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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/56

10:00 a.m., March 30, 1983

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
	M. K. Diallo, Temporary
J. Anson	
	H. G. Schneider
	A. Le Lorier
	J. Delgadillo, Temporary
	C. Dallara
	T. Alhaimus
	I. R. Panday, Temporary
	T. Yamashita
R. K. Joyce	
	J. R. N. Almeida, Temporary
G. Laske	
G. Lovato	C. P. Caranicas
	V. K. S. Nair, Temporary
	J. E. Suraisry
J. J. Polak	T. de Vries
	K. G. Morrell
G. Salehkhou	
F. Sangare	E. I. M. Mtei
M. A. Senior	
	A. Lindå
Zhang Z.	Wang E.

L. Van Houtven, Secretary
J. C. Corr, Assistant

Also Present

P. Mentré de Loye, Consultant. Asian Department: F. Le Gall, Wang X. European Department: B. Rose, Deputy Director; T. R. Boote, E. O. C. Brehmer, P. C. Hole, J. Prust, J. K. Salop. Exchange and Trade Relations Department: S. Mookerjee, Deputy Director; M. Allen, D. J. Donovan, J. M. T. Paljarvi. Legal Department: W. E. Holder. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. P. Bhagwat. Advisors to Executive Directors: A. A. Agah, S. E. Conrado, L. Ionescu, H.-S. Lee, P. D. Péroz. Assistants to Executive Directors: H. Arias, M. Camara, L. E. J. Coene, T. A. Connors, I. Fridriksson, M. Hull, W. Moerke, Y. Okubo, E. Portas, D. I. S. Shaw, A. Yasseri.

1. ROMANIA - REVIEW UNDER STAND-BY ARRANGEMENT, AND EXCHANGE SYSTEM

The Executive Directors considered a staff report for the review under the stand-by arrangement for Romania and approval of exchange restrictions (EBS/83/54, 3/8/83; Cor. 1, 3/24/83; Sup. 1, 3/10/83; and Sup. 1, Cor. 1, 3/24/83).

The staff representative from the European Department made the following statement:

> During a recent visit to Romania a staff team discussed with the Romanian authorities the status of the payments arrears of $370 million outstanding at the end of 1982 1/ and owed to (non-guaranteed) large suppliers who had previously refused to accept rescheduling terms comparable to those agreed with the banks. The Romanian authorities stated that Romania (a) had made 20 per cent down payments to all of these suppliers; (b) had settled, by March 12, 1983, $307 million or 83 per cent of these claims; (c) had made bona fide rescheduling offers to all suppliers to whom it owed the remaining $63 million; and (d) expects to make full settlement of the remaining $63 million owed to a large number of suppliers by mid-1983. In view of this, the Romanian authorities consider that they have made adequate efforts to regularize the aforementioned payments arrears in accordance with their undertakings in paragraph 2 of the February 1983 letter of intent.
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> Only one bilateral agreement under the aegis of the Paris Club remains to be signed. An agreement with the United States was signed on March 10, 1983.
>
> Romania expects to initiate and conclude 1983 debt rescheduling negotiations under the Paris Club during April 1983. The Romanian authorities expect the 1983 debt rescheduling agreement with foreign banks to be concluded by about mid-May 1983 and at conditions described in EBS/83/54 (3/8/83). The envisaged increase in the percentage for down payments is expected to facilitate the conclusion of this agreement.
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> The current account in convertible currency may be adversely affected by withdrawal on June 30, 1983 of Romania's most favored nation (MFN) status by the United States. If this measure is applied, the Romanian authorities intend to offset the resultant direct loss of export revenue (roughly estimated by them at $150-200 million on an annual basis) so as not to endanger the attainment of the 1983 performance criteria for the convertible trade balance. To remain competitive in the U.S. market after the eventual loss of MFN status would require a reduction in the export prices of most items sold in the U.S. market by between 20 per cent and 40 per cent.

1/ An amount of $18 million also outstanding at end-1982 and owed to small suppliers was repaid in January 1983.

Mr. Polak made the following statement:

The Board has had an extensive discussion of the Romanian program as recently as December 20, 1982. On that occasion it had before it a very thorough review of the program as it stood in late 1982, as well as the results of negotiations with the Romanian authorities in September/October 1982 and in early November. Because that review fell very close to the end of 1982, the discussions not only covered some residual policy adjustment for 1982 but also addressed the status of the stand-by arrangement as a whole, with full consideration of the measures that would be appropriate in 1983. However, the elaboration of the more detailed aspects of the 1983 program was left to be worked out by the Fund mission that was to visit Romania in mid-January 1983.

The present review paper fills in these more detailed policy aspects. The mission also took advantage of the first opportunity to review the data for the full year 1982 and the report contains an admirable analysis of the developments of that year. The thorough knowledge that the staff has acquired of the working of the Romanian economy permits it to present a valuable picture of the development of the major variables in the Romanian economy during 1982, in response to the policies with respect to supply, demand, exchange rates, interest rates, subsidies, etc. Finally, the report enters more fully than could be done last December into the subjects of the four studies that are to be undertaken jointly by the Romanian authorities and the Fund staff later this year and that constitute an integral part of the development of the Romanian program.

As the staff points out in its paper, the overriding goal of economic policy in Romania during 1982 was to improve further the convertible current account position. The authorities pursued this goal with determination. As late as last spring, it seemed reasonable to accept a current account deficit for 1982 of $450 million, as against the deficit of about $800 million for 1981. In view of the difficult external situation it proved necessary to bring about a more rapid external adjustment and late last year the target was raised by some $700 million, to a surplus in the range of $250-300 million. The actual outturn was still considerably better, viz. a surplus of $650 million. Thus in two years (from 1980 to 1982) the current account was improved by the equivalent of 6 per cent of the 1982 gross national product.

The dramatic change in 1982 was obtained in spite of a large decline in exports. In other words, the authorities were obliged to bring about a sharp curtailment of imports. Such action could well be counterproductive if it were seen as a lasting solution to the problem of Romania's balance of payments--but this is not the case. For 1983, both exports and imports are expected to increase; while oil imports will decline further, sufficient room has been left for the imports of other commodities to increase by some 20 per cent to provide a badly needed increase in industrial inputs. In 1982, however, the reduction of imports was the only measure at the disposal of the authorities, and it was necessary to convince Romania's creditors of the determination of the authorities to provide the resources needed to meet the obligations on capital account. The harsh action taken on the trade account has indeed been instrumental in bringing about a considerable improvement in the relations between Romania and its creditors; this in turn has facilitated the rescheduling negotiations for 1983.

It should be noted, incidentally, that half of the reduction in exports was the result of deliberate action: the Government decided to lower exports of refined oil products, which permitted a corresponding decrease of imports of crude oil. This is the direct result of the fact that during the year the authorities introduced better profitability criteria for the import of crude oil to be refined for export.

Romania met all performance criteria in 1982, except settling a part of the arrears to suppliers. It should be mentioned here that in rescheduling exercises for other countries, suppliers' credits were not subjected to rescheduling, inter alia, because of the great difficulties in doing so. However, in the case of Romania the banks insisted on a "comparable treatment" for suppliers. This raised serious difficulties of implementation as described in footnote 2 on page 4 and footnote 1 on page 5 of the staff paper. The rescheduling of arrears to suppliers thus took much time, and although most of these credits were settled by end-1982, it was not possible to finish the task by that time. However, as is clear from the staff's statement, satisfactory arrangements for the settlement of the bulk of arrears to suppliers have now been concluded, and a 20 per cent down payment has been made on all such arrears.

The authorities are strongly committed to the implementation of all adjustment measures agreed with the Fund. In fact, they see the adjustment of their economy as a long-run process, and they intend to continue it even after the present stand-by arrangement will be completed. But this process should be gradual, with measures being implemented only after a careful preparation, in order to avoid disruptions in the economic and social life of the country. The authorities have implemented all the measures that were scheduled for January 1, 1983. As regards other adjustment measures described in the November letter of intent, the authorities are preparing the conditions for implementing them during 1983, as committed. Against this background it appears to me premature for the staff to pass a judgment in January 1983 that there were "some shortcomings in the implementation, up to early 1983, of the adjustment program prescribed by the Romanian authorities in their letter of intent of November 1982."

As mentioned above, the stand-by arrangement foresees collaboration between the Romanian authorities and the Fund staff in four major studies. These relate to

(i) the choice of the basket as a basis for pegging the leu, instead of its present peg to the U.S. dollar, as well as a decision on the level at which the peg should be set;

(ii) the method of determining the best way to close the gap between domestic and international prices of energy products;

(iii) the implementation of the commitment to move to a structure of positive real interest rates, which amounts to finding a suitable definition of the inflation rate against which the nominal interest rates are to be measured;

(iv) the costing of capital, both in terms of appropriate amortization schedules and of taking better account of interest rates.

These various studies are closely interconnected and their general purpose is to establish a more efficient connection between the Romanian economy and the outside world, functioning through appropriate exchange rates, prices, and interest rates. This will also imply the need for a much greater devolution of decision making.

The Romanian authorities are committed to move forcefully in this direction, and to reap the benefits from a greater role for profits in the determination of the course of the economy, even though there is perhaps ground for some modesty as to the benefits that can be expected from the implementation of these changes. In particular, I would regard with a certain skepsis the idyllic picture painted by the staff of the dynamic optimality that would result if all pricing, production, and investment decisions of socialist enterprises were guided by the profit motive.

The rescheduling exercise for 1983 is well advanced. The amount involved is much smaller than that of the previous rescheduling. The authorities are confident that no rescheduling will be necessary in 1984, and that the somewhat larger debt service in 1985 can be handled, given their intention to earn substantial reserves in 1983 (and possibly in 1984) and the evidence, which is surfacing already, of a restoration of Romania's creditworthiness.

It should be stressed in this connection that the Romanian authorities are on record that they have no desire for any increase in the net external debt of the country in the future. On the contrary, it is the intention to make every effort to repay all external debt before the end of this decade.

I recommend the two proposed decisions for adoption by Directors.

Mr. Laske recalled that the Board had had an extensive discussion of Romania's policies at the time of the review of the stand-by arrangement in December 1982 (EBM/82/164, 12/20/82). The policies formulated by the authorities for 1983 broadly followed the advice given by the Fund. They were designed to bring the balance of payments back to a viable position and to restore the confidence of foreign creditors, badly shaken by the events of the previous two years and by the lengthy negotiations about clearing up arrears and rescheduling debt. The debt profile of Romania showed that there would be massive repayment in the years to come, even after the restructuring to be completed for 1982 and the further restructuring anticipated for 1983. Repayments could be made successfully only if Romania achieved a substantial surplus on current account and if it was able to make some further use of foreign credit.

The current account with the convertible area had undergone a dramatic improvement compared with a year earlier, surpassing original expectations, Mr. Laske continued. A further increase was projected for 1983, based on careful assumptions with regard to both exports and imports. However, the achievement of the targets would hinge to a considerable extent on the strength of the economic recovery in major industrial countries. The Romanian authorities would need to monitor developments with great caution and to stand ready to take corrective action if the assumptions were not realized. The Romanian economy remained plagued by many distortions that needed to be corrected if the country was to prosper more than it had in the past. He attached great importance, therefore, to the four studies to be conducted in the period immediately ahead on the exchange rate, interest rates, the costing of capital, and energy prices. Every effort should be made to complete those studies by their target dates and to take promptly the actions found to be necessary.

In their letter of intent, Mr. Laske observed, the Romanian authorities had stated that they would have regularized the arrears on suppliers credits outstanding in March 1982 by March 15, 1983. He assumed that no new arrears had been allowed to arise since that date. In its statement, the staff had informed Directors about the steps taken by the authorities to clear up the old arrears, indicating that satisfactory progress was being made. The Romanian authorities seemed to consider the efforts that they had made as being in conformity with the commitment contained in the letter of intent. However, German exporters with outstanding claims that would be covered by the arrears clause had informed his authorities that a substantial amount of such arrears remained unregularized at the end of February 1983. He hoped that further progress had been made in that area in the meantime, and he hoped that at the next review of the stand-by arrangement for Romania it would be possible to assure Directors that all arrears on suppliers' credits had been settled to the satisfaction of the creditors. That observation applied in particular to the $63 million of arrears, the final settlement of which was reported to have been promised by the middle of 1983. He supported the draft decision.

Mr. Anson stated that he agreed with Mr. Polak's observation that the program was subject to frequent review. In the circumstances, that approach was appropriate. Generally speaking, the program appeared to be moving in the right direction; he particularly commended the shift to greater domestic demand restraint, the increases in energy prices and interest rates in January, and the 9 per cent devaluation of the leu. However, he shared the staff's view that further adjustment measures would be needed in 1983; it was not clear that the adjustment effort was being implemented with the required urgency. It would not be sufficient to achieve a balance of payments target only in 1983; there had to be a prospect of a satisfactory performance also in 1984 and 1985 so as to preclude the need for net new market finance. If the debt service ratio continued at the 1983 level of about 50 per cent, some creditors could become concerned that Romania might eventually be unable to service its obligations without further adjustment, including its obligations to the World Bank and the rescheduled debt. Conversely, if the overall debt burden could be significantly reduced, Romania could improve its creditworthiness over the longer term, leading to a more rapid restoration of commercial confidence.

Commenting on domestic policies, Mr. Anson remarked that the slippages already acknowledged by the authorities were worrying. The staff had pointed out that the energy constraint alone might be consistent with only a modest increase in national income. Indeed, there had to be doubt whether room existed for even a small increase in domestic incomes. Given the severe adjustment that was needed, and the slippages already mentioned, there was a clear need for further adjustment measures at once. For example, following the January devaluation, enterprises could have been allowed to pass through more of the price increases. He agreed with the authorities and the staff that further movement on prices, interest rates, and exchange rates was needed; he welcomed the four joint studies and the commitment of the authorities to move forward energetically in those areas. He hoped that adjustment would not be precluded in the interim.

The authorities were correct in wishing to reverse the excess buildup of liquidity in the household sector, Mr. Anson continued. He also agreed that the swing to negative real interest rates had to be reversed, and he was pleased that the authorities recognized that further adjustments were necessary within the coming three months or so. A positive structure of real interest rates had to be established as soon as possible.

The staff should continue to monitor the extent and trend of countertrade, especially in the next review, Mr. Anson suggested. Whether or not countertrade breached the performance criteria--and, in his view, the question remained open--it was a structural distortion; he urged the staff to explore with the authorities a firm timetable for its elimination within the program. A complementary factor would be the necessary improvement in the marketability of Romanian exports with regard to quality, delivery dates, consumer preferences, and the like.

With regard to external financing, Mr. Anson went on, he welcomed the progress that had finally been made with the 1982 rescheduling, and he commended the speed of the 1983 negotiations with the banks. However, it was regrettable that some governments had not yet received all the necessary data. It was also open to question why government debt should be subject to a rescheduling of 75 per cent of both principal and interest when banks were effectively being asked to reschedule only 60 per cent of principal. He invited the staff to comment on whether it would be possible to avoid rescheduling in 1984 if, for example, suppliers' credits were lower than projected in Table 7 of EBS/83/54. The surplus on current account in nonconvertible currencies was also a matter of concern. While creditors from countries within the Council for Mutual Economic Assistance (CMEA) appeared to have received payment for their goods and services in 1982, creditors from other countries had either had to accept rescheduling or would receive payment in 1983. It would be very unsatisfactory and, in a sense, discriminatory against the Fund membership, if the assistance given to Romania appeared to be not wholly devoted to improving Romania's reserves and balance of payments on current account in convertible currencies.

The authorities had consistently overestimated the net yield from private capital inflows, Mr. Anson commented, and there was a danger that they might continue to do so for the mid-1980s. For 1983, it might have been better to have aimed for a total current account surplus closer to the $1.4 billion implied in the national accounts rather than the $0.7 billion actually projected. Even the latter target would be difficult to achieve without further adjustment measures. The authorities had to be prepared to act promptly to maintain their current account surplus, but they should resist the temptation to repeat the import cuts of 1982, which could be detrimental to the Romanian economy in the longer term. While he supported the decisions, he believed that the caution expressed in the staff appraisal was fully justified. The authorities were right to see the adjustment of the economy as a long-run process. Further measures were needed in 1983 and thereafter; speedy action in the areas covered by the four studies was vital.

Mr. Schneider noted that when the Board had reviewed the stand-by arrangement for Romania in December 1982, his chair had doubted whether the desired long-term effects could be achieved by predominantly administrative measures. There had also been doubt whether the usual Fund policy recommendations, such as exchange rate and interest rate changes, would really contribute to the long-term adjustment process in an isolated economic environment managed by central directives. At the same time, his chair had expressed optimism that the authorities' control of the external sector would generate current account surpluses within the desired short period.

The staff report under discussion reflected both aspects of recent economic developments, Mr. Schneider continued. Romania had achieved a considerable foreign trade and current account surplus in convertible currencies. However, the surplus had been achieved through drastic cutbacks in imports, while exports had also decreased. Although the Romanian authorities had been adopting all measures recommended by the Fund, such as sharp consumer price increases, cutbacks in investments, devaluation of the leu, increases in interest rates, decreases in subsidies, and the achievement of a huge budget surplus, the export sector had not yet been adequately stimulated. The lack of progress could, of course, partly be attributed to the depressed world trade level.

Even in those circumstances, however, Mr. Schneider remarked, he agreed with the staff that not only the export performance but the overall performance had been disappointing. The staff was beginning to recognize that, while the usual policy measures advocated by the Fund could be successfully applied in some countries, they might represent only an empty formal set of indicators in others. For example, the proper functioning of an exchange rate required at least two preconditions: an adequate domestic price system and an exchange rate that influenced the decision-making process of the economic units. If the domestic price system was more or less isolated from market forces, and if the decision-making process lay in the hands of the central planners, the exchange rate, whether it was unified or not, played a secondary role. That proposition was also true for interest rates and for other other economic variables.

He continued to have doubts about the long-term viability of the program, Mr. Schneider went on, having read in the staff appraisal that the pass-through effects on prices of the devaluation of the leu on January 1, 1983 had not, for the most part, been left to enterprises themselves; that the reserve requirement scheme had only been implemented in a limited way; and that the enhancement of the role of enterprises in making investment decisions had not yet been implemented to any significant degree. While he could agree with Mr. Polak on the need for gradualism in the adjustment effort, it appeared that not much had been done beyond the correction of the relative price structure.

The efforts of the staff and the Romanian authorities to work together on the four studies described on pages 18 and 19 of EBS/83/54 were welcome, Mr. Schneider stated. He hoped that the joint work on those studies, along with the shared responsibility, would lead the Fund and the authorities to a better understanding of the problems and requirements of an economy such as Romania's. He expected that it would assist the authorities to develop and to implement an economic management system that, in the long run, would speed up the adjustment process. At the same time, the studies should convince Directors that countries with different economic management systems needed different approaches with respect to the performance criteria, especially for the achievement of long-term adjustment.

Commenting on the program for 1983, Mr. Schneider suggested that some explanation of the revised balance of payments forecast for 1983 would have been helpful. He noted that the projected level of imports from the convertible currency area in 1983 was much lower than in the November forecast, although at that time the staff had viewed that level as already barely sufficient to sustain economic activity. The reduction in oil imports for domestic consumption seemed unusually large; it could affect economic activity. Finally, he commended the Romanian authorities for their efforts to conclude the necessary rescheduling agreements on time. However, if the authorities wished to regain the confidence of the international banking community, it was essential that they should implement promptly the terms of all those arrangements. The approach taken by the international community to Romania's problem had been based on a general willingness to help a country whose unresolved problems had an aggravating effect on the present financial crisis. He supported the proposed decisions.

Mr. Dallara stated that the studies under way in the areas of exchange rates, interest rates, the costing of capital, and energy prices were important; he was pleased to note that they would be completed by midyear. His chair and others had pointed out at earlier Board discussions on the policies of Romania that there appeared to remain serious inadequacies in existing policies in those areas; he urged that the result of the studies be implemented as promptly as possible. Timely implementation was especially important in the present case since two years of the program would have elapsed by the scheduled completion date. He looked forward, in particular, to the implementation of further interest rate adjustments by July 1, 1983, as indicated in EBS/83/54, and to the determination of the appropriate level of the exchange rate. The recent exchange rate change was welcome, but he shared Mr. Schneider's concern that, unless the change was passed through the domestic pricing system fully, its positive effects would be limited. It was not clear why a deadline of October 1, 1983 had been set for the implementation of the conclusions of the exchange rate study. Given overall exchange rate developments under the program and the need to lay the basis as soon as possible for a sustainable payments position, earlier implementation would be appropriate.

The program included an increase in reserves of at least $250 million as a performance criterion, Mr. Dallara noted. It was an important objective, since reserves had to be built up to a comfortable level if they were eventually to play a role in cushioning the effect of unexpected external developments. He also noted with interest that the staff had determined that the countertrade arrangements were legally neither an exchange restriction nor an import restriction for balance of payments purposes. Nevertheless, he joined the staff in urging the removal of those distorting practices as soon as possible.

With regard to the projected external developments for 1983, Mr. Dallara commented, the forecast increase of 17 per cent in the value of petroleum product exports in the coming year was somewhat puzzling, as was the likely overall effect of the petroleum refinery operations on the external accounts. In spite of the positive changes that had taken place, the oil trade operations would continue to create a net deficit of $500 million in the current account for the coming year; he invited the staff to comment further on the implications for future policies in that area. Finally, he urged the authorities to settle the remaining $63 million in arrears owed to suppliers. He also recommended that the authorities remain current in their payments to the suppliers that had already agreed to terms for rescheduling. His authorities had received disturbing reports of lateness of payments to companies that had agreed to rescheduling terms.

Mr. Joyce remarked that the Romanian authorities were to be congratulated for the real progress that had been made in 1982 in improving the convertible currency current account position. Nevertheless, that success had resulted from a draconian reduction in imports; hence, it was not without costs, in both the short run and long run. At best it was only a temporary solution; future success in improving the surplus on current account could be achieved only if there was a substantial improvement in exports.

The Romanian authorities had also made considerable headway in rescheduling their international obligations, Mr. Joyce continued, although he understood that they had not yet reached a full settlement with regard to all the suppliers' credits for 1982; further debt relief would be required in 1983 if the program targets were to be met. The authorities had also taken a number of important policy steps and had made some adjustments, particularly in interest rates and the exchange rate. The objectives for 1983 were attainable, and he could support the proposed decisions. The 1983 results would depend not only upon the actions taken by the Romanian authorities themselves, but also on the extent to which the world economy--and hence Romania's export possibilities--improved.

His main concern, shared by many Directors, was for Romania's medium-term outlook, Mr. Joyce stated. The Romanian economy would not be viable in the medium term unless the authorities managed to restore its competitive position and to regain the confidence of the international banking community. Progress had been made under the stand-by arrangement to date; the real question was whether the rate of progress had been sufficient to achieve medium-term sustainability. The Romanian balance of payments was currently in surplus, mainly as a result of restraints on domestic demand that were leading to increased distortions and reduced competitiveness for Romania's products. Inevitably, there would be renewed pressures on the balance of payments position.

The staff's projection that Romania could again have a serious balance of payments deficit problem by 1985 unless there was a resumption of net foreign borrowing was a matter of concern, Mr. Joyce went on. The staff correctly noted that the authorities would have to implement additional adjustment measures in 1983 to avoid such a development. He was unsure, and perhaps the international financial community was also unsure, whether the studies that the authorities were committed to undertake would, in fact, produce concrete adjustment measures in sufficient time to offset the projected erosion in the balance of payments position. In view of the crucial need to bolster Romania's creditworthiness, the authorities would have to act aggressively in implementing new adjustment measures as the opportunities arose.

Exchange rate policy could clearly play a useful role in the adjustment program, Mr. Joyce considered, helping not only to improve external competitiveness but also to ease the fiscal position through a reduction in the number of exchange rates and, therefore, the need for exchange subsidies. The simplification of the exchange rate achieved to date was encouraging, but the rate of adjustment had been slow. The leu had been devalued at the beginning of 1983, and a further devaluation was planned for July 1, 1983 but, as pointed out in the staff paper, those two devaluations were not expected to offset the real effective increase in the leu that had taken place in 1981 and 1982. Moreover, the effect of the devaluation on domestic prices did not appear to have been determined by the market, but by government action. The Romanian authorities should be urged to consider further devaluations of the leu in the near future and to give enterprises a greater role in determining the extent to which those devaluations were reflected in final prices. Over the longer term, the study being undertaken to examine the possibility of changing the exchange system from a peg to the U.S. dollar to a multicurrency peg was desirable, but the results of that study would not be put into effect until October 1. He wondered whether the authorities had considered accelerating that timetable.

A decline in consumer price inflation was projected, Mr. Joyce noted, but its significance was unclear. Much would depend on the extent to which authorities allowed increased costs to be passed through the system. He invited the staff to comment on the question whether the current rate of inflation reflected the actual level of inflationary pressures.

The authorities had shown their commitment to the program and their determination, Mr. Joyce concluded; he understood the point made by Mr. Polak that, to some extent, adjustment had to be gradual in relation to the social requirements of the country. Nonetheless, the key to Romania's future lay in making the necessary fundamental changes in the economy as quickly as possible. Until they were made, or until the international community was sufficiently convinced that they would be made promptly, it would remain difficult for Romania to have access to the financial resources that a developing economy needed in order to grow and to prosper.

Mr. Lovato commented that the basic picture of economic development in Romania that had emerged on an earlier occasion was confirmed by the information in the staff paper. The strong adjustment measures implemented by the Romanian authorities, together with a reduction in international interest rates, had contributed to the achievement of a current account surplus of 1.3 per cent of GDP, well beyond original expectations, and a remarkable turnaround from the situation of just two years earlier. An adjustment effort of that magnitude could not be effected without consequences, particularly given the fact that the brunt of the improvement in the trade account had fallen on imports. While increased economic efficiency and import substitution might provide an alternative to dependence on foreign inputs in order to increase capital formation, imports of foreign goods would have to increase substantially beyond the depressed level of 1982 if serious damage to the productive apparatus was to be avoided.

In that connection, Mr. Lovato continued, the projected 20 per cent increase in non-oil imports seemed necessary to ensure an orderly completion of production plans in 1983. However, the large swings in the projections for 1983 were somewhat puzzling. The staff report for the review of December 1982 (EBS/82/218) had projected a slight percentage decrease in non-oil imports in contrast to the large increase currently forecast. It was true that total imports in 1982 had turned out to be much lower than expected, but exports had also performed dismally. He invited the staff to comment on the degree of trust to be placed in the 1983 balance of payments projections. The Romanian authorities had little choice but to seek debt rescheduling again in 1983; however, the latest developments described by the staff were encouraging. The assumptions incorporated in the program seemed reasonable.

Commenting further on the external sector, Mr. Lovato noted that a 9 per cent devaluation had taken place on January 1, 1983, and that a further devaluation was planned for July. However, those measures seemed barely sufficient to counteract the 20 per cent nominal appreciation of the leu between 1981 and 1982. In light of the Board's discussion of surveillance procedures, he wondered whether the staff had attempted an evaluation of the extent of the real appreciation of the leu. The decline in the profitability of export industries, as well as the possible loss of most favored nation status with the United States, suggested that the authorities should take a close look at their competitive position. He appreciated their intention to eliminate the peg to the U.S. dollar and to unify the commercial exchange rate in the coming few months.

More detailed information on the causes of the surplus with the nonconvertible currency area would be welcome, Mr. Lovato added. His understanding was that trade with member countries of the Council for Mutual Economic Assistance (CMEA) was to be conducted on a balanced bilateral basis. What precisely had caused the 1982 outcome? He hoped that the situation would not be repeated in 1983, since it represented a provision of net credit to the nonconvertible currency area.

The other aspects of the program appeared to be generally in line with the adjustment effort needed, Mr. Lovato remarked. The staff was concerned about the feasibility of the growth target in view of the energy situation. He invited the staff to comment further on the question, particularly since Table 9 in Supplement 1 to EBS/83/54 was difficult to interpret. While the effectiveness of monetary policy was rather limited in economies like Romania's, he welcomed the continued restrictive stance, as well as the decision to increase interest rates in order to foster the development of a more efficient financial system. However, the major problems seemed to lie in the medium term. Despite all the adjustment efforts, the possible emergence of a financing gap was in prospect for 1985; furthermore, it appeared that the work on structural reform, badly needed to support a different development path in the years ahead, had yet to proceed past the planning stage.

It was reassuring that Mr. Polak had emphasized the commitment of his authorities to long-run reforms, Mr. Lovato commented. Such reforms were not easy to devise and to implement, but, given the changed position of Romania in the international capital markets, they were the only way to reach a viable balance of payments position and a satisfactory growth path. He hoped that, by July, Directors would be in a position to evaluate actual progress in those areas. In the meantime, he supported the proposed decisions.

Mr. Senior observed that Romania had complied with all performance criteria under the 1982 program, with the exception of the settlement of part of the arrears to suppliers. As the staff had indicated, adequate and satisfactory efforts had already been concluded to regularize those arrears and to meet the undertakings of the February 1983 letter of intent. In 1982, the overriding goal of economic policy in Romania--to improve further the convertible currency current account position--had been more than amply achieved. The current account had shifted markedly from a deficit of more than $800 million in 1981 to a surplus of more than $650 million in 1982, mainly as a result of a further decline in imports, which had fallen by about one third relative to the already depressed level of 1981. That dramatic change, signifying a heavy adjustment burden, demonstrated clearly the authorities' commitment to redressing the external disequilibrium, a commitment that was further underscored when account was taken of the fact that exports had also suffered a large decline in the same year.

The appropriate level of the current account position of Romania in relation to development strategy and its effects on encouraging additional capital inflows deserved consideration, Mr. Senior continued. The convertible currency current account of the balance of payments had moved to a substantial surplus of $655 million in 1982, from an even more substantial deficit of $2.4 billion in 1980; i.e., in only two years the convertible currency current account had improved by more than $3 billion, or the equivalent of 6 per cent of 1982 GNP. The overall convertible currency balance of payments had not improved to the same extent, however, mainly because net capital inflows had been disappointing. Although debt relief had been provided to Romania, the necessary new funds had not flowed in the required amounts. The expected overall debt for the coming few years would clearly require additional relief from creditors.

Table 7 of EBS/83/54 indicated that continued further improvements in the convertible currency current account position of Romania would not be sufficient to restore reserve levels to their former relative position, Mr. Senior commented, and that a financing gap would arise in 1985. That development clearly underscored the need to restore Romania's access to overseas financial markets, and external creditors should help in that process, if only in their own interests. The support provided by the Fund and the World Bank was clearly highlighted in the same table, but such support could only serve as an initial catalyst for obtaining the required financing. If no additional financing was forthcoming, there could be severe problems for Romania in trying to meet its external obligations. He invited the staff or Mr. Polak to assess the sustainability of the expected current account surplus position in the next few years. The question arose whether such a strategy was appropriate for a country in Romania's stage of development. Could a developing country realistically base its development strategy on continued current account surpluses?

When the Romanian request for a stand-by arrangement had initially come to the Board, Mr. Senior stated, it had been appropriate to have frequent reviews in order to familiarize Directors with the workings of the economy. At the present stage, however, such frequent reviews were not justified to the same degree; they could even be considered an increase in conditionality. The point was especially relevant since the phasing of purchases had been strictly linked to those reviews, with further purchases practically dependent on still undetermined future understandings between the Fund and Romania. Was there any reason why quantitative and other criteria could not be set out initially so that, if Romania complied with such criteria, purchases would be allowed automatically? Essentially, the reviews were similar to staged preconditions for purchases. Romania's compliance with the performance criteria in the previous two years had clearly shown the authorities' commitment; Romania deserved the trust of the Executive Board. In that regard, he agreed with Mr. Polak that it was premature for the staff to pass judgment in January that there had been shortcomings in the implementation of the adjustment program in early 1983. As far as could be determined, all the scheduled measures had already been implemented.

Under paragraph 4 of the decision on the stand-by arrangement, Mr. Senior continued, following the initial purchase of SDR 91.9 million for 1983, further purchases during 1983 were to be determined only after it had been decided that satisfactory arrangements had been made for the rescheduling of debt payments falling due that year. Such a condition seemed vague; what could be considered "satisfactory arrangements" in that context? Did the staff have in mind a certain amount to be rescheduled, or did the amount remain open for the Fund to determine? When could Romania consider that it had the right to make additional purchases, and what kind of saving could the member expect once such "satisfactory arrangements" were concluded? He invited the staff to clarify the point.

The orientation being given to economic policy in Romania under the Fund's guidance should be considered, Mr. Senior suggested. It was clear from the four studies being undertaken by the authorities in cooperation with the Fund that the economy was being moved from its relatively rigid, centrally planned character to a much more market-oriented one. In some instances, such a shift might be appropriate; he did not wish to argue the merits of one system over another. However, such a fundamental shift should be decided upon voluntarily by the authorities; the Fund should remain more or less passive in that regard. It was not clear that the Fund had a precise understanding at present of the role that different instruments of economic policy played in a centrally planned economy. The point had been highlighted in the Board's discussion of such economies, and it should serve as a basis for caution in the Fund's recommendations regarding fundamental changes. Interest rates provided a clear example: Was the role of interest rates in a planned economy the same as in a market economy? What should be the most appropriate interest rate policy for either economy? Only when firm answers to such questions were available could the Fund move confidently toward fundamental changes and firm recommendations. He shared the skepticism that Mr. Polak had expressed with regard to the "idyllic picture painted by the staff of the dynamic optimality that would result if all pricing, production, and investment decisions of socialist enterprises were guided by the profit motive."

Mr. Zhang commented that he was impressed by the determination of the Romanian authorities to avoid an increase in the net external debt of the country in the future and to repay all external debt before the end of the decade. The authorities had adopted all the measures scheduled for January 1, 1983, and their achievements in the external sector had been remarkable. They should be commended for those steps. Furthermore, the authorities were prepared to implement the additional measures for 1983 to which they had committed themselves in the letter of intent. Nevertheless, the staff had passed a judgment, in January 1983, that there had been "some shortcomings in the implementation, up to early 1983, of the adjustment program presented in the letter of intent." He agreed with Mr. Polak that such a judgment was premature; it could even be described as unfair.

The Romanian authorities and the staff were preparing four major studies on the exchange rate, energy prices, interest rates, and the costing of capital, Mr. Zhang noted. He hoped that the results of those studies would enable future decisions on changes in policies and on the adoption of new adjustment measures in the Fund program to be determined on a sounder and more objective basis.

He was also impressed by the Romanian authorities' recognition that the adjustment of their economy was a long-run and gradual process, Mr. Zhang continued, and that the measures should be implemented only after careful preparation, in order to avoid abrupt changes in the economic and social life of the country. In that process, profits would be allowed to play a greater role in determining the course of the economy. However, Directors should not lose sight of the fact that in an economy like Romania's, the profit motive was not always the overriding factor in economic policy decisions. The distribution of income was also a major factor. The present adjustment and reform process was not intended to transform the Romanian economy into a capitalist economy without capitalists. He hoped that the Romanian authorities could continue to implement successfully their 1983 program for the convertible currency current account, since the expected withdrawal of most favored nation status by the United States would certainly adversely affect the performance of Romanian convertible currency exports.

Mr. Delgadillo stated that he was in broad agreement with the staff appraisal. On the external front, the developments that had taken place in 1982 and the results reflected in the balance of payments presented valuable lessons. The existence of a substantial surplus on the convertible currency current account, at the cost of reduced imports, carried a number of implications that deserved a greater degree of attention in future reviews. In the face of weakening imports, high external debt service ratios, and reduced capital inflows, it would be difficult to sustain such results for the current account in the future.

Although a favorable harvest provided room for the maintenance of some growth of real GNP, Mr. Delgadillo continued, he wondered what might happen to output in 1983. As pointed out by the staff, the 1983 program could not be expected to restore a viable balance of payments position for Romania; it would constitute only a step in the long-term adjustment process. The role of enterprises in the investment decision-making process and the implementation of export-oriented policies were two areas of critical importance.

The additional adjustment measures contemplated for 1983, particularly with regard to external debt, Mr. Delgadillo remarked, would improve the outlook for the years ahead if adopted in a timely fashion. The expected effect of such actions could attract financial resources from the private market. In that context, it was crucial to assess the magnitude and quality of capital inflows while the program was in effect. Undertaking the four studies planned for the first half of 1983 would certainly be useful in providing the basis for future policymaking with regard to the exchange rate, interest rates, the costing of capital, and energy prices.

Miss Le Lorier noted that, three months earlier, the Board had had an extensive discussion of the Romanian adjustment program for 1983. With regard to the objectives of the program, the provision for a substantial increase in non-oil imports was welcome, particularly since the supply of spare parts and other inputs, even at the projected level, was likely to constrain the growth of marketable industrial production and, therefore, eventually the growth of exports. The intended policy actions, particularly with regard to energy and prices, went in the right direction, although it was difficult to assess fully their adequacy before the results of the four major studies to be completed by July were available.

The exchange rate study was obviously of critical importance, Miss Le Lorier considered. She was concerned about the provision made in advance for a specified depreciation in the commercial exchange rate on July 1, 1983. Ideally, the size and form of the next depreciation should depend more on the outcome of the study under way than on the specification made in advance. She expected that the study would pay due attention to the specific factors influencing the Romanian economy.

A number of questions remained to be answered, Miss Le Lorier continued. Should the exchange rate be determined more in line with movements in the capital account or with those in the trade account? What relevant indicators of competitiveness should be taken into account? Among other things, they should certainly include an appropriate definition of the inflation rate and an assessment of the remaining gap between the cost of inputs and the world price levels of those inputs, while the choice of adequate indices of relative costs and prices would also be relevant. Export promotion would perhaps be a more prominent objective than demand restraint, depending on what happened to real incomes. To the extent that the determination of the exchange rate would have to reflect a forward-looking approach in future, export promotion might become more important.

Similar concerns were relevant to Yugoslavia and Hungary, Miss Le Lorier added. The consistency of the Fund's recommendations on exchange rate actions in neighboring countries, all of which were attempting to achieve dramatic shifts in their exports from the nonconvertible area to the convertible area, should be a matter of concern. In addition, uncertainties about the time lag between exchange rate action and changes in export volumes, and about the adequacy of the design and quality of products for convertible currency markets, arose in all three countries.

The study on the costing of capital also raised a number of difficult questions, Miss Le Lorier suggested. She wondered whether the results of the study should be used in the short run to reduce the excessive liquidity of enterprises, presumably partly the result of the previously inadequate treatment of the cost of capital. She invited the staff or Mr. Polak to comment on that point.

Commenting on the longer-term aspects of the program, Miss Le Lorier noted that Mr. Polak had expressed reservations about the benefits to be reaped from the greater role of profits in determining the course of the economy. It was unclear whether his reservations stemmed from the practicality, i.e., the methods and timing, of the reorientation, or from its broad purpose. The particular approach adopted was an integral element of any such structural reform. She wondered whether the authorities intended to experiment in some sectors or enterprises, taking into account their experience in the energy sector, before embarking on a more comprehensive policy.

Concerning the crucial question of the necessary restoration of Romania's creditworthiness, Miss Le Lorier continued, the authorities should be commended for their timely approach to the various creditors in their rescheduling process for 1983. She urged them to aim at an early settlement of the rescheduling issue, which would require both their full compliance with the arrangements agreed upon for 1982 and their keeping the creditors well informed of the adjustment measures and their results. The intention of the authorities to repay all external debt before the end of the present decade was slightly puzzling. While she accepted the need for a cautious management of external borrowing, paying due attention to the medium-term prospects and selecting carefully the projects that the borrowing would help to finance, she doubted whether such an ambitious objective would be fully compatible with the further opening of the Romanian economy to the benefits of international trade.

She could support the phasing of purchases, as well as the performance criteria for 1983, Miss Le Lorier stated. They provided adequate insurance to the Fund with regard to the use of resources. She invited the staff to comment further on the sensitivity of the criteria relating to the minimum level of reserves in 1983, both with regard to the assumptions made on the terms of the expected rescheduling arrangements and with regard to the availability of suppliers' credits. She hoped that the active collaboration between Romania and the Fund would be extended beyond the present arrangement.

Mr. Morrell said that he supported both the proposed decisions. The Romanian authorities had made considerable progress in their adjustment efforts, but there remained some way to go. There had been a dramatic turnaround in the balance of payments with the convertible currency area, although, unfortunately, at the expense of a massive reduction in imports. He welcomed the progress that had been made in the removal of subsidies to natural gas prices, noting that those prices remained substantially below world levels. He looked forward to the completion of the study on energy pricing. He welcomed the authorities' intention to pursue an active interest rate policy in the coming year, and he noted their commitment to re-establish a structure of real interest rates by July 1, 1983.

The appreciation of the Romanian currency had clearly had an adverse impact on the country's external position, Mr. Morrell continued. The recent devaluation and the proposed further devaluation were steps in the right direction. He welcomed the study by the staff and the authorities to determine an appropriate currency basket to which to peg the leu; the fact that the study would include a timetable for the unification of the commercial and noncommercial exchange rates was also welcome. The poor analysis of the cost of capital, presumably incorporated in investment decision making in the past, was disturbing. Whether the decision-making process was centrally planned or otherwise, decision makers needed sound information. He looked forward to seeing the results of the study on the cost of capital; it was a problem on which views differed considerably.

He agreed basically with the staff appraisal, Mr. Morrell added, although he also agreed with Mr. Polak that the adjustment process should be gradual and that it would have to take place over a number of years. He believed it was important to avoid excessive disruption of the economic and social life of the country while the adjustment process was taking place. It was unfortunate that the debt rescheduling arrangements had not been completely satisfactory; he hoped that they would be finalized by the time of the next review, i.e., by the end of July 1983.

Mr. Lindø remarked that the adjustment efforts already undertaken by the authorities were strong. Directors would agree that imports had been reduced to a dangerously low level and that, to continue the external adjustment effort, the authorities would have to rely on an expansion of exports. However, export performance in 1982 had been disappointing, and the expansion projected for 1983 was modest at best. The prospect was in contrast to the strong growth of exports expected in the programs for Hungary and Yugoslavia. He wondered how seriously exports might be affected by the sharp reductions in imports during 1982. He noted with particular satisfaction the studies being undertaken in cooperation with the staff. He supported the proposed decisions.

The staff representative from the European Department observed that some Directors had commented that creditors had had difficulties in receiving payment on arrears due. The question had been discussed with the authorities in March, and an understanding had been reached that, if about 80 per cent of the arrears were settled by March 15, the effort would be considered adequate. He believed that the goal had been achieved. In considering the examples mentioned by a number of Directors, it should be borne in mind that some of the complaints by firms might have been made two or three weeks earlier; they could have been settled in the meantime. In addition, some large firms might have obtained settlement of some of their claims but they could have other claims outstanding under the unregularized $63 million, an amount that the Romanian authorities had undertaken to settle by June 1983. The staff intended to pursue the question as far as it was possible to do so during the next mission in May. The authorities had been very cooperative; they had provided the staff with a list of suppliers to enable it to gather information.

A number of Directors had wondered whether it would be possible to bring forward some of the measures planned for the 1983 program, the staff representative commented. They had been particularly concerned that action in light of the forthcoming exchange rate study would not take place until October. However, it had not been possible for the staff to negotiate an earlier date. The staff agreed with the comments by one Director that the projected increase of 17 per cent in the dollar value of oil exports appeared too high; a lower increase in the volume and, to a lesser extent, in the price of oil exports could be expected in view of recent developments.

There were a number of reasons for the differences between the 1983 balance of payments projections made at the time of the November 1982 mission and those made during the most recent mission, the staff representative went on. First, the base had changed dramatically; imports had been much lower in 1982 than had been assumed in the November forecast. Second, a law had been passed to restrict all imports for domestic use to 1.5 million tons in 1983. In addition, the inflow of suppliers' credits, as well as new medium-term and long-term private capital, had been overestimated. At the time of the November forecast, it had been assumed that the arrears problem would have been resolved fairly quickly; however, that had not occurred and the Romanian authorities had had to curb imports more than had been originally assumed in order to make the adjustment in the balance of payments to meet the additional financing requirements.

Nevertheless, the staff did not believe that exports in 1983 would be severely affected by the sharp reduction in imports in 1982, the staff representative added. Imports of input goods in 1983, excluding agricultural raw materials, were forecast to rise by no less than 41 per cent, although admittedly from a very low level. If the economy grew at 2 per cent a year, there would be room for an expansion of the export sector. However, the lack of spare parts could act as a hindrance to exports.

The large current account surplus with the nonconvertible currency area in 1982 had not been planned by the Romanian authorities, the staff representative noted. It had arisen as the result of delayed exports to Romania by one large trading partner in the CMEA area. The Romanian authorities believed that the import shortfall would be made up in 1983 and that there would be a movement to a deficit on the current account with the nonconvertible currency area. The improvement in the quality of export products to the convertible area was not a major problem in Romania.

The phasing of purchases under the program in 1983 had not been covered in detail in the staff report, the staff representative observed, although the staff had noted that much would depend on a satisfactory outcome of the debt rescheduling in 1983. The staff believed that the second 1983 purchase could take place in May or June, if the debt rescheduling arrangements were in place by that time, and if the March performance criteria had been met. The third purchase could probably be made in August, if the June performance criteria had been met, and if the Executive Board judged that the actions to be taken on the basis of the four studies were satisfactory at the time of the July Board review. The fourth purchase could take place following the review by the Executive Board in November, if the results of the study of energy prices were satisfactory, and if the September performance criteria had been met.

The staff had referred to shortcomings in the implementation of policy in early 1983, the staff representative continued, having in mind in particular the implementation of the minimum reserve requirements on enterprise deposits. Instead of applying the reserve ratio of 10 per cent to the enterprise deposits outstanding at end-1982, the authorities had applied it to a fluctuating base every month; it thereby yielded less than had been expected. Efficient enterprises would suffer, while others could take advantage of them through "window dressing." In addition, the staff had considered that the pass-through of price increases had not been made to the fullest extent possible at that time.

Commenting on the question whether price increases in Romania were a true reflection of the underlying rate of inflation, the staff representative noted that prices remained very much under the control of the central authorities, despite the somewhat greater freedom that had been given to enterprises in determining price changes. There was also a significant amount of rationing, which was not reflected in the inflation rate. In addition, the staff believed that the projected increases in prices in 1983 might be on the low side, because a large part of the adjustments in relative prices arising from the devaluations and changing energy prices would be made in 1983. It was difficult to believe that the rate of inflation could come down from 18 per cent in 1982 to about 7 per cent in 1983, when structural price adjustments had become more important than in 1982.

The role of interest rates in a centrally planned economy was a difficult issue, the staff representative from the European Department commented. The recent increased flexibility in interest rates in Romania was a new experience; it remained to be seen how it would affect, for example, household savings, investment, and stocks. It would almost certainly have an effect on such variables, particularly investment, since the authorities intended to reduce investment grants and, as a result of the increase in interest rates, investment would become more influenced by monetary policy. The study of the costing of capital was not intended to suggest mechanisms for reducing liquidity, as one Director had wondered; it was primarily seen as a means of improving resource allocation in the economy in general.

The Deputy Director of the Exchange and Trade Relations Department recalled that, on the occasion of the Executive Board's discussion of planned economies, Directors had endorsed the need for the application of review clauses to such economies. Directors had noted that financial variables in those economies were often accommodating, that they did not represent the main adjustment mechanism, and that, therefore, their effectiveness as performance criteria was limited. In supporting an adjustment program, the Fund was interested not only in seeing that certain results were achieved in relation to the balance of payments, but also that the means used were appropriate, and that the results would be sustainable. Such considerations pointed to the need for more frequent use of review clauses in the case of centrally planned economies to evaluate the implementation of the adjustment measures and to ascertain that the program remained on course.

Most Directors believed that there had to be a substantial strengthening of adjustment in Romania in the remainder of 1983, the Deputy Director said, in order that the balance of payments position could be brought to a level that would be sustainable over the medium term. The staff entirely agreed with that view; the program provided for a phased intensification of adjustment measures. The planned reviews in July and in November would give the Executive Board an opportunity to evaluate the adequacy of the measures to be taken and also to judge the adequacy of the timetable for future action.

The Acting Chairman remarked that he did not believe that Mr. Polak's reference to "gradual" adjustment had been intended to convey the impression that adjustment should be slow, but rather that it should be deliberate. As Mr. Polak had noted, the Romanian authorities wished to avoid increasing the net external debt of the country in the future, and even to repay all external debt by the end of the decade. To the extent that they could fulfill those desires, there would be a substantial constraint on the speed with which they would have to adjust. It was clear that they could not afford to lose any time in making adjustments.

Mr. Polak commented that almost all Directors had agreed on the importance to be attached to the four studies to be undertaken by the Romanian authorities in cooperation with the staff. A large number of Directors also had firm views on what should be the appropriate outcome of those studies, an important point that he would convey to his Romanian authorities. The exchange rate study was probably the most important, consisting of two parts. First, the selection of a currency basket as a peg to replace the U.S. dollar; the peg to the dollar had turned out to be unsatisfactory to Romania, as to a number of other countries, because the dollar had appreciated sharply against most European currencies. Any basket of a reasonably diversified composition would avoid such a difficulty in future, and almost any basket could prove satisfactory, if the level of pegging was correct and if it remained flexible.

The second, much more difficult issue in Romania's case, was the appropriate level of the peg, Mr. Polak continued. A number of Directors had noted the effective appreciation of the leu over the previous two years, but the appreciation in nominal terms was not a sufficient indicator; the important consideration was the real effective rate, as one Director had pointed out. Determining that rate could be difficult; certainly, adjustment by a cost of living index would be quite unsuitable in Romania's case, since consumer prices--primarily agricultural prices--had been raised sharply. Such prices were not immediately relevant to costs and prices in the production of export commodities. One Director had observed, in commenting on the elements and objectives to be taken into consideration with respect to the capital and current accounts in the course of the exchange rate study, that the exchange rate for the leu should not be examined in isolation from the exchange rate for the currencies of neighboring countries, i.e., Hungary and Yugoslavia, when each country was seeking to penetrate Western markets with similar types of exports and to reduce its surpluses with the CMEA. It would be inappropriate if exchange rates in countries with similar economic structures were to become competitive with each other as a result of individual Fund missions to each country. All such factors would have to be taken into account in the study.

A number of speakers questioned the timing of the implementation of the study's conclusions, Mr. Polak observed, on the assumption that one conclusion would be to adjust the exchange rate further. A complicating factor was that the study was to be completed by July 1, while a decision had already been made to adjust the rate on that date, not in anticipation of the study, but as a result of conclusions reached at the time of the review in November 1982. The Romanian authorities believed that there should be a reasonable interval between exchange rate changes, and they had, therefore, agreed to October 1 as the date for any further change.

His reference in his statement to "gradual" adjustment had not been intended to suggest that adjustment should be slow, Mr. Polak added. He had meant that adjustment should be made on the basis of sound and objective considerations, not in an abrupt manner. The Romanian authorities did not intend to delay the necessary adjustments, but they could not be expected to make major decisions too frequently. For example, it would have been unrealistic to expect them to have made new decisions in the middle of January 1983 following the measures that had been agreed with the Executive Board on December 20, 1982. They were prepared, however, to take major decisions after they had worked out fully the likely effects on the economy, and after they were convinced that such decisions were necessary.

It was true that more could be done in Romania to have prices and the exchange rate influence economic decision making, Mr. Polak remarked, but Directors should bear in mind that, even after the managers of enterprises were made aware of all pertinent economic indicators and had received appropriate incentives to retain profits for the use of the enterprises, Romania would not be a capitalist country, as one Director had observed. It would remain a centrally planned economy. He agreed with the Director who had suggested that the Fund should remain neutral on the issue and that it should not attempt to force a country into one system or another; rather, it should try to persuade the authorities to manage their own system more effectively. It should also be borne in mind that devolution of investment decisions to enterprises did not necessarily mean that investment made on that basis would maximize the benefits to the system as a whole. For example, an elementary investment decision was whether there should be competition among enterprises, but no enterprise would use part of its retained profits to start another independent enterprise to compete with it. If the authorities wished to encourage competition among enterprises, they would have to take the appropriate investment decisions to that end; and such decisions did not necessarily flow from even the most sophisticated analysis of all available economic indicators.

Similarly, the ability of enterprises to use their retained profits, and their obligation to pay the correct interest rate on capital obtained in other ways, did not necessarily lead to the kind of major, truly entrepreneurial decision making crucial to the development of any economy, Mr. Polak continued. At the present stage of the Romanian system, it was possible for, say, a second bicycle factory to be built to produce more or better bicycles for sale to a larger market at home or abroad. However, under the Romanian system, or, indeed, under the system prevailing in most capitalist countries, it was not possible for the managers of a bicycle factory to decide that there was a good world market for aircraft and that they should use their resources to penetrate that market. In Romania, as in many countries, such decisions had to be made at the government level. For that reason, he believed that the staff's optimism about the direction of the development of the system should have been toned down.

Commenting on the general question of reliance on foreign capital, Mr. Polak observed that a number of countries, including Romania, had become disenchanted with the idea of rapid development on the basis of imported capital. Some countries might not be in a position to do without such resources in the short run, but many found themselves in a situation in which they could no longer count on substantial continued inflows of capital. The position of the Romanian authorities was to go further and to attempt to reduce the stock of foreign capital in Romania through repayment of all outstanding debt by the end of the decade. Whether that objective would be realized could not be judged at present. However, the objective was not necessarily incompatible with full integration of Romania into the international market. Many countries did not import capital, and if Romania wished to move to that stage of its development at a somewhat forced pace, it was a judgment that should be left to the authorities, following consideration of the costs involved.

Directors had generally commended the Romanian authorities for the negotiations on arrears with the commercial banks, governments, and other creditors, Mr. Polak stated. Romania had re-established its reputation with its creditors, and, as a result, the rescheduling negotiations with the banks for 1983 appeared to be going well. The negotiations with official creditors were to be undertaken in the near future; they were unlikely to raise difficult problems, since the amounts involved were relatively small. The arrears remaining on suppliers' credits, about $60 million, were also being put in order. He hoped that all those arrears with individual creditors would be settled satisfactorily by the time of the next review. However, Directors should bear in mind that there was simply no mechanism for collective negotiation with the very large numbers of commercial creditors involved. The Romanian authorities had approached each of them with proposals that had been accepted by the great majority, and they had made a down payment of 20 per cent on all credits, whether agreement had been reached with the creditor or not. Certain creditors remained dissatisfied with the proposals made by the authorities. If they continued to insist on their own terms, it was possible that not all the negotiations would be concluded satisfactorily by May.

The problem did not arise with the commercial banks or official creditors, Mr. Polak added, because those negotiations were conducted until a generally accepted arrangement was concluded. However, such an approach could not be taken with private commercial creditors. From a practical point of view, it was unfortunate that the banks had insisted on "comparable treatment" for all commercial creditors, that the banks had defined "comparable," and that the Romanian authorities had then been left to try to reach a satisfactory agreement with all suppliers. The question of arrears was, in a sense, closely related to the phasing of purchases. In that regard, he agreed with Mr. Senior that it was possible that the program contained too many reviews. The comments by the staff representative from the European Department on the likely timetable for purchases were helpful; he hoped that the phasing of the remaining amounts for 1983 would take place in the three steps indicated by the staff representative.

The Executive Directors then turned to the proposed decisions, which they approved.

The decisions were:

Review Under 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 shall 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.

Decision No. 7375-(83/56), adopted
March 30, 1983

Exchange System

The Fund approves through December 31, 1983 the restrictions on payments and transfers resulting from the existence of external payments arrears described in paragraph 5 of Decision No. 7375-(83/56), adopted March 30, 1983, entitled "Review Under Stand-By Arrangement."

Decision No. 7376-(83/56), adopted
March 30, 1983

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/55 (3/28/83) and EBM/83/56 (3/30/83).

2. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 82/131 are approved (EBD/83/68, Sup. 1, 3/21/83), with Mr. Polak recording a reservation on the basis that material included on pages 41 to 43 was not germane to the Article IV consultation with Jordan.

Adopted March 28, 1983

3. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/83/87 (3/29/83) is approved.

4. STAFF TRAVEL

Travel by the Managing Director as set forth in EBAP/83/88 (3/28/83) is approved.

5. STAFF TRAVEL

Travel by the Acting Managing Director as set forth in EBAP/83/91 (3/29/83) is approved.

APPROVED: August 30, 1983

ALAN WRIGHT
Acting Secretary