establish a program for 1983, to explore the status of the rescheduling of debt falling due in 1982 and 1983, and to discuss the broad outlines of the four studies--of the exchange rate mechanism, interest rates, the inclusion in prices of the total cost of capital, and the appropriate price of energy--to be undertaken by the Romanian authorities in 1983 jointly with the Fund staff. The Romanian delegation was led by the Deputy Minister of Finance, Mr. Bituleanu, and Mr. Marin of the Ministry of Finance. The mission was received by the Minister of Finance, Mr. Gigea, the Governor of the National Bank, Mr. Rauta, and the President of the Romanian Bank for Foreign Trade, Mr. Eremia.

The current stand-by arrangement for Romania was approved by the Executive Board on June 15, 1981 (EBS/81/111, 6/1/81) in an amount of SDR 1,102.5 million, equivalent to 300 per cent of quota. Romania has so far made three purchases under the arrangement--for SDR 140 million in June 1981, SDR 10 million in June 1982, and SDR 300 million in December 1982--bringing the total amount drawn to 122 per cent of quota. As of February 15, 1983, the Fund's holdings of lei amounted to the equivalent of SDR 1,144 million or 311 per cent of quota, 2/ including holdings related to purchases under the compensatory financing facility (SDR 317 million or 86 per cent of quota) and under enlarged access (SDR 222 million or 60.5 per cent of quota).

Romania met all performance criteria during 1982 except that, as of the end of the year, external payments arrears had not been eliminated as

1/ A statistical supplement will be issued shortly.

2/ For details of Romania's relations with the Fund, see Appendix I.

obligations to suppliers totalling US\$388 million remained unsettled. It is the authorities' intention to regularize this situation by March 15, 1983.

In the attached letter to the Managing Director, the Minister of Finance sets out the Government's principal policy intentions for 1983 (Appendix III). The proposed next purchase under the stand-by, SDR 91.9 million, would become available following satisfactory completion of the present review.

Total gross disbursements by the World Bank to Romania in 1982 amounted to US\$331 million and are projected at about US\$250 million in 1983. At the time of writing this report, an IBRD mission is in Romania taking stock of changes in the structure of new investment and the reorientation of investment under the Five-Year Plan for 1981-85.

II. Economic Developments in 1982

1. External developments

a. Convertible balance of payments

(1) The current account

During 1982 the overriding goal of economic policy in Romania was to obtain a further improvement in the convertible current account position. Following the reduction of the current account deficit from US\$2.4 billion in 1980 to US\$818 million in 1981, the 1982 program, described in the April paper (EBS/82/73, 4/29/82) and presented to the Board in June 1982, was designed to limit the deficit to US\$450 million. However, since the assumptions concerning Romania's ability to finance this deficit turned out to have been too optimistic, the adjustment effort had to be accelerated during the year; thus the November paper (EBS/82/218, 11/24/82) changed the program target to a surplus of US\$257 million on external current account, and at the time of the December review that target was further raised to US\$300 million. In the event, the convertible current account registered an even larger surplus of US\$655 million (1.3 per cent of GNP), bringing the improvement in the current account in the period since 1980 to the equivalent of 6 per cent of the 1982 GNP. Practically all of the turnaround in the current account between 1981 and 1982 was accounted for by an increase in the trade surplus from US\$204 million to US\$1,525 million.

Even allowing for the sluggishness of export markets, Romania's export performance in 1982 was disappointing, putting the whole adjustment of the convertible trade balance on the curtailment of imports. The original 1982 program envisaged an increase in convertible exports of 5 per cent, to a total of US\$7,600 million; in the event, exports reached only US\$6,235 million, or 14 per cent less than the year before. About half of the reduction from 1981 is explained by developments related to

lower exports of refined petroleum products. During the year the authorities introduced stricter profitability criteria on the importing of crude oil to be refined for export. This measure, together with declines in world market prices for oil and refined oil products reduced oil exports by US\$500 million. However, this was matched by an even larger reduction in crude oil imports. Non-oil exports also fell by US\$500 million or 9 per cent, partly reflecting lower prices in terms of U.S. dollars stemming from the latter's appreciation against major European currencies and supply constraints for some exporters.

With the decline of exports, the improvement in the trade surplus in 1982 was achieved through a further reduction in imports. Compared with the marginal increase originally programmed and the decline of 17 per cent forecast in November, convertible imports fell by one third in 1982, bringing the cumulative fall from 1980 to over 40 per cent. The retrenchment, which was particularly severe during the last two quarters of 1982, resulted from curbs on consumption and on import-intensive fixed investment expenditures, intensified efforts to economize on imported inputs by producing enterprises, a drawdown of raw material stocks, and stringent energy-saving measures. The process was also substantially assisted by record harvests for most agricultural products. Of the total reduction in imports of US\$2.3 billion, the decrease in crude oil imports for re-exporting accounted for nearly US\$600 million and the reduced imports of crude oil for domestic consumption for another US\$300 million. Non-oil imports fell by almost two fifths during the year. ^{1/}

As in recent years, interest payments formed the major part of the convertible services account in 1982. Interest rates in the international markets were substantially lower than had been projected in the program and net interest payments accordingly were almost US\$300 million less. With falling imports, net transportation expenditure declined by US\$200 million. Net receipts from tourism were disappointing, falling by about US\$70 million in 1982 and remaining US\$90 million less than expected. In total, the deficit on account of services was US\$870 million, compared with the program estimate of US\$1 billion and the deficit of US\$1 billion recorded in 1981.

(2) The capital account, debt rescheduling, payments arrears, and reserves

The initial current account target for 1982 had been calculated on the assumption of a net inflow of capital of US\$1,297 million. Of this, US\$675 million represented fresh medium- and long-term credits from both the IBRD and foreign suppliers and US\$500 million short-term import-related suppliers' credits. Early in the year the Romanian authorities approached the country's major creditors to obtain a rescheduling of payments arrears and debt service obligations falling due during 1982. Negotiations carried out during the first part of the year gave promise

^{1/} Developments of major subitems of imports are discussed in Chapter II, section 2, below.

that the total amount of debt service obligations to be rescheduled with commercial banks, official creditors, banking institutions from socialist countries, certain central banks from the Middle East as well as foreign suppliers might amount to US\$3.3 billion in 1982. In the event, the amount of debt relief was only US\$2.7 billion as official short-term credits were excluded from rescheduling, and some banks and suppliers were able by various means to obtain debt repayments from Romania totaling US\$400 million. In addition, Romania had to place US\$120 million on special accounts to guarantee import payments. Accordingly, the financial resources at Romania's disposal turned out to be less than initially programmed. All told, the capital account in convertible currencies registered a surplus of barely US\$100 million.

The debt rescheduling agreements 1/ with governments provided that 80 per cent of the interest, principal, and arrears on official and officially guaranteed medium- and long-term debts due by the end of 1982, and unpaid, would be rescheduled over six and a half years, including a three-year grace period, at interest rates based on market rates. By the end of the year bilateral agreements had been signed with all but three countries (Canada, Germany, and the United States) and with few exceptions downpayments under these agreements had been made. Since then the agreement with Canada has also been signed and in the attached letter of intent the authorities have undertaken to conclude the remaining agreements by the end of February 1983. The rescheduling agreement with commercial banks was signed by Romania and the coordinating group of nine banks on December 7, 1982. The terms of this agreement are similar to those arranged with the Paris Club, but exclude interest payments and include short-term debt. The 20 per cent downpayment of US\$307 million is split into two equal installments: the first one was made at the end of January 1983 and the other is due by March 31, 1983. For this purpose Romania opened a special account with the BIS in late 1982, financed mainly by purchases from the Fund. The two CMEA banks in Moscow were not officially included in the rescheduling agreements, but separate agreements with these institutions provide for rescheduling on terms similar to those applied to official creditors in the Paris Club.

The process of obtaining rescheduling agreements with suppliers not covered by government guarantees has been difficult and time consuming. Of the total US\$1,270 million reschedulable nongovernment guaranteed debt owed to suppliers as of March 1, 1982, an amount of US\$388 million had not been settled by end-1982. Of the latter amount, US\$18 million represented claims of small suppliers which were repaid in January 1983, and US\$370 million comprised arrears to large suppliers, who declined to accept rescheduling terms comparable to those agreed with the banks. Most of the large suppliers were willing to reschedule their claims for shorter periods, but the authorities were reluctant to accept offers not in accordance with the agreement signed with the commercial banks. 2/

1/ For more details, see Annex I to EBS/82/218 (11/24/82).

2/ The "suppliers arrears program" included in the rescheduling agreement between Romania and the commercial banks requires that the outstanding stock of debt to suppliers not fall below a certain amount

In the attached letter, the authorities have expressed their intention to eliminate the remaining arrears by March 15, 1983, i.e., prior to Board consideration of the economic program for 1983.

Despite the substantial adjustment of the current account, and the relief afforded by debt rescheduling, the targeted increase in gross convertible reserves of US\$125 million was not achieved in 1982. Instead, at the end of 1982 gross reserves stood, at US\$587 million, only slightly higher than a year earlier. However, with the sharp decline in imports, the import coverage of reserves rose from 0.9 months at end-1981 to 1 1/2 months at end-1982.

b. Nonconvertible balance of payments

At the start of 1982 Romania expected to run a current account deficit vis-à-vis the nonconvertible area of some US\$100 million, but instead the outcome was a surplus of US\$385 million. This mainly resulted from significantly lower levels of imports and, to a lesser extent, exports than had been planned. There was a net capital outflow to the nonconvertible area of US\$343 million. With an increase in debit balances of about US\$150 million under bilateral payments arrangements with countries outside CMEA, the implication is that Romania registered an overall payments surplus vis-à-vis CMEA countries of almost US\$200 million. The authorities were insistent that no part of the surplus was due to sales of goods that could have been sold in hard currency markets.

2. Domestic implications--1982

As outlined above, the larger-than-forecast surpluses on the external trade and current accounts in 1982 were achieved by an even sharper decline in imports than had been projected in November. This was largely brought about by administrative measures supported by financial and incomes policies, including a sharp decline in real wages, a doubling of the budget surplus, and tighter monetary and credit policies. Together with weak foreign demand, the measures to conserve energy and to limit enterprise imports held back domestic production, and in particular kept the growth in gross industrial production to about 1 per cent in 1982. This marked the second consecutive year of almost no growth and contrasted sharply with the 10 per cent average annual growth recorded in 1976-80. Overall, industry, which accounts for about 60 per cent of national income, contributed about half of the officially estimated 3.2 per cent growth in GNP, while agriculture, about 20 per cent of national income, contributed the other half.

1/(Cont'd from p. 4) (estimated at US\$275 million) until May 1985. Hence, strictly speaking, the arrears could have been rescheduled on different terms or even paid in full (without violating the bank agreement) on the basis of fresh supplier credits. However, unless these credits could be rolled over until 1985, it might turn out that, the arrears having been paid, the stock of suppliers' debt would fall below the stated floor, putting Romania in violation of the agreement and triggering a mandatory prepayment to the banks.

a. Aggregate demand

The improvement in the external current account in 1982 exceeded the growth of the economy and thus necessitated a reduction in domestic absorption of 0.5 per cent compared with the increase of 2.0 per cent forecast in November. Relative to 1981, consumption declined by 1.2 per cent and gross fixed investment by 3.1 per cent, while additions to stocks as a proportion of GNP rose from 1.2 per cent in 1981 to 2.3 per cent in 1982.

(1) Consumption

Real consumption fell by 1.2 per cent, mirroring an estimated 5.3 per cent decrease in household real cash income, and a 7.4 per cent decrease in real wages. 1/ These developments largely reflect substantial consumer price increases--17.8 per cent on average--for which less than full wage and benefit compensation was provided to the population. The fact that consumer purchases in real terms fell by less than household real income implied a decline in the net 2/ savings rate of 3.0 percentage points, to 2 per cent of disposable income. The drop in the savings rate--to an historically very low level--suggests that the balance struck between price increases, on the one hand, and compensation, on the other, was at least sufficient to bring the purchasing power of the cash income of the population into line with the overall availability of goods; furthermore, the large rise in consumer prices was probably sufficient to much reduce the previous excess in household liquidity.

(2) Investment

The behavior of fixed investment also reflected the balance of payments constraint. Instead of growing by 3.0 per cent as planned, gross fixed investment fell by 3.1 per cent as the investment program was revised to take account of the need to conserve imports and to increase exports. In real terms, gross fixed investment declined by 11.1 per cent in industry and 1.8 per cent in agriculture, was flat in construction, and rose by 10.9 per cent in housing and 32.0 per cent in transport and telecommunication. Within industry, energy-intensive lines of production were curbed, energy efficiency was improved, and production of raw materials was encouraged. As a result, there was a fall in real investment outlays for machine building, ferrous metallurgy, and chemicals, and a rise for electricity and thermal power. Investment in nonferrous metallurgy rose substantially, reflecting newly begun

1/ Retail sales of socialist units declined by 4.1 per cent in real terms. The disparity between the development of overall consumption and retail sales is due to a 1.1 per cent growth in nonproductive services and to an estimated 12 per cent rise in the real value of sales on peasant markets and peasant consumption of home-grown crops; the latter were due to the favorable harvest and increases in relative prices of agricultural products in 1982.

2/ Net savings comprise household gross savings minus net credit to households; the latter is small in magnitude.

import substitution projects. While total investment in the fuel sector declined, investment expenditures for projects that actually began operations in 1982 rose sharply, reflecting an emphasis on completing existing projects, particularly in the energy sector.

In contrast to the decline in fixed capital formation, additions to stocks in 1982 more than doubled. This occurred despite the sharp cutbacks in imports of intermediate goods and concomitant depletion of stocks of spare parts and raw materials, especially crude oil and petroleum products. It can be explained by the favorable harvest and the need to replenish agricultural stocks that had been drawn down in 1980 and 1981; by an increase in stocks of unfinished products that accumulated owing to the lack of complementary imported inputs; and by an increase in inventories of unsold consumption and investment goods due to the stagnation of domestic demand.

b. Aggregate supply

Real GNP is officially estimated to have grown by 3.2 per cent, and real national income by 2.6 per cent. The 2.2 per cent growth in value added in industry, while disappointing by past standards, is surprisingly high considering the magnitude of the decline in imported inputs and the weak foreign demand situation. The 7.3 per cent growth in value added in agriculture reflected favorable weather conditions, particularly at harvest time, and was achieved despite stagnation in the application of chemical fertilizers and a large drop in investment. Output in the construction sector remained sluggish partly reflecting cutbacks in the availability and use of energy-intensive materials such as cement and glass.

(1) Industry

The growth in industrial production was impeded by the cutbacks in imports. Excluding oil, imports of raw materials and intermediate goods declined by 19 per cent in all currencies. Although these cutbacks were offset somewhat by modifications in the composition of production and utilization of domestically produced substitutes, the supply situation was very tight particularly for hard currency intermediate goods. Despite these constraints, growth in gross industrial production was maintained, though at a rate of only 1.1 per cent. Marketable production--i.e., the gross value of finished industrial output--grew by the same rate in contrast to recent years when marketable production grew faster, thus suggesting that the share of unfinished production rose in 1982. In every quarter, marketable production was higher than in the corresponding quarter of the previous year. However, in both 1981 and 1982 marketable production peaked in the second quarter, and fell in the third and fourth quarters, following very much the pattern of convertible imports. Given the very low level of convertible imports in the fourth quarter of 1982 and the associated destocking of spare parts and raw materials, industrial production in the first quarter of 1983 is expected to be only at the level recorded in the first quarters of 1981 and 1982.

Industrial production was also affected by reduced energy supplies, particularly of crude oil. The volume of crude oil imports fell by some 14 per cent in 1982 following a 21 per cent decline in 1981, while net domestic consumption of crude oil from imports--net of exports of refined petroleum products--fell by 5 per cent in 1982 following a 41 per cent decline in 1981. The situation became particularly tight in the fourth quarter of 1982, when net imports of crude oil for domestic use were limited to 200,000 tons per month compared with a 425,000 monthly average in 1981 and 500,000 in the first three quarters of 1982.

In the framework of the overall energy balance, however, the cutbacks in oil imports were somewhat less dramatic, since even at their peak in 1980 net crude oil imports supplied only 14 per cent of net domestic energy needs. This percentage declined to 8 per cent in 1981 and 7 per cent in 1982 when net energy usage declined by 1.2 per cent and 1.7 per cent, respectively. These declines mirrored a continuing improvement in the efficiency of domestic energy use. Thus, following a reduction of 3.3 per cent a year on average during 1975-80, and one of 4.6 per cent in 1981, the ratio of net energy use to nonagricultural national income fell by a further 3 per cent in 1982. The 1982 result was achieved primarily through a decline in the share of the energy-intensive branches of production. Gross production in ferrous metallurgy was practically flat in 1982, while output in nonferrous metallurgy declined by 3.2 per cent. Machine building, a large consumer of products of the ferrous metallurgy sector and usually the strongest branch growing typically by 10 per cent, grew by only 3.6 per cent, which represents a modest recovery from the flat performance in 1981. Production of electricity and thermal power declined by 1.2 per cent, because of conservation on the demand side and the poor rainfall and cutbacks in coal imports on the supply side.

(2) Agriculture

Despite its strong recovery, the contribution of agriculture to national income in 1982 was still 11 per cent below what it had been in 1979. The increase in output in 1982 largely reflected record crops; production of meat and meat products, by contrast, declined, although exports to the convertible area rose. The grain harvest totaled 19 thousand tons in 1982 and was 4 per cent higher than the previous record harvest in 1976; the sugar beet crop was 20 per cent above 1981, but some 4 per cent below 1976; and output of field vegetables, fruits, and grapes set new records in 1982, the good results being largely due to the dry weather at harvest time rather than to increased use of inputs. Fertilizer use reached only 89 per cent of the amount used in 1979, the low level reflecting exports to hard currency markets. The urgent need to increase exports prevented the stock of tractors in use from rising despite sizable production, thereby contributing to the decline in agricultural investment in real terms.

3. Domestic policies

a. Prices and incomes

In 1982, the consumer price index rose by 17.8 per cent on an annual average basis as compared with only 3.5 per cent in 1981. The main contributory factors were increases in the price of agricultural products in February 1982 and of energy products on July 1, 1982. On the latter date the price of natural gas was doubled and there were substantial increases in the prices of all the main refined petroleum products, including rises for heating oil and gasoline of 43 per cent and 20 per cent, respectively. In absolute terms, total price adjustments affecting consumer expenditure amounted to lei 43 billion for the year as a whole, the equivalent of 6.7 per cent of total consumer expenditure on goods and services in 1981. Compensation was provided for a part of these price increases in the form of higher wages, children's allowances, and pensions; as a result of such compensation but excluding the growth in the labor force, nominal wages were lei 19.3 billion higher than in 1981, i.e., an increase of 8.7 per cent. Overall, the authorities estimate that average real wages declined by 7.4 per cent in 1982.

Industrial producer prices rose by 11.2 per cent in 1982 as against 12.4 per cent in 1981. The 1982 increase was due mainly to energy price increases on July 1 which, for intermediate users, doubled the price of natural gas, and raised the price of crude oil at the refinery gate by a third and that of heavy oil by over 80 per cent. The effects of these measures on the prices of final products were partially offset by cost savings associated with increases in efficiency.

b. Budgetary policies

Budgetary developments in 1982 marked a continuation of the trends of earlier years. The size of the budget has been declining in recent years, both in absolute and relative terms, reflecting longer-term reforms as well as limitations on expenditure growth imposed for shorter-term stabilization purposes. The long-term reforms have two parts. First, expenditure responsibilities, including those for investment, are being shifted from the Central Government to enterprises and other decentralized units. Second, subsidy payments from the budget have been sharply reduced as a result of price rationalization measures. The reduction in the number of exchange rates, including the abolition of the special subsidized exchange rate for oil imports, has been of particular importance in this context. Together, these reforms have reduced the absolute size of budgetary expenditures by about 24 per cent between 1979 and 1982, with a corresponding fall from 50 per cent to 35 per cent in the ratio of such expenditures to GNP.

Regarding developments in 1982, total budgetary expenditures continued to fall (by almost 5 per cent in nominal terms), revenues also fell by some 1 per cent, and the budget surplus more than doubled to almost lei 20 billion, or 2.7 per cent of GNP (Table 6). On the revenue side, the most significant change was a substitution of turnover tax

receipts for profit payments. Turnover tax receipts nearly doubled to lei 65 billion mainly reflecting the doubling in the price of natural gas that became effective on July 1, 1982, and certain other increases in final sales prices. As a result, enterprises faced higher input costs and also higher wage costs to the extent of the partial compensation provided for consumer price increases. The overall effect was a sharp drop in enterprise profits which was reflected in a near halving of payments of profits to the budget. On the expenditure side of the budget, there was a further decline in subsidies, whose share in total expenditures fell to 6 per cent from over 12 per cent in the previous year. This mainly resulted from the further reduction in the number of exchange rates and the corresponding decline in the need for exchange subsidies. One area in which the trend of earlier years was not continued was in the financing of investment where the share of total gross fixed investment financed from the budget rose to about 50 per cent. In part, this was the result of increased outlays on major infrastructural projects which are financed from the budget; in addition the decline in enterprise profitability reduced the scope for enterprise self-financing.

c. Monetary policies

Consistent with the overall thrust of demand management policies, monetary policy was tightened in 1982. Liquid liabilities of the banking system grew by only 8 per cent during the course of the year compared with 20 per cent during 1981, implying a significant increase in the income velocity of monetary circulation. As in previous years, enterprise deposits were the fastest growing major component of the money supply, growing by 12 per cent. However, this represented a sharp deceleration from the immediately preceding years and prevented any further accumulation of excess liquidity. ^{1/} Savings deposits, the main component of liquid asset holdings of the household sector, grew by only 3 per cent, reflecting the decline in the savings ratio referred to above.

The decline in the rate of liquidity expansion was entirely attributable to the behavior of net domestic assets whose growth rate fell from 12 per cent in 1981 to less than 3 per cent in 1982, i.e., significantly below the increases foreseen in either the original or revised programs for 1982 of 9 per cent and 6 per cent, respectively. This in turn reflected mainly the higher budget surplus, with net government deposits rising by almost lei 18 billion, and also a lower-than-expected growth in credit to enterprises and individuals. In the fourth quarter, as in the preceding quarters, the limit on net domestic assets of the banking system (NDA) agreed under the stand-by was comfortably observed (Table 5).

^{1/} For a fuller discussion of the evolution of enterprise liquidity, see EBS/82/218 (11/24/82), pp. 16-20.

III. Economic Policies and Prospects for 1983

1. External sector

a. Convertible balance of payments and debt rescheduling

While Romania's access to fresh credits from international capital markets continues to be limited, debt amortization will remain high in 1983 (US\$2.7 billion or over 30 per cent of forecast current receipts). ^{1/} Considering also the low level of reserves, Romania has no option but to seek a rescheduling of part of its debt falling due in 1983 and, at the same time, to adopt a policy program aimed at increasing the current account surplus in convertible currency, to US\$800 million.

In contrast to the 1982 outturn, the authorities now look for exports to contribute to the external improvement in 1983, and thus to permit a much-needed increase in imports, too. In total the U.S. dollar value of exports to the convertible area is officially projected to grow by 6 per cent, of which about two thirds is expected to represent a gain in volume. Refined petroleum products are forecast to increase in value terms by 17 per cent to US\$2 billion and to account for three fourths of the total increase in exports. Non-oil exports, by contrast, are projected to increase by only 2 per cent. The expectation does not appear unreasonable, given both the excellent harvest of 1982, which will be largely reflected in exports of agricultural products in 1983, and the strengthening in Romania's competitive position as a result of the depreciation of the effective exchange rate for the leu (see section III.1.c. below). Imports from the convertible area are also projected to increase at a rate of 6 per cent in 1983. However, within this forecast the authorities intend to limit imports of crude oil to some US\$2.3 billion, representing a 6.5 per cent decline from 1982. This implies that other imports (which in 1982 were at roughly half of their level in 1980) are expected to increase by some 20 per cent, thus permitting some increase in essential industrial inputs and in investment activity. In the staff's view, the trade in crude oil and refined petroleum products is likely to yield a much lower deficit than is officially forecast (US\$500 million), leaving room within the forecast current account surplus for larger non-oil imports or smaller non-oil exports.

A small reduction in the deficit on services account is estimated for 1983, mostly on the basis of lower projected interest payments as a result of a decline in Romania's total external debt, a change in the composition of debt away from costly arrears, and a lower average level of international interest rates.

The capital account is forecast to show a net outflow of some US\$800 million. Underlying this forecast are inflows of US\$145 million of fresh long- and medium-term import-related suppliers' credits and US\$200 million of short-term credits related to crude oil imports.

^{1/} Including interest payments, debt service would amount to US\$3.6 billion or some 50 per cent of current receipts.

Disbursements of IBRD loans are estimated at about US\$250 million. On the other hand, maturities on outstanding debt total some US\$2.7 billion. Even allowing for the targeted increase in the current account surplus, this would leave a substantial financing gap. In view of this, the authorities have again approached the coordinating group of nine banks and the Paris Club to obtain a rescheduling of debt service payments due in 1983. A basic agreement concerning the general terms of rescheduling has been reached with the coordinating group of banks: the rescheduling would cover 70 per cent of principal repayments on long- and medium-term debt falling due in 1983. The first installment of 10 per cent of the total maturities under the rescheduling would fall due in 1984, with the remaining 60 per cent to be repaid over six and one half years, including a three-year grace period. These terms have been incorporated as an assumption in arriving at the above capital account forecast. It has also been assumed that official creditors would accept comparable terms, as requested by Romania, with regard to the percentage, downpayment, and maturity of principal and interest payments on official and officially guaranteed debt falling due in 1983. Total debt relief from these two operations is projected at about US\$800 million. In contrast to 1982, nonguaranteed suppliers' credits are not to be included in the rescheduling negotiations. This approach is intended to improve the prospect for concluding the agreements without the delays experienced in 1982.

The current and capital account projections show virtual overall balance in the convertible balance of payments; however, large changes are foreseen within the total item of monetary movements (Table 2). As noted in section II.1. above, the elimination of external payments arrears will require payments of US\$388 million. In addition, the downpayments to banks under the 1982 rescheduling--which were postponed to the first quarter of 1983--are to be made by drawing down the special deposit of US\$316 million with the BIS. If Romania were to make the maximum proposed purchases from the Fund in 1983, net use of Fund credit would total some US\$334 million. As a result, the authorities would be in a position to increase reserves significantly in 1983. The program provides for an increase in reserves, as a performance criterion, by at least US\$250 million during the year; this would bring reserves to the equivalent of about two months of convertible imports.

b. Nonconvertible balance of payments

The Romanian authorities expect the previous surplus on current account vis-à-vis the nonconvertible area to be replaced by a small deficit (US\$66 million) in 1983. Exports to this area are projected to grow by over 10 per cent and imports at twice that rate, implying a trade deficit of US\$150 million. The projected change in the current account is accompanied by a planned reduction of the deficit on capital account to near balance, as there is no longer a need to finance a trade surplus with a net outflow of capital.

c. Exchange rate policies

The competitive position of Romania deteriorated in 1981 and 1982. There has been both an effective appreciation of the leu against the currencies of Romania's trading partners, as well as relatively large cost and price increases in Romania. In nominal terms, the export-weighted effective exchange rate of the leu (which is pegged to the U.S. dollar), appreciated by some 20 per cent between January 1, 1981 and end-1982. More recently some of this appreciation has been reversed. The real overall trade-weighted rate of the leu appreciated by some 13 per cent during the course of 1981, and by another 7 per cent during 1982.

To make the Romanian economy more competitive, the authorities have decided to devalue the commercial and noncommercial exchange rates of the leu. With effect from January 1, 1983, the commercial rate was devalued from lei 15.0 to lei 16.5 per U.S. dollar (or by 9 per cent) and the noncommercial rate from lei 11.0 to lei 12.5 per U.S. dollar. On July 1, 1983 the commercial rate will be devalued further to lei 17.5 per U.S. dollar or by 5.6 per cent, and the noncommercial rate to lei 13.5 per U.S. dollar. On the same date the peg to the U.S. dollar will be dropped in favor of a basket of currencies weighted in accordance with their importance in Romania's trade transactions in convertible currencies. Ahead of this change, in the first half of 1983, the authorities and Fund staff will collaborate on a study of exchange rate policy that will: (i) establish appropriate weights for the basket; (ii) determine the level of the peg of the leu to the basket that would yield an adequate level of competitiveness, with action on this determination to be taken no later than October 1, 1983; and (iii) formulate guidelines for maintaining a suitable level of competitiveness.

One of the key elements of the program is to unify the exchange rates applied to foreign trade. The program for 1983 has accelerated the process, and the authorities now plan to move to a single commercial rate by July 1, 1983. ^{1/} In addition, the Government has decided to unify the commercial and noncommercial exchange rates during the course of 1984, with a first step to take place on January 1 of that year, the precise timetable for unification to be established in the joint study mentioned above.

d. Exchange and trade system

The current shortage of foreign exchange has not permitted the authorities to make headway in liberalizing Romania's relatively restrictive trade and payments system. However, with the reduction of external payments arrears by US\$755 million in 1982 and their elimination according to the program in 1983, an important exchange restriction is being removed.

^{1/} At present, imports are governed by a unitary rate, but there are two multiple rates for exports.

In recent years Romanian foreign trade enterprises have applied countertrade requirements as a condition for import contracts, especially in the machine building industry. The legal constraints on enterprise behavior in this matter are specified in Article 7 of the Foreign Trade Law No. 12 of 1980, a translation of which reads as follows:

Planned imports can be effected only to the extent that the quarterly payments established in the plan are realized or there exist export contracts which assure the necessary foreign exchange. In case these resources are not assured, the ministries, the other central and local organs, the centrals and the enterprises have the obligation to adapt the volume of imports in an adequate manner in the framework of the planned equilibrium value.

For units where the imports are made in order to achieve exports from other producing units, the preceding paragraph applies in the framework of the equilibrium value of these downstream units.

The staff has taken the view that these practices as applied in Romania are legally neither an exchange restriction nor an import restriction for balance of payments purposes, since the ultimate responsibility of balancing trade is at the ministry level. However, it would be highly desirable that these practices be eliminated as soon as possible in line with the Government's objective of moving towards a flexible multilateral approach to trading relations. The reduction in imports of machinery and equipment has clearly diminished the quantitative significance of countertrade in the last two years.

2. Domestic implications--1983

The official national accounts forecast for 1983 looks for real GNP growth of 3.8 per cent, but with a growth in real domestic absorption of only 0.9 per cent. As such, it contains a sizable safety margin for meeting the external current account target. Indeed, the improvement in the real foreign balance implied by the national accounts forecast would be consistent, other things being equal, with a current account surplus (in all currencies) of some US\$1.4 billion, as against the US\$0.7 billion surplus that is actually projected. However, considerable uncertainties exist with respect both to the feasible growth of output and--assuming the production targets were to be met--to the ability to expand exports. These uncertainties are related to three principal considerations: the implications for output growth of the dramatic cutback in imported inputs in 1982; the likely constraints on energy supplies in 1983; and the prospect of only a slow recovery in 1983 in Romania's export markets.

On the demand side, real consumption is forecast to grow by 1 per cent. Fixed investment is planned to rise by 2.7 per cent and additions to stocks are expected to fall by 10 per cent. On the supply side, according to the official forecasts, value added is to grow by 4.7 per cent in industry, by 4.0 per cent in agriculture, and by 1.0 per cent in

construction. On this basis, the overall rate of growth in real national income is assumed to be 3.5 per cent. This forecast is based, in part, on an expected growth in non-oil imports from the convertible area of 20 per cent, and an increase of 41 per cent in imports of production inputs excluding crude oil and raw materials for foodstuff production. Following the very large decline in 1982, such imports would be restored to about 90 per cent of their level in 1981. It is unlikely that the growth in industrial output and GNP of the order posited in 1983 can be achieved unless non-oil imports reach at least the forecast magnitude. Even then supplies of spare parts and other inputs are still likely to limit industrial growth, and could prevent the official targets from being achieved.

The energy situation will remain very tight in 1983. Available energy supplies--from planned imports and likely domestic production--are likely to support a growth in national income from nonagricultural sources of only 1 per cent, ^{1/} which in turn would be consistent with a forecast growth in national income of only 1.5 per cent and in GNP of only 2 per cent. Shortages in energy-intensive industries are expected to continue, particularly in those that are heavily dependent on oil products, inasmuch as crude oil imports for domestic use are to be limited to only 1.5 million tons in 1983, against some 5 million tons a year in 1981 and 1982. Petroleum refining is also expected to be adversely affected by the restriction on imports of crude oil for refining-for-export to operations that are profitable in hard currency terms.

3. Domestic Policies

a. Introduction

Domestic policies in 1983 will continue to be largely determined by the state of the balance of payments. Thus, the primary objective is to restrain the growth of domestic demand further, while continuing with the restructuring of relative prices, including the planned depreciation of the exchange rate. Domestic incomes are forecast to rise by only a small amount in real terms; budgetary expenditure will continue to fall in real terms and a budget surplus of approximately the same size as in 1982 is projected; finally, monetary growth is again targeted at a level significantly below the expected rate of increase of nominal incomes.

b. Prices and incomes

In 1983, producer prices are forecast to increase by 6-7 per cent on an annual average basis. There are three principal components in the anticipated price increase: (i) the increase in costs resulting from the January 1 and July 1, 1983 exchange rate changes; (ii) the effect of energy price increases introduced on July 1, 1982, which will only have their full year impact in 1983; and (iii) the further increases in the

^{1/} Staff estimates (based on past relationships) of energy supply are less than official forecasts for coal by 1.4 thousand tons of oil equivalent and for crude oil by 0.7 thousand tons of oil equivalent.

price of natural gas that are scheduled for 1983. The price of natural gas (for all uses) is to be raised by a total of 50 per cent, with the first step taking place on July 1, 1983 from lei 1,000 to lei 1,350 per thousand cubic meters, followed by a second step to lei 1,500 per thousand cubic meters on October 1, 1983. Consumer prices are officially forecast to rise by 5-7 per cent in 1983 also on an annual average basis.

The actual rate of price increase in 1983, both for producer and consumer prices, will depend on a number of factors whose effects cannot be precisely quantified at the present time. These include: (i) the size of any additional exchange rate and interest rate changes made in the course of 1983 beyond those presently foreseen, and the rapidity with which such cost changes are passed through to final prices; (ii) the exact amount of reductions in enterprise costs resulting from reductions in net production taxes paid by enterprises and in profit transfers to the budget, and the extent to which these cost reductions affect producer and consumer prices; and (iii) the extent to which wages and other incomes are adjusted to compensate for price changes. While these policies remain to be finalized, and will also be modified in the light of changing conditions during the year, the authorities intend to restrict the increase in real incomes to a rate consistent with the targeted 1 per cent rise in real consumption, taking account of an expected small increase in the savings ratio.

c. Monetary policy

Monetary policy will remain tight in 1983 as the growth in liquid liabilities of the banking system slows down further to less than 2 per cent. Given that the growth in nominal income is likely to be significantly higher, this implies a further increase in the income velocity of money. Within the total, deposits of the household sector are projected to increase by some 5 per cent--consistent with the small projected rise in the savings ratio--but to remain substantially unchanged in real terms. Deposits of the enterprise sector, by contrast, are projected to fall slightly in nominal terms. For enterprise deposits that are freely usable, rather than blocked for specific purposes, a small decline of 2 per cent is forecast despite a projected rise in producer prices of 6-7 per cent. This is in line with the desire of the authorities to reverse the earlier accumulation of freely usable liquid funds, some 10 per cent of which is generally thought to have been excessive. Absorption of the excess in 1983 will also be facilitated from January 1, 1983 by a 10 per cent reserve requirement against freely usable enterprise deposits with banks, although the impact of this measure is now expected, because of the method of its implementation, to be significantly weaker than originally envisaged.

The net foreign assets of the banking system are projected to decline by about lei 25 billion ^{1/} in the course of 1983. Accordingly, the

^{1/} This is consistent with a current external surplus in all currencies of US\$734 million and of net capital outflow on the part of the nonbank sector of US\$1,105 million, and takes account of anticipated valuation changes.

growth in the banks' net domestic assets (NDA) will need to be limited to no more than lei 30.9 billion, or 7 per cent, 1/ if the targeted increase in total liquid liabilities is not to be exceeded.

An active interest rate policy will also be pursued in 1983. With the emergence of significant rates of inflation, real interest rates have become negative. The authorities recognize the importance of re-establishing and maintaining a structure of positive real interest rates. Toward this end, interest rates were increased on January 1, 1983, by 1 percentage point on savings deposits and by 3 percentage points on loans. At the same time the interest rate charged on loans by the National Bank to the specialized banks was raised to 3 per cent. As a result maximum rates of interest on deposits and advances (other than those that are overdue) are now 6 per cent and 8 per cent, respectively. These changes went hand in hand with a simplification of the overall structure of interest rates. The authorities accept that further adjustments are necessary, the precise extent to be determined by a joint study with the Fund staff. This study is to be completed by June 30, 1983 and the agreed measures are to be implemented by July 1, 1983.

d. Budgetary policy

By law the Romanian budget is to be in balance when initially presented. However, the expenditure estimates include an allocation for a reserve fund to cover contingencies which is generally not fully used. An amount of lei 23.7 billion is allocated to this item in 1983, and the authorities expect the budget surplus, ex post, to be of the order of lei 20 billion, or much the same as in 1982.

In 1983, budgetary expenditures are programmed to continue to fall, by almost 8 per cent excluding the allocation for the reserve fund. The reduction is to come primarily under the heading "financing of the national economy" and to reflect two principal factors: a moderate cutback in the amount budgeted for investment financing, and more importantly, a further decline in subsidies. Subsidies to the Conjunctural Fund--mainly paid for foreign exchange operations to the Romanian Bank for Foreign Trade--have been abolished, with the introduction of a unified commercial exchange rate for imports, and the reduction in the number of exchange rates for exports. The remaining subsidies, representing barely 2 per cent of total budgetary expenditures, will be entirely allocated to mass transportation and to a limited number of agricultural and mining operations.

In line with the further cut in expenditures, budgetary revenues are also forecast to decline by almost 6 per cent in 1983. The devolution of expenditure and financing decisions away from the Central

1/ Part of the increase in net domestic assets reflects adjustments arising from changes in the valuation of net foreign liabilities in line with the depreciation of the leu; without such adjustments, the increase would be 2.5 per cent (Table 6).

Government to enterprises partly explains a budgeted fall of nearly 25 per cent in profit payments to the budget in 1983. Measures of price rationalization also affect revenues. Largely as a result of the increase in the price of natural gas introduced on July 1, 1982, and the two other increases to be implemented in the course of 1983, receipts from turnover taxation are budgeted to rise by about 25 per cent. However, the authorities intend to mitigate the inflationary cost-push effects of these increases, as well as of the adjustments to the exchange rate and interest rates, while at the same time safeguarding the change in relative prices. To meet these two objectives, rates of net production tax ^{1/} are being reduced across the board. In addition, profit transfers to the budget are also being cut back.

IV. Structural Reform and Medium-Term Outlook

1. Structural reform

The need to ensure the viability of the balance of payments, and the resumption of an adequate rate of growth in domestic output, requires a wide range of adjustment measures over an extended period beyond 1983. A central element in this process is the rationalization of the structure of relative prices. As noted above, significant steps in this process have already been taken, most recently at the beginning of 1983, and other measures are planned later in the year and beyond.

The general objective is to restructure relative prices so as to reflect the changes in the economy's circumstances in recent years. The main elements include increases in the relative price of energy and related products, and exchange rate changes to promote competitiveness. The price changes effected to date have significantly raised the general price level. The consumer price index increased by about 18 per cent in 1982 after negligible changes for many years previously. Recognizing that further price adjustments will be required in the period ahead, the authorities raised nominal interest rates on January 1, 1983 and plan further adjustments to restore them to positive levels in real terms. The authorities also plan to review arrangements for the costing of capital.

Overall objectives have been clearly determined in all the key areas of pricing policy. However, the precise magnitude and timing of the measures to be taken is in many cases still undecided. Mainly with a view to quantifying the needed adjustments and to determining precise operational mechanisms, the Romanian authorities will be collaborating with the Fund staff in four studies over the coming months. These studies will cover the following areas:

(i) The exchange rate. The main purposes will be to determine an appropriate basket peg for the leu and to decide the level at which the

^{1/} Essentially a value-added tax on enterprises.

leu should be pegged to such a basket in order to secure an appropriate level of competitiveness. The study will also develop an agreed timetable for the unification of the commercial and noncommercial exchange rates.

(ii) Energy prices. The main purpose of this study will be to determine the best way to close the gap between domestic and international prices of energy products. Particular emphasis is to be placed on the pricing of natural gas but the level of energy prices on a broader front will also be considered, including the prices of domestically produced crude oil both at the wellhead and the refinery gate and of refined petroleum products. (An increase in the wellhead price of domestically produced crude oil from lei 1,100 per ton to lei 1,650 per ton is already scheduled for January 1, 1984, irrespective of the outcome of the study).

(iii) Interest rates. Since the authorities are committed to the establishment of a structure of interest rates that is positive in real terms as from July 1, 1983, the main function of this study will be to determine an appropriate definition of the inflation rate by reference to which the equivalent in real terms of given nominal rates of interest may be assessed.

(iv) Costing of capital. The treatment of the cost of capital to enterprises is deficient in a number of ways at present. First, interest is not charged on investment financed from the budget. Similarly, the imputed interest cost on use of enterprises' own financial resources for investment seems unduly low. Lastly, amortization schedules seem excessively long. The study will determine an appropriate charge on finance from the budget or from the enterprises' own resources, and a method for setting appropriate amortization schedules.

Except for the one on natural gas and energy prices, these studies are to be completed by end-June, 1983, and to set agreed timetables for making the necessary adjustments in time for the July 1983 Board Review. On interest rates, the authorities are committed to make the necessary adjustments by July 1, 1983, and on exchange rates they are similarly committed to review and, if necessary, adjust the level of the leu's basket peg no later than October 1, 1983. The study of natural gas and energy prices is to be completed by September 30, 1983, although preliminary indications of its likely conclusions are to be available for the July Board Review. On completion, a method and a timetable for future energy price adjustments will also be established, with the first significant step to be taken no later than January 1, 1984.

The above measures are to be accompanied by reforms of an institutional nature. The latter entail a gradual devolution of decisionmaking to enterprises. At present the proportion of output for which prices can be freely set at the enterprise level is estimated at only 20 per cent, but the authorities contend that this proportion will continue to rise. In addition, the share of the budget in investment financing, which rose somewhat in 1982 due to a sharp decline in enterprise profitability and increased outlays on some major infrastructural projects, is planned to decline in 1983 and further thereafter. Instead, greater

emphasis is to be placed on self-financing and bank credit, thus making investment expenditure more amenable to monetary control. Investment projects still to be financed from the budget will include large infra-structural projects.

The policy initiatives described in the previous paragraph are complementary. On the one hand, a devolution of decisionmaking, especially on pricing, is necessary to ensure that cost and price adjustments are comprehensively reflected throughout the economy. On the other hand, once rationalized the structure of prices would promote an efficient allocation of resources via production and investment decisions by enterprises on the basis of profitability considerations, profitability being already an important success indicator (for instance, in assessing managerial performance and in setting bonus payments). The efficiency implications of the devolution of decisionmaking to enterprises will depend on how powerful an incentive profits will prove to be in encouraging enterprises to adapt the structure of output and prices to changing world market and domestic conditions and on how much interenterprise competition will be permitted in order to keep costs and prices down. For these conditions to be fulfilled, considerable flexibility will have to be introduced into the Romanian system of central planning.

3. Medium-term outlook

The Romanian Government is firmly committed to a substantial reduction of outstanding external debt during the five-year period 1984-88. To make this possible it is the stated official objective to bring about a further, though gradual, improvement of the current external account over this period and to limit the contracting of new foreign debt to relatively small amounts (Table 7). Given the continued large debt service payments, only a limited increase in reserves over this period as a whole is envisaged, implying probably a decline in the import coverage of reserves. No buildup of reserves is foreseen in 1984 despite a decline in external debt repayment obligations, and a considerable drawdown of reserves is likely in 1985, when debt repayment obligations are scheduled to rise. In view of the relatively low level of reserves, projected for the start of 1985, this means that, if Romania does not restore its access to financial markets abroad, a financing gap might arise in 1985.

V. Performance under the Stand-By Arrangement and
Performance Criteria for 1983

Most of the quantified performance criteria for end-1983 were modified by the Board at its December 1982 Review. Higher targets were set for the trade surplus in convertible currencies, and somewhat lower targets for net domestic assets of the banking system because of an improvement in the net foreign position of the banking sector. Because of smaller-than-expected capital inflows, the target for gross convertible international reserves of US\$675 million as of December 31, 1982, which would have implied an increase of US\$125 million during the course of 1982, was modified to require at least no decline during that year.

Romania met all performance criteria in 1982 as amended except one. The exception was that, as of the end of the year outstanding payments due suppliers totaling US\$388 million had not been settled. This situation is to be regularized by March 15, 1983. The quantified performance criteria are set out in Table 8 (see column (b) under December 1982). The targets for the foreign trade balance in convertible currencies, short-term debt in convertible currencies, and net domestic assets of the banking system were met comfortably in December 1982.

The 1983 segment of the stand-by period is subject to the following performance criteria, the quantified components of which are shown in Table 8:

- (a) quarterly limits on net domestic assets of the banking system;
- (b) quarterly minimum targets for the foreign trade surplus in convertible currencies;
- (c) semiannual limits on short-term foreign debt in convertible currencies; 1/
- (d) an annual upper limit on the contracting or guaranteeing of new external debt in convertible currencies in the maturity range of one to five years (excluding purchases from the Fund); 1/
- (e) an end-year lower limit on the gross convertible international reserves;
- (f) the elimination by the end of 1983 of payments arrears that will accumulate until agreement has been reached in the present rescheduling negotiations, and the avoidance of any other new arrears in 1983;
- (g) the standard performance criterion on trade and payments restrictions, multiple currency practices, and bilateral payments agreements; and

1/ Excluding credits obtained to refinance any of the US\$370 million in debts to suppliers referred to in paragraph 2 of the attached letter of intent.

(h) two Board reviews under the program with the Fund, one before July 31, 1983 and the other before November 30, 1983. At the time of the second review, understandings will also be reached with the Fund for the remaining period of the arrangement.

Purchases under the arrangement in calendar 1983 are not to exceed SDR 367.5 million. The draft decision envisages a purchase of SDR 91.9 million (25 per cent of quota) after regularization by March 15, 1983 of the remaining part of the (nonguaranteed) reschedulable arrears to suppliers owed up to March 1, 1982. The phasing of further purchases during 1983 is proposed to be determined only after satisfactory arrangements have been made for the rescheduling of debt payments falling due in 1983.

VI. Staff Appraisal and Proposed Decisions

Romania's balance of payments problem continued in 1982 despite the swing into substantial surplus of the current account in convertible currencies. This turn around was achieved solely by a curtailment of imports. Even so, some growth of real GNP was sustained, partly by a favorable harvest. Exports to the convertible area declined steeply, with non-oil items falling by nearly 10 per cent. Weak foreign demand, the real effective appreciation of the leu, and reduced supplies of imported inputs contributed to this result. Even with the considerable strengthening of the current account, the large amount of debt service payments falling due in 1982 and disappointing capital inflows, led Romania to seek debt rescheduling and to retreat from the objective of increasing external reserves.

Settlement of nonguaranteed credits owed to suppliers as of March 1, 1982 proved much more time consuming and difficult than had been expected. By the end of 1982 a considerable part of these reschedulable debts had not yet been settled. In early 1983 the amount owed to small suppliers was repaid, but a group of large suppliers, to whom Romania owes US\$370 million, declined to settle on terms comparable to those agreed with the banks. The staff welcomes the intention of Romania to regularize this situation by March 15, 1983. As external payments arrears have arisen (as explained in the attached letter) during the period of the stand-by arrangement, the staff recommends a waiver of the performance criteria on governing payments arrears in view of the intentions of the Romanian authorities, specified in the attached letter.

Debt service payments falling due in 1983 remain substantial in relation to the likely inflow of foreign credit. Because of this, and of the need to strengthen reserves, Romania aims at a further increase in the surplus on current account in convertible currencies, to US\$800 million. This target is to be achieved partly by a 2 per cent expansion in non-oil exports, reflecting a significant rise in agricultural exports. This will permit an expansion of non-oil imports sufficient to support growth of GNP that is, although below the official forecast, at least consistent with the targets for the current account. The external targets

appear to be safeguarded against a shortfall in non-oil exports, as the oil trade deficit is expected by the staff to be lower than officially forecast. This implies that non-oil imports can occur in the forecast amount even if there is a slippage in non-oil exports, without jeopardizing the projected overall trade surplus. Indeed, it is a critical aspect of the program that, at a minimum, non-oil imports grow as forecast, their value and volume having fallen substantially since 1980. To enable imports to grow fast enough to achieve a satisfactory growth of real GNP and to maintain external balance in the longer run, the authorities should not hesitate to take additional measures to foster exports.

To close the financing gap in 1983 Romania is seeking further debt relief and there is a prospect that debt rescheduling agreements could be reached in the first half of the year. Together with possible purchases from the Fund, these will enable Romania not only to avoid new payments arrears in 1983, but also to rebuild international reserves by a significant amount.

Financial policies for 1983 seem appropriate. Monetary policy is being made more effective by the upward adjustment of bank lending and deposit rates in January 1983 and further planned adjustments in July and by a planned reduction in the share of budgetary grants in investment financing in 1983. The introduction of a reserve requirement against enterprise deposits in January 1983 should help to absorb excess enterprise liquidity. Consistent with the targets for domestic liquidity and those for the balance of payments, the growth in net domestic assets of the banking system (including valuation changes) is to be held to a rate of 7 per cent, or within the presently forecast price increases. The budget for 1983 provides for continued expenditure restraint. The revenue gains, which are expected to accompany changes in prices, especially for energy, will be partly offset by an across-the-board reduction in net production tax rates, so as to minimize the effect of price restructuring on the general price level. The budget is expected to show a surplus of about the same order as in 1982. The policy of wage restraint is also to be continued in 1983.

Several important policy measures are being implemented in 1983, designed to improve the economic mechanism with particular emphasis on adjusting prices of imports, capital, and energy. The staff welcomes the devaluation of the leu on January 1, 1983 and the devaluation decided for July 1, 1983, as well as the unification on the latter date of the commercial rate which from then on is to be pegged to a basket of currencies. The two devaluations are unlikely to fully offset the real effective appreciation of the leu in 1981 and 1982. The appropriateness of the exchange rate will be subject to a study to be completed for the July 1983 Board Review, with action to follow no later than October 1, 1983. In the field of energy, the staff also welcomes the further upward adjustment of prices of domestically produced crude oil and of natural gas during 1983, although these adjustments still leave energy prices well below world market prices.

The 1983 program should be above all looked at as part of a longer-term policy to restore a viable balance of payments position. After four years of a rapid deterioration of the external current account to an unsustainable level (5.8 per cent of GNP in 1980), a severe adjustment of the economy was needed. The interruption of foreign short-term credits and withdrawals of deposits starting in mid-1981, intensified the magnitude of the problem. These major difficulties were compounded by Romania's excessive reliance on short-term financing, a low level of reserves, and delayed reactions to world developments. After a protracted period of accumulation of arrears, and of uncertainty, significant improvements did take place in the second half of 1982, and purchases under the Fund stand-by have been resumed.

The improvement of the balance of payments in 1982, renewed access of Romania to the Fund's resources, and the announcement on January 1, 1983 of the aforementioned comprehensive measures on interest rates, exchange rates, and energy prices contributed to a more positive perception of Romania's intention by the world financial community. In particular, the initial reactions of creditors toward rescheduling agreements in 1983 have been positive.

These achievements should not, however, obscure some shortcomings in the implementation, up to early 1983, of the adjustment program described by the Romanian authorities in their letter of intent of November 1982.

First, on the external side, due to persistent difficulties in reaching an agreement on terms for the rescheduling of arrears acceptable both to suppliers and bankers, payments arrears to large suppliers are still outstanding. Although an understanding has been reached about the regularization of this situation before any further use of Fund resources can be made, this development has not helped to restore confidence in Romania as a reliable trading partner, for suppliers already subject to persistent countertrade practices. In addition, and contrary to previous expectations, the current account in nonconvertible currencies registered in 1982 a large surplus (US\$385 million). Unless this situation is reversed in 1983, the adjustment efforts by Romania and the assistance provided to it could be regarded as not wholly devoted to the restoration of convertible currency reserves and the balance of payments position of the country itself.

Second, there were some slippages on the domestic side. The pass-through into prices of the devaluation of the leu on January 1, 1983 has not for the most part been left to enterprises themselves. In addition, the reserve requirement scheme, which was aimed at reducing by about 10 per cent existing enterprises' deposits and at strengthening the role of the National Bank, was implemented only in a limited way. While the excess liquidity which thus still prevails in the Romanian economy will be mopped up in 1983 by correspondingly more restrictive domestic credit ceilings, the staff hopes that the intention to move toward a monetary policy relying less on rigid credit plans and toward a modernization of the financial instruments and financial entities will be implemented

with greater vigor. More fundamentally, the intention of the Romanian authorities, as stated in November 1982, to enhance the role of enterprises in making investment decisions, and to foster competition in foreign trade operations, have not yet been implemented to any significant degree.

The measures taken on January 1, 1983 and those already set for the rest of the year, as described in the new letter of intent, constitute an important additional adjustment effort. Inevitable uncertainties with respect to the development of individual components of the balance of payments, particularly exports, remain. On balance, nevertheless, the program for 1983 appears sufficient to achieve the two key goals that have been set, namely, a further increase in the current account surplus, and a needed increase in reserves.

There is also a need now to look beyond 1983. Preliminary balance of payments projections for 1984 and 1985 suggest that, in the absence of some resumption of net foreign borrowing, Romania would again have to draw down its reserves excessively in 1985, to meet its external commitments. Additional adjustment measures are therefore needed to be taken in 1983, in time to have a marked effect in 1984. Delays might postpone the restoration of Romania's creditworthiness and raise doubts among foreign creditors as to the commitment with which the adjustment program is being pursued.

Against this background the two further Fund reviews which are to take place in July and November and the establishment of a timetable for action based on the four studies--of exchange rates, interest rates, cost of capital, and energy prices--which the Romanian authorities are committed to undertake with the Fund staff in the first part of 1983, are of vital importance. These individual studies should be viewed as part of a single evaluation of Romanian pricing whose focus is to determine the appropriate future path of the domestic relative price structure, and whose more immediate purpose is to outline specific additional steps that should be taken. The undertaking set out in paragraph 11 of the attached letter of intent, regarding the precise objectives of the studies, is therefore an essential element of the program.

Additional purchases in 1983, beyond 25 per cent of quota, SDR 91.9 million, which will be available following the Board review in early April 1983, provided that arrears have been regularized, will be contingent upon satisfactory arrangements for debt rescheduling, and any purchases after July 1, 1983 also upon a satisfactory outcome of the studies and the establishment of a mutually agreed timetable for implementation of their results.

The adjustment program for 1983 and the proposed purchase of SDR 91.9 million should thus be regarded as a part of an ongoing process which, through additional actions, will gradually restore a viable balance of payments situation for Romania and enable it by 1985 to regain some access to private financial markets.

In view of the policies that are being implemented during 1983, and the further adjustment effort that is likely to have its main effect in 1984, the staff believes that Romania should be permitted to purchase SDR 91.9 million after regularization by March 15, 1983 of reschedulable arrears owed to suppliers as of March 1, 1982. The staff recommends that the phasing of the remaining maximum amount that Romania can purchase during 1983 (SDR 275.6 million) be determined after the Fund has decided that satisfactory arrangements have been made for the rescheduling of debt service payments falling due in 1983.

The last Article IV consultation decision on Romania contained approval until the end of 1982 of an exchange restriction resulting from the existence of external payments arrears. For reasons explained above and in the attached letter, Romania was unable to eliminate all arrears by the end of 1982. Given that the authorities intend to eliminate the remaining arrears to suppliers by March 15, 1983 and that the process of the 1983 debt rescheduling gives rise to arrears on a temporary basis, the staff recommends approval of the exchange restriction in the form of payments arrears until December 31, 1983.

In view of the foregoing, the following draft decisions are proposed for adoption by the Executive Board:

I. Stand-By Arrangement

1. Romania has consulted with the Fund in accordance with paragraph 5(c)(ii) of Executive Board Decision No. 7144-(82/86) (EBS/82/73, Sup. 2, 6/25/82), and paragraph 19 of the letter from the Minister of Finance of April 20, 1982 in order to present its economic program for 1983 and reach understandings regarding circumstances in which further purchases can be made.
2. The attached letter from the Minister of Finance dated February 11, 1983, setting forth the objectives and policies which the Government of Romania will pursue during 1983, shall be annexed to the stand-by arrangement for Romania and the letters of May 26, 1981, April 20, 1982, and November 9, 1982 shall be read as supplemented and modified by the letter of February 11, 1983.

3. Accordingly, Romania will not make purchases under this stand-by arrangement:

a. during any period after December 31, 1982 in which the data at the end of the preceding period indicate that:

(i) the targets for the trade balance in convertible currencies described in paragraph 3 of the annexed letter of February 11, 1983, have not been observed; or

(ii) the limit on contracting or guaranteeing of external debt in the maturity range of one to five years or the limits on outstanding short-term foreign debt in convertible currencies described in paragraph 4 of the same letter have not been observed; or

(iii) the increase in gross convertible international reserves described in paragraph 4 of the same letter has not taken place; or

(iv) the limits on net domestic assets of the banking system described in paragraph 7 of the same letter have not been observed; or

(v) the intentions concerning external payments arrears described in paragraph 4 of the same letter have not been carried out; or

b. (i) during any period after July 31, 1983 unless the first review referred to in paragraph 13 of the same letter has been carried out, or

(ii) during any period after November 30, 1983 unless the second review referred to in paragraph 13 of the same letter has been carried out, or

c. during any period after December 31, 1983 until suitable performance criteria have been established in consultation with the Fund in light of paragraph 13 of the same letter, or after such performance criteria have been established, while any of these criteria are not being observed.

4. Purchases under the stand-by arrangement shall not, without the consent of the Fund, exceed SDR 817.5 million through December 31, 1983, provided that purchases shall not exceed SDR 542 million until the Fund has decided that satisfactory arrangements have been made for the rescheduling of debt service payments falling due in 1983. At the time of that decision, the Fund will establish the phasing for the remainder of 1983.

5. In light of the letter of February 1983, the Fund waives, for the purpose of purchases available through December 31, 1983, the application of the performance criteria in paragraph 4(c)(i) of the stand-by arrangement in EBS/81/111 and in paragraph 5(a)(iii) of Decision No. 7144-(82/86) adopted June 21, 1982, with respect to external payments arrears.

II. Approval of Exchange Restrictions

The Fund approves through December 31, 1983 the restriction on payments and transfers resulting from the existence of external payments arrears described in paragraph 5 of Decision No. entitled "Stand-By Arrangement."

Table 1. Romania: Schedule of Purchases Under Stand-By Arrangement

(In millions of SDRs; figures in parentheses are in per cent of quota)

	First year (June 1981- June 1982)	Second year (June 1982- June 1983)	Third year (June 1983- June 1984)	Total (June 1981- June 1984)
1. Original phasing and drawings				
Amount available	367.5 (100.0)	367.5 (100.0)	367.5 (100.0)	1,102.5 (300.0)
Amount drawn	140.0 (38.1)	310.0 (84.4)	-- (--)	450.0 (40.8)
Amount undrawn	277.7 (61.9)	57.5 (15.6)	367.5 (100.0)	652.5 (59.2)

2. In its December 20, 1982 (EBM/82/164) review the Board decided to limit purchases in calendar year 1983 to SDR 367.5 million (100 per cent of quota). A purchase of SDR 91.9 million (25 per cent of quota) is proposed in the first part of April 1983, immediately following Board approval of the 1983 program and after regularization of the remaining part of (non-guaranteed) arrears to suppliers owed up to March 1, 1982. The phasing of further purchases during 1983 are proposed to be determined by the Fund when satisfactory arrangements have been made for the rescheduling of debt payments falling due in 1983.

Source: IMF, European Department.

Table 2. Romania: Balance of Payments, Convertible Currency

(In millions of U.S. dollars) 1/

	1981			1982						1983		
	Actual			Original Program Forecast			Actual 2/			Program Forecast		
	Receipts	Payments	Balance	Receipts	Payments	Balance	Receipts	Payments	Balance	Receipts	Payments	Balance
Goods and services												
Commodity trade 3/												
Exports, f.o.b.	7,216	--	7,216	7,600	--	7,600	6,235	--	6,235	6,600	--	6,600
Imports, f.o.b.	--	7,012	7,012	--	7,050	7,050	--	4,710	4,710	--	5,000	5,000
Trade balance	7,216	7,012	204	7,600	7,050	550	6,235	4,710	1,525	6,600	5,000	1,600
Services												
Tourism	202	18	190	225	15	210	121	5	116	165	10	155
Transportation and telecommunications	372	718	-346	405	675	-270	294	433	-139	350	570	-220
Interest on debt	68	1,115	-1,047	75	1,275	-1,200	45	962	-917	85	890	-805
Other services	223	42	181	294	34	260	120	50	70	180	110	70
Total services	871	1,893	-1,022	999	1,999	-1,000	580	1,450	-870	780	1,580	-800
Balance on goods and services	8,087	8,905	-818	8,599	9,049	-450	6,815	6,160	655	7,380	6,580	800
Capital												
Medium- and long-term	2,248	1,352	896	4,124	2,568	1,556	2,976	2,374	602	1,404	1,669	-265
Credits received	(2,107)	(1,106)	(1,001)	(3,979)	(2,273)	(1,706)	(2,833)	(2,081)	(752)	(1,247)	(1,319)	(-72)
Credits extended	(141)	(246)	(-105)	(145)	(295)	(-150)	(143)	(293)	(-150)	(157)	(350)	(-193)
Short-term	744	2,210	-1,466	500	759	-259	...	...	-485	617	1,156	-539
Credits received	(643)	(2,125)	(-1,482)	(500)	(759)	(-259)	(956)	(1,089)	(-133)	(385)	(956)	(-571)
Credits extended	(101)	(85)	(16)	(--)	(--)	(--)	(...)	(...)	(-352)	(232)	(200)	(32)
Total capital	2,992	3,562	-570	4,624	3,327	1,297	...	...	117	2,021	2,825	-804
Net errors and omissions	--	--	--	--	--	--	...	...	23	...	...	...
Overall balance	--	--	-1,388	--	--	847	...	...	795	...	...	-4
SDR allocation	--	--	32	--	--	--	--	--	--	--	--	--
Monetary movements												
(net) 4/	...	...	1,356	--	--	-847	...	...	-795	...	...	4
Monetary gold	...	...	4	--	--	--	...	...	--	--	--	--
SDR holdings	...	...	...	--	--	--	...	...	12	--	--	--
Special escrow deposit 5/	...	...	--	--	--	--	...	...	-316	...	...	316
Foreign exchange	...	...	-81	--	--	-125	...	...	-37	...	...	-258
Use of Fund credit	...	...	290	--	--	421	...	...	301	...	...	334
Arrears	...	...	1,143	--	--	-1,143	...	...	-755	...	...	-388

Source: Data supplied by the Romanian authorities.

1/ Figures may not add exactly due to rounding.

2/ Preliminary.

3/ Excluding "lohn" transactions.

4/ Increase in assets (-).

5/ Established to make the downpayment under 1982 rescheduling agreement with commercial banks.

Table 3. Romania: Balance of Payments, Nonconvertible Currency

(In millions of U.S. dollars) 1/

	1981			1982						1983		
	Actual			Original Program Forecast			Actual 2/			Program Forecast		
	Receipts	Payments	Balance	Receipts	Payments	Balance	Receipts	Payments	Balance	Receipts	Payments	Balance
Goods and services												
Commodity trade 3/												
Exports, f.o.b.	5,151	--	5,151	6,100	--	6,100	5,324	--	5,324	5,900	--	5,900
Imports, f.o.b.	--	5,252	5,252	--	6,300	6,300	--	5,035	5,035	--	6,050	6,050
Trade balance	5,151	5,252	-101	6,100	6,300	-200	5,324	5,035	289	5,900	6,050	-150
Services												
Tourism	95	49	46	74	35	39	82	79	3	75	60	15
Transportation and telecommunications	151	163	-12	186	196	-10	153	170	-17	182	197	-15
Interest on debt	45	15	30	49	7	42	74	8	66	45	6	39
Other services	46	24	22	35	21	14	55	11	44	60	15	45
Total services	337	251	86	344	259	85	364	268	96	362	278	84
Balance on goods and services	5,488	5,503	-15	6,444	6,559	-115	5,688	5,303	385	6,262	6,328	-66
Capital												
Medium- and long-term	178	222	-44	173	245	-72	122	264	-142	95	275	-80
Credits received	(53)	(27)	(26)	(65)	(35)	(30)	(27)	(38)	(-11)	(70)	(45)	(25)
Credits extended	(125)	(195)	(-70)	(108)	(210)	(-102)	(95)	(226)	(-130)	(125)	(230)	(-105)
Short-term	203	122	81	262	195	67	...	...	-201	120	25	95
Credits received	(195)	(120)	(75)	(260)	(195)	(65)	...	...	(-172)	(120)	(25)	(95)
Credits extended	(8)	(2)	(6)	(2)	(-)	(2)	...	...	(-29)	(-)	(-)	(-)
Total capital	381	344	37	435	440	-5	...	...	-343	315	300	15
Net errors and omissions	--	--	--	--	--	--	--	--	2	--	--	--
Overall balance	--	--	22	--	--	-120	--	--	44	--	--	-51
Monetary movements (net) 4/ 5/	...	...	-22	...	...	120	...	...	-44	...	...	51

Source: Data supplied by the Romanian authorities.

1/ Figures may not add exactly because of rounding.

2/ Preliminary.

3/ Excluding "lohn" transactions.

4/ Increase in assets (-).

5/ Comprises changes in payments agreements and IBEC.

Table 4. Romania: Aggregate Demand and Supply

	1980	1981	1982	Official forecast ^{1/} 1983
(Annual percentage increases in constant prices)				
Aggregate Domestic Demand	1.7	-0.2	-0.5	0.9
Consumption	3.3	2.7	-1.2	1.0
Gross fixed investment	2.6	-7.1	-3.1	1.5
Additions to stocks	-24.5	-77.7	105.1	-10.0
GNP	3.3	2.7	3.2	3.8
National income produced	2.8	2.2	2.6	3.5
Nonagricultural national income produced	5.8	3.0	1.4	3.4
Energy				
Net crude oil imports (tons)	20.9	-41.2	-4.8	-65.8
Net energy use (tons)	2.1	-1.2	-1.7	1.8
Ratio of net energy use to nonagricultural national income	-3.3 ^{2/}	-4.6	-3.0	-1.8
Intermediate imports (non-oil, nonagricultural)				
All currencies	5.4	4.0	-13.8	20.6
Convertible currencies	-4.6	-13.1	-34.6	40.9
(In per cent of GNP) ^{3/}				
Current account				
All currencies	-5.2	-1.7	2.1	1.3
Convertible currencies	-5.1	-1.7	1.3	1.5

Sources: Romanian authorities and staff estimates.

^{1/} In the official projections, the decline in the ratio of net energy use to nonagricultural national income is derived from the official energy and national income forecasts.

^{2/} Average for period 1976-1980.

^{3/} GNP measured in 1982 U.S. dollars by converting 1982 leu value using lei 15 = US\$1 and interpolating on the basis of real growth rates.

Table 5. Romania: Monetary Survey 1/

(In billions of lei)

End of period	1980	1981	1982 <u>2/</u>	Forecast <u>3/</u>							
				March 1983		June 1983		September 1983		December 1983	
				(1)	(2)	(1)	(2)	(1)	(3)	(1)	(3)
1. NFA	-126.6	-122.8	-111.2	-118.3	-130.1	-118.5	-130.4	-118.3	-138.0	-116.8	-136.3
2. NDA	368.1	412.7	424.6	431.8	444.0	431.5	443.8	432.7	453.0	435.4	455.5
Of which:											
Credit to enterprises and individuals	(427.3)	(461.1)	(490.7)	(505.9)	(513.9)	(519.3)	(527.5)	(527.4)	(541.4)	(516.5)	(530.2)
3. Liquid liabilities	241.5	289.9	313.4	313.5	313.9	313.0	313.4	314.4	315.0	318.6	319.2
Of which:											
Enterprise deposits	(75.3)	(104.1)	(116.5)	(111.8)	(111.8)	(109.8)	(109.8)	(109.5)	(109.5)	(109.2)	(109.2)
Savings deposits	(101.4)	(114.6)	(118.2)	(119.2)	(119.2)	(119.2)	(119.2)	(119.2)	(119.2)	(124.2)	(124.2)

Sources: Data provided by the Romanian authorities and staff estimates.

1/ Data for the ends of 1981 and 1982 include no arrears adjustment. If this adjustment were made the following amounts would be subtracted from net foreign assets and from liquid liabilities: lei 9.8 billion for 1981 and lei 5.8 billion for 1982.

2/ All items denominated in foreign currency are valued at an exchange rate of lei 15 = US\$1.

3/ In all columns headed (1) foreign currency denominated items are valued at an exchange rate of lei 15 = US\$1. In columns headed (2) an exchange rate of lei 16.5 = US\$1 is used and in columns headed (3) as exchange rate of lei 17.5 = US\$1 is used.

Table 6. Romania: Revenue and Expenditure of the State Budget, Annual

	1979 Outturn	1980 Outturn	1981 Outturn	1982 Outturn ^{1/}	1983 Planned	1980 Outturn	1981 Outturn	1982 Outturn	1983 Planned
(In millions of lei; at current prices)					(Percentage change) ^{2/}				
A. Revenue, total	339,309	298,004	280,342	277,631	261,332	-12.2	-5.9	-1.0	-5.9
Turnover tax	35,674	39,420	34,933	65,260	81,454	10.5	-11.5	86.8	84.8
Tax on net production	65,248	69,019	59,101	61,847	36,116	5.8	-14.4	4.6	-41.6
Payments from profits	80,149	82,977	81,929	45,159	34,214	3.5	-1.3	-44.9	-24.2
Other taxes and revenues from socialist units	75,030	21,427	20,809	18,716	18,239	-71.4	-2.9	-10.1	-2.6
Taxes on agricultural cooperatives	1,041	1,065	942	1,176	1,480	2.3	-11.5	24.8	25.8
Tax on total Remunera- tion Fund	31,606	34,115	36,701	39,618	42,170	7.9	7.6	7.9	6.4
Taxes and duties on the population	2,750	2,956	3,216	3,853	4,101	7.5	8.8	19.8	6.4
Social insurance fees	29,987	32,324	34,740	37,644	39,304	7.8	7.5	8.4	4.4
Other	17,824	14,701	7,971	4,358	4,254	-17.5	-45.8	-45.8	-2.4
B. Expenditure, total	337,627	296,787	271,733	257,757	261,332	-12.1	-8.4	-5.2	1.4
Financing of the national economy	241,155	185,080	162,138	148,992	136,067	-23.3	-12.4	-8.1	-8.7
Social welfare and cultural activities	65,557	70,977	74,354	82,550	83,176	8.3	4.8	11.1	0.7
Education, culture and art	(18,565)	(18,872)	(19,638)	(19,731)	(18,745)	(1.6)	(4.1)	(0.5)	(-5.0)
Health, physical education and sports	(13,762)	(14,597)	(15,779)	(16,955)	(16,617)	(6.1)	(8.1)	(7.5)	(-2.0)
State social insurance and pensions	(23,833)	(26,728)	(28,068)	(31,227)	(32,679)	(12.1)	(5.0)	(11.3)	(4.6)
Children's allow- ances	(9,397)	(10,780)	(10,869)	(14,869)	(14,637)	(14.7)	(0.8)	(34.7)	(3.4)
National defense	11,835	10,394	10,503	11,339	11,725	-12.2	1.0	8.0	3.4
Administration and justice	3,360	3,440	3,657	3,789	3,856	2.4	6.3	3.6	1.8
Reserve funds	--	--	--	--	23,660	--	--	--	--
Other	15,720	26,896	21,177	11,087	2,849	71.1	-21.3	47.6	-74.3
C. Surplus (A - B)	1,682	1,217	8,519	19,874	--	...	...	...	...

Sources: Anuarul Statistic al Republicii Socialiste Romania; Law on Adoption of the State Budget for 1980; and data supplied by the Romanian authorities.

^{1/} Provisional.

^{2/} Compared with the outturn of the previous year.

Table 7. Romania: Foreign Exchange Requirements
and Sources of Financing, 1984-88

(In millions of U.S. dollars)

	1984	1985	1986	1987	1988
Requirements					
Repayment of debt outstanding at end-1982	1,170	1,584	1,346	1,158	981
Repayment of 1983 rescheduled debt <u>1/</u>	106	--	--	228	228
Repayment of credit received after January 1, 1983	229	128	212	454	604
Net credit extended	<u>200</u>	<u>-20</u>	<u>100</u>	<u>100</u>	<u>100</u>
Total	1,705	1,692	1,731	1,940	1,913
Reserve change	<u>-16</u>	<u>-309</u>	<u>228</u>	<u>183</u>	<u>198</u>
Total including reserve change	1,689 <u>2/</u>	1,383	1,959	2,123	2,111
Sources of finance					
Current account surplus	850	950	1,200	1,400	1,600
IMF	400	--	--	--	--
IBRD	220	220	220	220	220
Supplier credit	219	213	300	300	291
Bank credit	--	--	239	203	--

Source: Based on data provided by the Romanian authorities.

1/ Based on the assumption that the repayment terms for rescheduling are those proposed in the informal agreement with the nine banks.

2/ The comparable figure for 1983 is US\$2,968 million.

Table 8. Romania: Quantitative Criteria
for the 1981 and 1982 Programs

	Dec. 1981	Dec. (a) 1/ 1982	(b) 2/ 1982	March	June	Sept.	Dec.
					1983		
(In billions of lei)							
Net domestic assets of the banking system							
Ceiling <u>3/</u>	--	449	437	444	444	453	456
Actual <u>3/</u>	413	...	425				
(In millions of U.S. dollars)							
Trade surplus in convertible currencies (cumulative)							
Floor	--	550	1,200	350	700	1,100	1,600
Actual	204	...	1,525				
Gross inter- national reserves in convertible currencies							
Floor	--	675	550	(587) <u>4/</u>	(587) <u>4/</u>	(687) <u>4/</u>	837
Actual	550	...	587				
Outstanding short- term debt in convertible currencies							
Ceiling	--	1,000	1,000	...	500	...	400 <u>5/</u>
Actual	643 <u>6/</u>	...	564 <u>7/</u>	...	...	...	...
New external debt in convertible currencies in a maturity range of 1-5 years (maximum)	...	...	...	...	...	...	500 <u>5/</u>

Sources: Letter of Intent to the Managing Director; and data supplied by the Romanian authorities.

1/ As provided for in the original 1982 program (see EBS/82/73, 4/29/82).

2/ As provided under the amended program described herein.

3/ 1981 and 1982 data are based on the exchange rate of lei 15 = US\$1; data for the ends of the first two quarters are based on an exchange rate of 1983 lei 16.5 = US\$1 and data for the last two quarters are based on an exchange rate of lei 17.5 = US\$1.

4/ Indicative target.

5/ Excluding credits obtained to refinance any of US\$370 million in debts to suppliers referred to in paragraph 2 of the Letter of Intent.

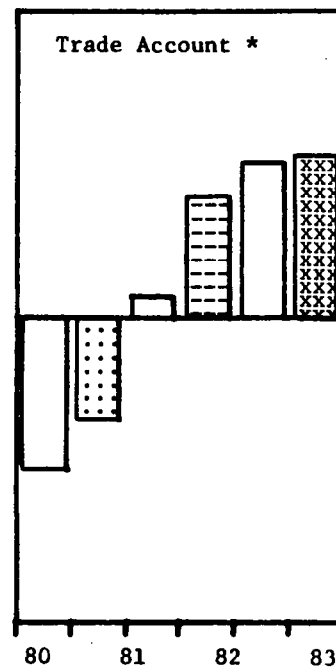
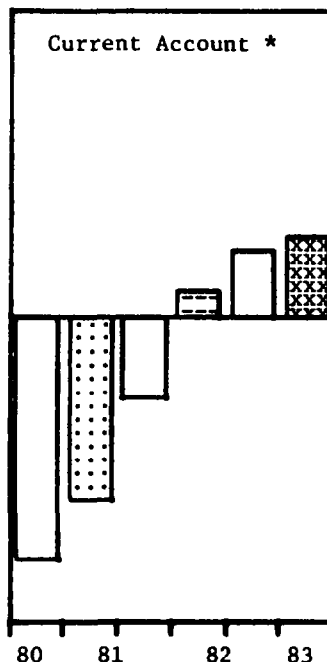
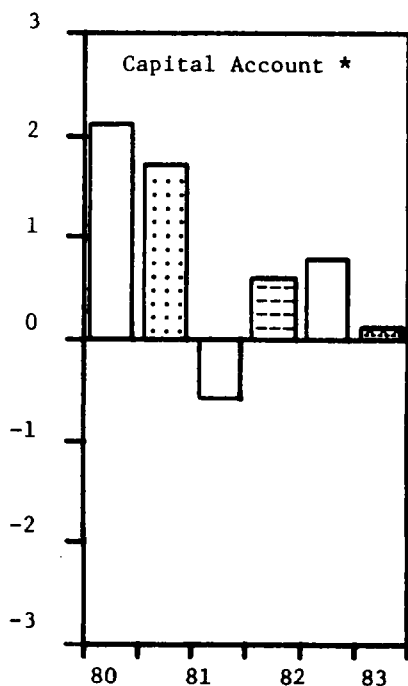
6/ Excluding arrears of US\$318 million on short-term credits.

7/ Excluding short-term credits arising from postponement to early 1983 of downpayments to banks (US\$307 million).

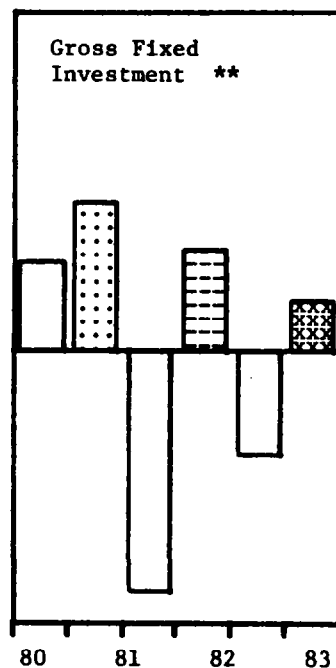
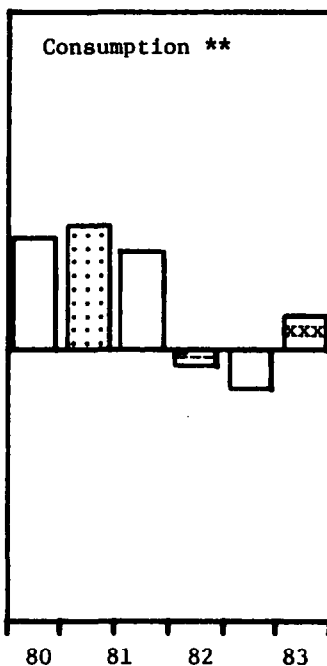
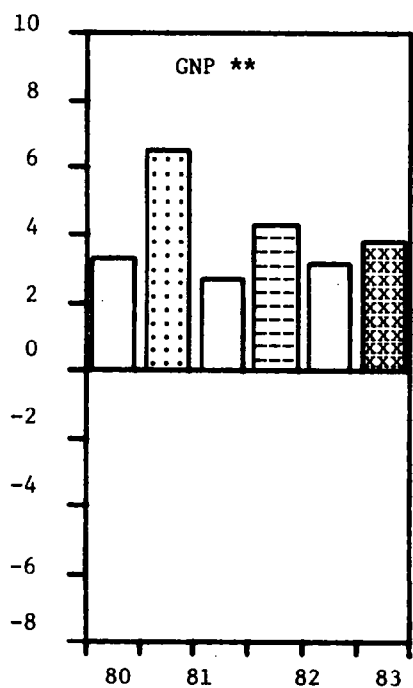
Romania: Program Targets

Actual
Original program
Revised program
Official forecast

US\$b



Per cent



* Convertible currencies.

** Rates of growth in constant prices.

Table 9. Romania: Selected Economic and Financial Indicators, 1980-83

	Actual 1980	Program 1981	Outturn	Original Program	Revised Program 1982	Outturn	Program 1983
(Annual per cent changes, unless otherwise specified)							
National income and prices							
GNP at constant prices	3.3	6.5	2.7	3.8	4.3	3.2	3.8
GNP deflator	0.6	4.0	5.8	10.3	18.0	13.1	7.0
Consumer prices	1.5	2.5	3.5	11.2	18.8	17.8	7.0
External sector (on the basis of U.S. dollars)							
Exports, f.o.b.	21.0	16.6	12.2	10.8	1.9	-6.5	8.1
Imports, f.o.b.	26.6	11.0	-3.3	8.9	-5.5	-20.5	16.6
Non-oil imports, f.o.b.	1.5	12.8	1.1	9.8	1.8	-21.3	24.8
Export volume	13.0	10.6	4.2	4.8	1.9	-6.6	4.0
Import volume	--	5.0	-5.8	5.5	-7.0	-22.5	14.5
Terms of trade (deterioration -)	-15.8	--	5.1	3.8	--	-2.0	2.0
Nominal effective exchange rate (depreciation -)	11.3	-10.0	-1.8	--	8.7	6.8	-14.4 <u>1/</u>
Government budget							
Revenue and grants	-12.2	0.6	-6.3	5.1	0.6	-1.0	-5.9
Total expenditures	-12.2	1.0	-8.5	4.4	0.1	-5.2	-6.4
Money and credit							
Domestic credit	24.7	19.6	13.5	8.8	5.9	2.9	7.3
Enterprises	5.7	16.3	11.9	5.5	4.2	6.4	8.0
Money and quasi-money (M ₂) <u>2/</u>	21.2	17.2	18.1	13.8	12.3	6.6	2.2
Velocity (GNP relative to M ₂) <u>2/</u>	-17.3	-6.7	-9.6	0.3	10.0	8.7	10.7
Interest rate (annual rate, one-year savings deposit)	5.0	5.0	5.0	5.0	5.0	5.0	... <u>3/</u>
(In per cent of GNP, unless otherwise specified)							
Overall public sector <u>surplus</u>	0.4	0.0	1.2	2.6	1.2	2.7	2.4
Central Government savings	18.7	13.7	16.2	14.5	15.7	17.3	15.9
Central Government budget surplus	0.2	0.0	1.0	2.6	1.2	2.7	2.4
Gross domestic investment	38.1	38.0	31.4	33.6	33.8	31.4	30.4
Gross domestic savings	36.8	35.6	38.7	41.7	37.4	36.3	37.9
Current account deficit	4.2	3.0	1.3	0.6	-0.3	-2.1	-1.4
External debt (inclusive of use of Fund credit)	16.6	17.5	15.1	15.9	21.1	20.1	17.9
Debt service ratio <u>4/</u>	18.4	21.7	22.2	21.1	23.1	25.7	22.2
Interest payments (in per cent of exports of goods and services)	11.4	11.6	13.9	15.0	15.8	14.1	12.1
(In millions of U.S. dollars, unless otherwise specified)							
Overall balance of payments	-198	-293	-1,366	727	754	839	-55
In convertible currencies	-245	-154	-1,388	847	851	795	-4
Current account of the balance of payments	-2,420	-1,945	-833	-567	140	1,040	734
In convertible currencies	-2,399	-1,825	-818	-450	257	655	800
Gross official reserves (months of imports)	0.73	0.85	0.94	1.15	1.24	1.5	2.0
External payments arrears	--	--	1,143	--	--	888	--

Sources: IMF, European and Exchange and Trade Relations Departments.

1/ On the basis of measures already decided.

2/ Excludes blocked enterprise deposits.

3/ The interest rate was raised by 1 percentage point on January 1, 1983 and will be further adjusted (by a hitherto unspecified amount) on July 1, 1983.

4/ Net of rescheduled amounts, in per cent of goods and services.

Fund Relations with Romania

(February 15, 1983)

Date of membership: December 15, 1972.

Quota: SDR 367.5 million.

Status: Article XIV.

Fund holdings of currency: SDR 1,143.8 million (311 per cent of quota), which includes SDR 316.5 million (86 per cent of quota) under compensatory financing and SDR 222.3 million (60 per cent of quota) under enlarged access.

SDR position: Current balance is SDR 4,530 million.
The net cumulative allocation is SDR 76.0 million.

Direct distribution of profits from gold sales (July 1, 1976-July 31, 1980): US\$30.16 million.

Gold distribution (four distributions): 162,589.303 fine ounces.

Romania: Summary of the Main Elements of the 1983 Program

I. Targets

1. A surplus on merchandise trade transactions in convertible currency of US\$1,600 million and a surplus on total convertible current account transactions of US\$800 million.
2. An increase in international reserves of US\$250 million.

II. Assumptions and Projections

1. Debt relief will be provided in respect of 70 per cent of debt repayments due on medium- and long-term debt to commercial banks and in respect of 75 per cent of total debt service obligations to foreign governments. Taking account of anticipated debt repayments to suppliers and other capital account transactions, net capital outflows in convertible currencies are projected at US\$804 million.
2. There will be a net turnaround of US\$451 million on current account in nonconvertible currencies to a deficit of US\$66 million, reflecting mainly an 11 per cent increase in merchandise exports and a 20 per cent increase in merchandise imports.
3. There will be an increase of 6 per cent in the nominal value of convertible exports in dollar terms, of which two thirds represents volume increases. The commodity composition of this increase in nominal terms is as follows: a 17 per cent increase in refined petroleum products and a 2 per cent increase in nonpetroleum items. With expected non-oil export market growth of about 1 per cent, the latter implies only a very small increase in Romanian market shares. Achievement of this outcome will be assisted by larger exports of agricultural produce, reflecting the good 1982 harvest, and by the nominal depreciation of the leu.
4. There will be an increase in convertible imports of 6 per cent. Together with the assumed outcome on nonconvertible trade, this would imply an increase in total imports of 13 per cent. For non-oil imports, the increase would be 20 per cent both in convertible currencies and in all currencies.
5. The officially forecast rates of growth in real GNP and real domestic expenditure are 3.8 per cent and 1.3 per cent, respectively. Even if there is some slippage from the growth target, attainment of the external convertible current account target would still be possible.

III. Program Policies

1. Domestic demand management policies will be tight. The growth of the net domestic assets of the banking system is forecast at 7.3 per cent (only 2.5 per cent abstracting from exchange rate-induced valuation effects) and total domestic liquidity is forecast to grow by less than 2 per cent, which is substantially less than the forecast rise in nominal incomes. The size of budgetary operations will continue to contract and, consistently with the forecast change in net domestic assets, a budget surplus equivalent to over 2.5 per cent of GNP is forecast. The growth of wages and other incomes will continue to be administratively constrained to a level consistent with the planned increase in domestic expenditure; similarly, the growth in investment expenditure will be kept at less than 2 per cent.

2. Partly with a view to influencing the 1983 outcome and also as part of the restructuring of domestic prices intended to have its full impact only in the longer term, a number of price and cost changes are being introduced in 1983. First, the commercial exchange rate was depreciated by 9 per cent against the U.S. dollar on January 1, 1983 and will be further depreciated by almost 6 per cent on July 1, 1983; as from the latter date all trade transactions will take place at a unified rate. Thereafter the leu will be pegged to a basket of currencies with regular adjustments in the level of the peg to ensure the achievement and preservation of a suitable level of international competitiveness. Second, interest rates were raised on January 1, 1983 by 1 and 3 percentage points for deposits and advances, respectively. Further adjustments to yield a structure of rates that is positive in real terms will be made on July 1, 1983. Finally, energy prices were raised substantially in mid-1982 and the full-year effect of these changes will not be felt until 1983. Moreover, further increases are to take place in 1983. The wellhead price of crude oil was doubled on January 1, 1983 and the price of natural gas is to be raised by 35 per cent on January 1, 1983 and a further 15 per cent on October 1, 1983.

February 11, 1983

Dear Mr. de Larosière:

1. In accordance with paragraph 19 of my letter to you of April 20, 1982, I am writing to you to describe the policy program to be followed in 1983 under the stand-by arrangement approved on June 15, 1981. As you know, since the inception of the stand-by, Romania has been able to improve sharply its balance of payments on current account, to make an extensive use of various economic instruments, including the exchange rate, to cope with the difficulties it was facing, and to initiate a comprehensive set of structural reforms in the field of energy, rationalization of production, and economic management, as described in my letter of November 9, 1982. The 1983 program should therefore be looked at as a part of an on-going process. Its presentation will be preceded by a description of developments in 1982 and complemented by a preliminary view of developments beyond 1983.

2. In 1982 there was a large shift of the convertible current account position to an estimated surplus of US\$655 million (1.3 per cent of GNP) from deficits of US\$2.4 billion in 1980 and US\$818 million in 1981. For 1982 a deficit of US\$450 million had originally been projected. The faster external adjustment was prompted by the lower-than-anticipated supply of foreign credit and was achieved mainly by an estimated 33 per cent curtailment of the dollar value of imports from the convertible area. This was not an easy task; it was achieved by a downward revision of import plans for enterprises, measures designed to curb private consumption and import-intensive investment, and stringent energy-saving policies. Despite the effect on output of the demand-reducing measures and reduced supplies of imported inputs, real GNP grew by 3 per cent in 1982, partly reflecting a favorable harvest.

Despite the sharp improvement of the current external account, the balance of payments problem has continued in 1982 mainly on two grounds. First, exports to the convertible area did not contribute to the external adjustment. They fell by 14 per cent from the previous year. The major part of the decline was attributable to lower exports of refined petroleum products following the adoption of a policy prohibiting imports of crude oil for refining for export unless such operations would be profitable in hard currency terms. In addition, export performance suffered on account of weak foreign demand and the strengthening of the U.S. dollar to which the leu has been pegged. Second, there was a large amount of debt service payments falling due in 1982 and capital inflows fell short of expectations. This led us to seek debt rescheduling, with the 20 per cent down-payment (US\$307 million) on the 1982 commercial bank rescheduling taking place in early 1983, and to retreat from the objective of increasing official foreign exchange reserves, which in fact remained basically unchanged in 1982 at a low level equivalent to only 1 1/2 months of convertible imports.

By the end of 1982 debt rescheduling agreements had been signed with the banks and most bilateral agreements with official creditors under the

aegis of the Paris Club had been finalized. The remaining agreements under the Paris Club will be signed by end-February 1983. The settlement of suppliers' credits proved, however, much more difficult and time consuming than we had expected; it also proved disruptive to our trade relations with partner countries and the flow of trade credit from abroad. Of the total reschedulable (nongovernment-guaranteed) arrears to suppliers as of March 1, 1982 (US\$1,270 million), a total of US\$388 million had not been settled by end-1982. An amount of US\$18 million was repaid in January 1983 to small suppliers. However, a group of big suppliers to whom we owe US\$370 million has not accepted the general conditions we have offered for rescheduling at terms comparable to those agreed with the banks. We intend to regularize this situation by March 15, 1983. The debt relief obtained in 1982 amounted to US\$2.7 billion.

3. We intend in 1983 and in the following years to continue our efforts to strengthen our external position. To that effect, there is a need for a further improvement of the current account in 1983 and beyond as well as for a rebuilding of gross convertible international reserves. In line with this, our program for 1983 aims at a convertible current account surplus of US\$800 million, representing an improvement of 0.3 per cent of GNP over 1982. This is to be achieved by a 6 per cent increase of the dollar value of exports, and by containing the growth in domestic consumption and investment to a rate of 1.3 per cent or below the forecast growth of GNP (3.9 per cent). We will ensure that the current account improvement will be achieved even if there should be a deviation from our targeted growth rate of GNP. We envisage that the growth in the dollar value of imports from the convertible area will be held at 6 per cent. To underline the importance of achieving the increased current account surplus, we intend to achieve a trade surplus in convertible currencies of at least US\$350 million in January-March 1983, at least US\$700 million in January-June 1983, at least US\$1,100 million in January-September 1983, and at least US\$1,600 million in January-December 1983. The nonconvertible current account is forecast to shift from a surplus of US\$385 million in 1982 to a deficit of US\$66 million in 1983.

4. To supplement our own efforts to restore our external situation, we will need to obtain in 1983 additional debt relief from our creditors. Debt service payments in 1983, including delayed 1982 downpayments on rescheduled debt to banks and the settlement of payments to suppliers, are projected to remain very high (US\$2.7 billion or somewhat more than 30 per cent of expected exports of goods and services). This has prompted us to seek in early January 1983 negotiations on the rescheduling of principal and interest payments due in 1983 on medium- and long-term debts to foreign official and officially guaranteed creditors and a rescheduling of principal due on medium- and long-term debt to banks; nonguaranteed debts to suppliers will not be rescheduled. The international financial community, mindful both of Romania's difficult external liquidity situation and of the considerable steps to adjust the balance of payments that have been taken in 1982, as well as the further measures that are contemplated in 1983, has in principle accepted this debt rescheduling. We propose to make larger percentage downpayments in 1983 than in 1982, and it is estimated that this would provide debt relief of some US\$800 million

in 1983. This together with a purchase of US\$400 million from the Fund will permit us to meet all our current payments obligations in 1983, although new arrears will have to be incurred temporarily until the signing of the agreements in respect of debt repayments which are the subject of rescheduling negotiations. We are firmly committed to eliminate any such arrears before the end of 1983 and, in addition, we will not incur any other arrears in 1983. On the contrary, we intend to rebuild our gross convertible international reserves, which stood at US\$587 million at end-1982, by US\$250 million during the course of 1983. We will monitor progress toward achieving this objective during the year against indicative targets for the level of reserves which provide for no reduction, from US\$587 million, during the first two quarters, and an increase of US\$100 million during the third quarter. Developments in our gross reserve position will be reviewed with the Fund. We also intend to bring about a further consolidation of convertible foreign debt in 1983. To this end Romania will not contract or guarantee new external debt in convertible currencies in the maturity range of one to five years (excluding purchases from the Fund) of more than US\$500 million in 1983. The level of outstanding short-term foreign debt in convertible currencies, which at the end of 1982 was US\$564 million, shall not exceed US\$500 million on June 30, 1983 and US\$400 million on December 31, 1983. Credits obtained to refinance any of the US\$370 million in debts to suppliers referred to in paragraph 2 will be excluded from these ceilings.

5. Taking into account the need to achieve a further improvement in the current account in 1983, the following decisions have been taken in the field of exchange rate policy. With effect from January 1, 1983, the commercial exchange rate has been devalued from lei 15 to lei 16.50 per US\$1 and the noncommercial exchange rate has been devalued from lei 11 to lei 12.50 per US\$1. From July 1, 1983, a further devaluation will take place: the commercial rate will be lowered from lei 16.50 to lei 17.50 per US\$1 and the noncommercial rate from lei 12.50 to lei 13.50 per US\$1. Also from July 1, 1983, the leu will be pegged to a basket of currencies weighted according to the direction of foreign trade in convertible currencies. The mechanism for applying this basket will be determined in the study on exchange rate policy which we have undertaken to prepare jointly with the Fund staff.

Restoration and maintenance of Romania's international competitiveness through the pursuit of an appropriate exchange rate policy is an essential element of our overall economic strategy. If it should appear that the devaluations already decided on in 1983 are insufficient in this respect, we will make such further adjustments of the exchange rate as are deemed to be necessary. Our decisionmaking in this regard will be guided by the study on exchange rate policy referred to above.

To enable the adjustments of the exchange rate of the leu to have a beneficial effect on the current external account, we will ensure that the cost increases resulting from the devaluations will be passed on fully to domestic producer and consumer prices; there will be no wage compensation for price increases related to the depreciation. Enterprises are required to integrate higher import costs into their overall cost and proposed

price structures. To assist in this process the proportion of output on which enterprises can set prices without ministerial or central approval increased in 1982; we intend to accelerate this process in 1983.

6. We believe that an adequate interest rate policy is essential for encouraging the most efficient resource allocation and promoting financial savings. As a first step in this direction, we have raised domestic bank lending and deposit rates by 3 percentage points and 1 percentage point, respectively, on January 1, 1983. We realize that further adjustments are necessary. During the first half of 1983 we shall conduct a study of the level of interest rates on credits and savings deposits and on July 1, 1983 shall modify them to the extent needed to give positive real interest rates.

7. We intend to make monetary policy more effective through a number of instruments including: an adjustment of interbank rates in line with the increase of interest rates referred to above; a reduction in the share of budgetary grants in investment financing to 40 per cent in 1983 and less in 1984; and maintenance of the reserve requirement on enterprise deposits that was introduced on January 1, 1983. The reserve requirement will gradually afford the National Bank better control over enterprise liquidity, both directly through the enterprise accounts kept therewith and indirectly through the specialized banks' redepositing of their reserves with the National Bank.

Freely usable enterprise deposits are forecast to decline by 2 per cent in nominal terms despite a projected rise in producer prices (6-7 per cent). Household savings deposits, after declining in real terms in 1982, are expected to remain substantially unchanged in real terms in 1983. Consistent with our targets for domestic liquidity and the balance of payments, we intend to hold the growth of domestic credit of the banking system to 7 per cent. Net domestic assets of the banking system, which amounted to lei 425 billion at end-1982, shall not exceed lei 444 billion on March 31, 1983, lei 444 billion on June 30, 1983, lei 453 billion on September 30, 1983, and lei 456 billion on December 31, 1983.

8. Budgetary policy in 1983 provides for expenditure restraint, with expenditure in nominal terms remaining approximately unchanged. The increase in revenue expected to accompany the changes in the exchange rate, energy prices, and interest rates will in part be offset by an across-the-board reduction in the net production tax rate of enterprises. Accordingly, we anticipate a budget surplus of about the same amount as in 1982. In formulating our policies we have been guided by the principle of not reversing the relative price effects of the devaluation and the increases in energy prices and interest rates.

9. We consider that an efficient energy policy is an essential element of our overall economic strategy. We have already taken a number of important steps, such as the doubling of the price of natural gas in 1982, the development of our oil and coal production capacity through the use of modern techniques, and the promotion of energy savings. As part of our effort to close the gap between domestic energy prices and those on

world markets, we intend to raise the price of natural gas by 35 per cent on July 1, 1983 and by 15 per cent on October 1, 1983 as indicated in my November 1982 letter. On January 1, 1983, we raised the wellhead price for crude oil from lei 550 per ton to lei 1,100 per ton, and will increase it further to lei 1,650 per ton on January 1, 1984.

As also indicated in my November letter, we will conduct a study on the pricing of natural gas by September 30, 1983; this study will also consider the structure of domestic energy prices on a broad front, including crude oil and refined petroleum products. A preliminary discussion of this study will take place at the July Fund review, with the full findings and timetable for further action, with a first step on January 1, 1984, to be available for the November Fund review.

10. Capital costs are paid by enterprises in Romania through transfers to the amortization fund and interest payments to the National Bank and the specialized banks on borrowed funds. For prices fully to reflect capital costs, however, depreciation schedules should accurately reflect the productive life of plant and equipment, and interest should be imputed to all nondepreciated capital used in the production process. To eliminate the present bias in relative prices arising from the underpricing of capital, we intend to introduce into production costs a charge, based on current interest rates, for capital financed from budget grants or own funds and to revise the depreciation schedules. The mutually agreed changes will be based on the study of the cost of capital referred to in my November 1982 letter.

11. We are aware of the role that prices should play, as a matter of policy, in promoting efficient resource allocation. The individual studies mentioned above should be viewed as a part of our overall policy. The purpose of these studies will be to determine the appropriate future path of the domestic relative price structure and, more immediately, to outline specific steps that should be taken to complete the exchange and price reform. We will therefore conduct these studies in parallel and have their results or, for the energy study, preliminary indications of the progress of the study, available at the time of the July review. For energy the results will be available at the time of the November review. All the studies will establish a mutually agreed timetable for the implementation of the necessary measures for achieving the following objectives:

Cost of capital: The inclusion in the price structure of the costs arising from adequate schedules for amortization on the basis of a comparison with practices in other countries plus current interest rate charges on all capital.

Interest rates: A modification on July 1, 1983 to yield a structure of interest rates that is positive in real terms. This would be followed by further action as necessary to maintain interest rates at a suitable positive level in real terms in the light of price and other developments.

Energy prices: The establishment of a timetable for closing the gap between domestic and world prices of natural gas, crude oil, and refined petroleum products. This timetable would include a program for 1984 with a first step on January 1, 1984.

Exchange rates: Pegging of the leu to a basket as of July 1, 1983, with periodic reviews of the level of this peg with a view to establishing and maintaining a suitable level of competitiveness. The first such review will be completed and acted upon by no later than October 1, 1983. The study will also establish a timetable for unification of the commercial and noncommercial exchange rates, which is to be completed in the course of 1984, with a first step on January 1, 1984.

12. Romania incurred payments arrears in 1981 and 1982 which were included in the rescheduling agreements signed in 1982 that we intend to implement according to paragraph 2 above. We have further simplified our exchange rate system by reducing the number of multiple export exchange rates from 12 to 2 on January 1, 1983 and will eliminate the remaining multiple export exchange rates on July 1, 1983. In line with our medium-term strategy of reforming the economic mechanism of Romania by decentralizing the decision-making process, we consider it important to liberalize our approach to the provision of foreign exchange. As soon as the present tight foreign exchange situation eases, we intend to take concrete steps in this direction. Romania will also continue its efforts to reduce the number of bilateral payments arrangements with Fund members.

13. The Government of Romania believes that the policies set forth above are adequate to achieve the objectives of its program but it will take any further measures that may become appropriate for this purpose. Romania will remain in close consultation with the Fund and will conduct two reviews of developments under the program with the Fund, one before July 31, 1983 and the other before November 30, 1983. At these reviews such further understandings with the Fund as may be necessary, relating to the studies mentioned in paragraph 11, will be reached. At the time of the November review understandings will also be reached with the Fund for the remaining period of the arrangement.

Sincerely,

Petre Gigea
Minister of Finance