FOR AGENDA

EBS/83/54
Correction 1

CONFIDENTIAL

March 24, 1983

To: Members of the Executive Board

From: The Acting Secretary

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

The following corrections have been made in EBS/83/54 (3/8/83):

Page 6, para. 3, line 6: For "17.7 per cent" read "1.8 per cent"

Page 8, last line: for "agricultural investment." read "agricultural investment in real terms."

Page 12, line 19: for "at US$1 billion." read "at about US$800 million."

Corrected pages are attached.

Att: (3)

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 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

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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.

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 leficit (US$66 million) in 1983. Exports to this area are projected to row by over 10 per cent and imports at twice that rate, implying a ade deficit of US$150 million. The projected change in the current ount is accompanied by a planned reduction of the deficit on capital ount to near balance, as there is no longer a need to finance a trade lus with a net outflow of capital.