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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 82/164

3:00 p.m., December 20, 1982

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
	A. B. Diao, Temporary
	C. Taylor
J. de Groote	
	A. Le Lorier
	M. Teijeiro
	C. Dallara
	S. R. Abiad, Temporary
	Jaafar A.
	T. Yamashita
R. K. Joyce	M. Casey
	C. Robalino
	G. Grosche
G. Lovato	C. P. Caranicas
	A. S. Jayawardena
	J. E. Suraisry
J. J. Polak	T. de Vries
	K. G. Morrell
G. Salehkhou	O. Kabbaj
	M. Camara, Temporary
M. A. Senior	
	L. Vidvei
Zhang Z.	Wang E.

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

Also Present

European Department: E. O. C. Brehmer, P. C. Hole, P. Mentré de Loye, J. Prust, J. K. Salop, G. Tyler. Exchange and Trade Relations Department: S. Mookerjee, Deputy Director; M. Allen, M. Guitian, J. Martelino, J. M. T. Paljarvi. Legal Department: W. E. Holder, S. A. Silard. Western Hemisphere Department: C. E. Sansón, Deputy Director; M. E. Bonangelino, C. Cha, M. T. Hernandez, I. C. Tandeciarz, S. Umana. Advisors to Executive Directors: S. E. Conrado, J. Delgadillo, L. Ionescu, M. A. Janjua, P. Kohnert, H.-S. Lee, I. R. Panday, P. D. Péroz. Assistants to Executive Directors: H. Alaoui-Abdallaoui, H. Arias, L. E. J. Coene, G. Ercel, I. Fridriksson, G. Gomel, M. Hull, M. J. Kooymans, P. Leeahtam, V. K. S. Nair, G. W. K. Pickering, J. Schuijer, D. I. S. Shaw, H. Suzuki, J. C. Williams, A. Yasseri.

1. ROMANIA - REVIEW OF STAND-BY ARRANGEMENT

The Executive Directors considered a staff paper reviewing the stand-by arrangement for Romania (EBS/82/218, 11/24/82; Sup. 1, 11/26/82; and Sup. 2, 12/14/82).

The staff representative from the European Department said that recent information from Bucharest suggested that the current account surplus in convertible currencies in 1982 might reach $300 million and the trade surplus $1,250 million. However, the addition to the current account surplus would probably be matched by a larger outflow of credit extended by Romania. Industrial production had declined in the third quarter of 1982 and, although 1.6 per cent higher than a year earlier, was unlikely to reach the target for the full year 1982.

Mr. Polak made the following statement:

> The Board discussed Romania as recently as six months ago--on June 21--when it considered the 1982 Article IV consultation and the review of the stand-by arrangement. When that review took place, considerable progress had been achieved on the rescheduling of Romania's arrears, but the negotiations on this subject had not yet been brought to a conclusion. Discussions were still proceeding with the commercial banks and, as far as intergovernmental credits were concerned, agreement had only been reached that a Paris Club meeting would take place a few weeks later, in early July. In part, the discussion by the Board at that time constituted a phase in the process of renegotiation of Romania's credits. The decision taken by the Board at the conclusion of this review served as a signal that the Fund was satisfied with the progress achieved by Romania's program at that stage of the three-year stand-by arrangement. In line with the signaling function that the Board decision was designed to have, only a token amount, SDR 10 million, was released to Romania. It was agreed that further releases would be conditional on the completion of arrangements with respect to the outstanding arrears. In addition, any drawing by Romania after November 1, 1982 would require a review of the performance under the stand-by arrangement.
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> In the months since our previous discussion the negotiations with the various groups of creditors have proceeded and these negotiations have now virtually been completed. Accordingly, the condition for additional drawings specified in the Board's decision of June 21, 1982--"that satisfactory arrangements have been made for the rescheduling of outstanding payments arrears and debt payments falling due in 1982"--has now been fulfilled. The process of reaching this stage has, however, taken more time than had been expected and has carried beyond the date of November 1. Accordingly, the review that is now before the Board brings together two of the three reviews that had been envisaged by the June decision.

With the passage of time it became appropriate to have a quite thorough review, which was accomplished by an extensive staff visit to Romania in September-October. I want to express the appreciation of the Romanian authorities for the thorough job performed by the staff. In early November, negotiations were concluded by a visit to the Fund of a high-level Romanian delegation. Because this review now falls very close to the end of 1982, these discussions covered not only any residual policy adjustment for 1982 but they were also addressed to the status of the stand-by arrangement as a whole, including consideration of the measures that would be appropriate for 1983. More detailed aspects of the 1983 program will be worked out by the mission that is to visit Bucharest around the middle of next month.

At a recent meeting in London, where the rescheduling with the commercial banks for 1981 and 1982 was brought to its conclusion, the banks agreed that the 20 per cent downpayment on the rescheduled amounts would not have to be made until the first quarter of 1983 (10 per cent in January and 10 per cent in March). An understanding has also been reached with the banks that discussions will start next month on the rescheduling of the amount falling due in 1983. The amounts involved are smaller than in the rescheduling just concluded and Romania will be able to make a larger downpayment; it will thus reschedule less than 80 per cent of the maturities falling due. Initial steps have also been taken for an early rescheduling of government debt falling due in 1983. There is a reasonable expectation that this second round of rescheduling exercises will be the last one and that Romania will be in a position to meet the maturities falling due in 1984 and subsequent years.

This expectation is based on the strong performance of the current account so far in 1982 and on the new supporting measures that have been taken or have been announced for the future. As the staff states (EBS/82/218, p. 30): "In 1982, Romania has taken the domestic measures needed to reduce purchasing power, domestic consumption and investment, in order to direct a larger part of resources to the restoration of a current account surplus."

The current account deficit, which reached $2.4 billion in 1980, was reduced to $800 million in 1981 and was projected at $450 million for 1982 at the beginning of that year. By the spring of 1982 it had become clear that Romania would not have the means to finance even this reduced deficit and in June the assumption was that the current account would be in approximate balance for the year. The staff now projects a surplus of about $250 million, to increase to a figure in the range of $450-650 million in 1983.

In the short run an economy as tightly controlled as that of Romania has possibilities to reduce its deficit without necessarily bringing about fundamental adjustment; imports can be cut down by tightening restrictions and additional supplies can be made available for exports by withdrawing supplies that would normally move into domestic consumption. While possible, such an approach has many drawbacks in the short run and is almost certainly self-defeating in the somewhat longer run. It is evident, however, from the staff paper that the current account improvement that the staff foresees for 1982 and 1983 does not in a major way rely on stopgap measures.

I would like to commend the staff for the very careful analysis they present in Annex II (EBS/82/218, p. 37) of what they call the internal consistency of the revised program for 1982, and from which they conclude that there are no "substantial doubts about the economy's ability to provide sufficient domestic resources to achieve the targeted current account improvement. Furthermore, current account performance during the first eight months of 1982 has been consistent with the revised target for the whole year, confirming that domestic resources are being made available in sufficient magnitudes for its achievement." The staff has carried out a similar analysis of the projected balance of payments for 1983 in which it derives its own projection for the current account surplus in that year which--though somewhat lower than that of the Government--still shows compatibility with the financial target of a less severe rescheduling than that of 1982.

In order to bring about the required internal adjustment it was necessary to plan a decline in consumers' real incomes. Real wages fell by about 3 per cent in 1982 and, although consumers offset part of this by drawing down their savings, real consumption still declined by 0.8 per cent. Other elements of domestic absorption have also been reduced so as to permit the modest increase in output in 1982 to be available for the improvement of the current account.

From the start, the Romanian program had recognized the need for structural changes in addition to demand management policies. In the face of a more difficult external situation than had been envisaged, the authorities have taken the step of accelerating the process of structural adjustment. With respect to the exchange rate, the following steps will be taken:

(a) unification of the rate, originally planned for January 1, 1984, will be brought forward to July 1, 1983. In fact, as from January 1, 1983 there will only be a single import rate and only three export rates, lei 16.5, 17.5, and 19 per dollar;

(b) the commercial exchange rate will be adjusted in two steps--from lei 15 to lei 16.5 on January 1, 1983 and then to lei 17.5 on July 1, 1983--to correct the overvaluation that has been brought about by the pegging of the leu to the dollar;

(c) that method of determining the rate will end on July 1, 1983, when the rate will become pegged to a suitably weighted basket of currencies, with the peg to be moved as necessary to maintain an adequate level of competitiveness.

The resulting increases in prices expressed in lei will be passed through to enterprises and to consumers, and consumer incomes will not be adjusted to compensate for these increases. This will also mean a very substantial reduction in consumer subsidies, which have already decreased greatly since 1980 (see Table 17 in EBS/82/218, Supplement 1). It can be noted in that connection (see Table 15) that the budget as a whole has been in surplus in 1979, 1980, and 1981.

Further action has also been announced in the field of energy prices. Crude oil prices are now roughly at world market levels, and the price of natural gas will be brought closer to that level in the course of 1983. Moreover, a study will be made by September 30, 1983 in order to determine what further changes may be needed in national gas prices.

The various measures announced with respect to exchange rates and domestic pricing go far to meet some of the major reservations expressed in the meeting of the Board last June. Important reservations were also expressed on that occasion with respect to the role of to interest rates in the management of the Romanian economy. The fact that interest rates had been kept unchanged since 1975, while the virtual stability of prices of that earlier period had disappeared, had led to substantially negative interest rates in real terms. The changes that will be made with respect to this aspect of economic policy are spelled out in paragraph 13 (last paragraph) and paragraph 15 of the letter of intent. Probably the most significant change in this area is the announced intention to conduct a study of interest rates during the first half of 1983, "and on July 1, 1983 [to] modify them to the extent needed to give positive real interest rates." Among the specific measures announced in this field, attention may be drawn in particular to a plan for long-term placements with enterprises at an interest rate of 6 per cent, with a profit-sharing feature that can raise the rate to 8 per cent, and a planned tax on capital, which would have the economic function of incorporating into the cost of production, and hence the price structure, the economic cost of the use of the own resources of an enterprise.

With the help of these various measures, Romania intends to introduce greater flexibility in the decision-making process, with a greater role for enterprises in this process. In this way, the ultimate responsibility of enterprises for the growth of production and the viability of the balance of payments is recognized.

Against the background of these adaptations of policy I recommend the proposed decision for adoption by Directors.

Extending his remarks, Mr. Polak said that thanks were due to the staff for its considerable effort in the long negotiations on the restructuring of Romania's external debt.

Mr. Lovato stated that the proposed decision was acceptable. He had no difficulty in agreeing with the staff's assessment of the present and prospective economic conditions in Romania, but several recent developments should be underscored and some areas of uncertainty should be further examined.

The most important development was the impressive outcome of the current account in convertible currencies, Mr. Lovato continued. The performance of the economy since the adoption of strong policies designed to correct the external imbalances had been remarkable. It was true that the unexpectedly rapid adjustment had been made possible by the dramatic decline in imports, which in turn was a response to the slow growth of exports caused by the stagnation of world demand and the worsening of Romania's competitive position. On the other hand, the large cutback in imports from the convertible currency area had been achieved without severe domestic shortages or dislocations in domestic production. A number of favorable factors--including import substitution, increasingly accurate and thorough design of import plans at the enterprise level, some reorientation of the structure of domestic output toward less import-intensive industries, and, possibly, productivity gains--had been instrumental in reducing the import component of output, thereby enabling Romania to record a strong decline in imports without experiencing an adverse effect on real output growth. However, that outcome was unlikely to be repeated in the coming year. The projections for the trade and current accounts in 1983 were based on a quantitative appraisal of the likely evolution of imports, and the scope for further import saving was difficult to assess. Domestic expenditure would have to be restrained if the 4 per cent target for the increase in non-oil imports in 1983 was to be met. Even if the target was met, the staff felt, an increase in oil imports in excess of the projected volume might be needed if the planned GDP growth rate of 3.6 per cent was to be realized. The lack of a sufficiently large volume of energy supplies might disrupt domestic activity.

The increases in producer and retail energy prices introduced in January and July 1982 had played a significant role in reducing domestic demand for energy, Mr. Lovato commented. An increase in import prices following the proposed currency depreciation in January 1983 and the passing on of that increase to domestic consumers should have a further restraining effect on energy use.

The staff had explained, Mr. Lovato remarked, that the price mechanism had been assigned a dominant role in reorienting resource allocation and production activities in Romania under the Fund-supported three-year program. The staff had argued that, partly because of the price structure, the pattern of investment in Romania had been distorted in favor of capital-intensive and energy-intensive industries. The staff could usefully comment further on the ways in which the price reform initiated in 1981, in conjunction with other structural policies, had contributed to reorienting the investment plans, particularly those designed to encourage import substitution and to promote exports. As both the authorities and the staff had concluded, only a well-designed and mutually consistent combination of structural policies supplementing continued domestic demand restraint could restore confidence in Romania, thereby ensuring that there would be a steady inflow of external finance in coming years.

The Government's decision to unify the commercial exchange rate and to devalue that rate in two discrete steps in 1983 was welcome, Mr. Lovato said. Given the objective of correcting the external imbalances and the urgent need to improve Romania's competitive position, the authorities' intention to peg the domestic currency to a trade-weighted basket of currencies, thereby eliminating the unfavorable effects of the peg to the U.S. dollar, was also welcome.

The staff had described the technical aspects of the present external debt rescheduling exercise, Mr. Lovato commented, and it would be useful to know whether a final agreement for the period through end-1982 had been reached. The level of official reserves was expected to remain unchanged in 1982, but to increase in 1983. Was that a normative projection, reflecting the desired increase in reserves in anticipation of the larger import requirement? If so, he would not object to a building up of reserves which, although small, would entail a larger financing gap and, therefore, a greater debt rescheduling effort.

Mr. de Groote noted that the authorities had reacted to the liquidity squeeze in 1982 by drastically reducing import demand, implementing a stringent energy conservation program, cutting back import-intensive production, and tightly limiting enterprises' import plans. Those measures had been reinforced by a reduction in private income through several price increases.

The authorities had had no choice but to react immediately in whatever areas had promised immediate results, Mr. de Groote continued. However, Romania could not continue to rely on administrative measures alone to achieve a sustainable balance of payments deficit together with appropriate growth rates. The drastic reduction in imports would ultimately affect output capacity, a point the staff had made in raising serious doubts about the present import program.

The exchange rate was expected to play a crucial role in achieving the desired adjustment, Mr. de Groote commented. The intended simplification of the exchange rate was therefore welcome, but it should be taken further than the authorities had planned, since the schedule of simplification established at the beginning of the existing program period had been overtaken by events. The action that the authorities had taken to simplify the rate did not actually constitute a unification; at present, three different rates were applied to exports, and noncommercial payments were subject to other exchange rate arrangements.

The planned exchange rate adjustments were unlikely greatly to improve the export performance, since they would barely neutralize the real effective appreciation of the leu in the period January 1, 1981 to end-August 1982, Mr. de Groote went on. Various studies would have to be undertaken to analyze further the exchange rate system, and additional measures in that area were not expected to yield results before 1984. Whatever measures might be taken, the main objective should be to ensure that changes in relative prices were passed through to consumers. It was not clear to him from the staff paper whether increases in input costs could be reflected in domestic prices under the present system of price determination.

The interest rate system would also have to be studied, with a view to introducing real positive interest rates in the second half of 1983, Mr. de Groote commented. However, interest rate adjustments would be useful only if they affected investment and consumption decisions. The transmission mechanism in Romania was not clearly described in the staff report. Investment allocation seemed to be based primarily on administrative decisions, and the precise ways in which interest rate levels influenced such decisions--and particularly the effect of interest rate movements on enterprise and household saving--was unclear to him. Apparently enterprises kept available liquid reserves for themselves in the absence of an organized mechanism for absorbing their financial surpluses. At the same time, savings decisions by households seemed to be a kind of residual; they dealt with the fraction of income that would have been consumed in the absence of scarcities of consumer goods.

The staff had made little mention of price adjustments other than the increases in energy prices, Mr. de Groote observed, and even the hikes in energy prices had left domestic prices substantially below market levels. The price changes would have important implications for future investment policies; the redirection of investment would have to wait until ongoing projects, which were based on a biased price structure, had been completed. The staff had not clearly stated how price and exchange rate adjustments would increase the efficiency of resource allocation by channeling resources toward the more productive sectors.

Annex II (EBS/82/218) and Mr. Polak's opening statement clearly showed that the various administrative measures that had been adopted would lead to the desired balance of payments position, Mr. de Groote said. The program was obviously internally consistent. However, in the longer-term perspective the reliance on administrative measures to ensure the desired outcome seemed inappropriate and cast serious doubt on the viability of the adjustment effort. Through their program the authorities were attempting to send the correct signals, but the signals alone might not be sufficient; if market participants did not or could not react to the signals, little adjustment would be achieved. The authorities had proposed that enterprises play a larger role in price formation, but the manner in which prices would affect enterprise decision making and enhance the efficiency of resource allocation had hardly been touched upon. As a result, the program failed to give the impression that it could produce a viable and sustainable balance of payments position in the medium term. To achieve that outcome, the improvement of the existing economic mechanisms and the introduction of procedures allowing the decision-making process in the enterprise sector to respond to price and cost incentives would have to be accelerated.

The viability of the adjustment effort in the eyes of observers was crucial, Mr. de Groote considered. The successful implementation of the program would depend on the achievement of satisfactory rescheduling operations and, therefore, on restoring and maintaining the confidence of the financial community. The various lenders all expected to receive similar treatment by Romania in its effort to reduce its payments arrears. In that connection, two statements in the staff paper seemed inconsistent. In the portion of his letter cited on page 45, the Finance Minister had stated that negotiations were taking place to reschedule suppliers' credits on terms comparable to those applying to bank reschedulings. In Annex I, however, it was stated that the authorities thought that it was unrealistic to seek agreement from the suppliers on those terms because the suppliers would be unwilling to accept the long repayment periods involved.

He agreed with the staff that the authorities needed to develop as soon as possible an adjustment policy that would include some action to improve the resource allocation mechanism, Mr. de Groote said. The purchase that Romania wished to make would be made possible by the Executive Board's approval of the proposed decision, which he supported, although mainly in the hope or expectation that the necessary adjustments would be implemented rather than on the basis of actual developments. The achievements made thus far would have to be followed by reform measures designed to lead to a viable external position in the medium term. In approving the proposed decision the Executive Board would be showing its confidence in the authorities' willingness to undertake further fundamental measures, and he hoped that the Board would not be disappointed.

Mr. Dallara stated that he generally agreed with the staff appraisal and accepted the proposed decision. On balance, the authorities were moving in the right direction in most policy areas, but he, like Mr. de Groote, was worried that some of the adjustments that had been made or that were planned did not go far enough. In addition, some of the actions that the authorities were considering should be taken as soon as possible rather than at some later date.

The recent movement toward unification of the exchange rate was welcome, Mr. Dallara commented. However, it was not clear to him why the authorities felt that it was advantageous to wait until July 1983 to implement the planned depreciation of the exchange rate. Under that approach, there might well be incentives to hold back exports until the depreciation occurred. He understood that the present timetable for the exchange rate move represented an acceleration of the original timetable, but the sooner the action was taken the more Romania would benefit from it. It would be useful to have a further comment on the adequacy--in terms of competitiveness--of the exchange rate that was to take effect in July 1983. The "street rate" might not be a good guide for determining the equilibrium exchange rate, but it was interesting to note that it was about lei 35-40 per U.S. dollar compared with the commercial rate of lei 17.5 per U.S. dollar planned for July 1983. Given Romania's serious external situation, the country could ill afford an overvalued exchange rate. Mr. de Groote's remarks on the matter were particularly relevant.

Commenting on monetary policy, Mr. Dallara said that the authorities appeared to be tightening credit after having allowed it to expand much too quickly in the first half of 1982. The authorities must persist in their attempts to control the provision of credit to the economy, and especially to enterprises. In that connection, he agreed with the staff that the reliance on interest rate policy should be increased, and he was pleased that the authorities planned to undertake with the staff a thorough review of interest rates in the first half of 1983 with a view to introducing real positive rates in the second half of the year.

Given the urgency of the economic situation in Romania, Mr. Dallara went on, he was somewhat puzzled by the proposed timing of the interest rate adjustments. The authorities should be urged to study the issue quickly and to implement the necessary changes as soon as possible and, ideally, well before the second half of 1983. The staff had clearly described the numerous problems that could be addressed by adjusting interest rates and, while the issue of the role that interest rates should play in Romania's economy was admittedly complicated, there seemed to be very little time left to study the matter. The proposal for taxing capital to offset other distortions, in addition to the below-equilibrium interest rates, was also puzzling. It seemed preferable to adjust the array of prices, thereby removing distortions, than to increase taxes in an attempt to offset them.

The authorities' significant adjustments in natural gas and oil prices were commendable, Mr. Dallara considered. Nevertheless, further action was needed in the pricing area, since gas prices were one third of world market prices on an oil-equivalent basis and would remain at half the world market price on that basis after the planned price adjustments in April 1983. Oil prices apparently also should be raised. If prices and exchange rates were at the correct levels, the authorities could avoid the problems associated with the use of quantitative restrictions on oil imports.

The authorities planned to conduct a study before September 30, 1983 to determine the appropriate level for the domestic price of natural gas, Mr. Dallara continued. By that time, however, the stand-by arrangement would have been in effect for roughly two and one-half years. It was somewhat disturbing that such a long time would be taken to review basic pricing issues.

Romania's external position was clearly difficult, Mr. Dallara said, and he was pleased that the authorities intended to foster greater competition in foreign trade by increasing the emphasis on the multilateral approach to foreign trade issues. He attached particular importance to having the authorities increase their reliance on the exchange rate while decreasing the use of countertrade in its attempts to achieve a sustainable external position. That some observers believed that Romania had intensified its requirements for countertrade during the period of the Fund-supported program was a cause for concern. How did the staff monitor countertrade arrangements? How did it determine whether or not the arrangements were being intensified and whether or not any intensification was consistent with the standard performance criterion concerning trade and payments restrictions for balance of payments purposes?

He had been critical of a number of policy areas, Mr. Dallara commented, although the authorities were clearly attempting to make important adjustments in difficult circumstances, and some meaningful changes had been made during the previous year. It was because of the seriousness of the situation in Romania that he had difficulty with the proposals for merely studying important issues related to the exchange rate, interest rates, and prices. While it might well take time to determine the optimal level of those variables, there was no doubt about the broad direction and rough magnitude of the changes that were needed.

Mr. Joyce stated that the authorities were to be commended for the steps that they had taken--albeit belatedly in some cases--to deal with the problems facing the economy. In June 1982 it had been clear that many of the problems had been caused by a combination of excessively rapid growth, deterioration in the terms of trade, and serious misallocation by the Government of resources available from commercial banks. Some of the problems had clearly been exacerbated by the attitude that commercial banks had taken toward Eastern Europe in general, but others had resulted from the failure of the Romanian authorities to move quickly enough to provide the information needed by commercial banks and governments that had lent money to Romania. He was therefore pleased that the authorities were providing much more extensive information at present, and that they recognized the importance of moving quickly to conclude the required rescheduling of debt in 1983. The long negotiations on the rescheduling of the 1981-82 debt had cast a pall over the market, thereby contributing to the problems facing the authorities.

There were three important lessons to be learned from the case of Romania, Mr. Joyce considered. First, no adjustment program, no matter how well conceived and crafted, should be seen as being cast in concrete. When conditions changed, the elements of a program must be modified or its implementation must be stepped up, and the initiative for such a response must come from the authorities. In that connection, the Romanian authorities were to be commended for having accelerated and modified the program in 1982 by adopting additional measures.

The second lesson, Mr. Joyce continued, was that the Fund had to be flexible. It had to be prepared to reassess the realism and adequacy of performance criteria and, if necessary, to modify them. The institution should approach programs in a realistic way. In the present case of

Romania, he had no difficulty in accepting the proposed modifications of the program in response to the deterioration in the situation, which had been more rapid than originally expected. Despite all the additional measures that had been adopted, it was unlikely that the Romanian authorities would be able to achieve the increase in international reserves at end-1982 that had originally been planned. The proposed decision constituted an example of a legitimate modification of a program target.

Third, the case of Romania reinforced his feeling that confidence--in particular, confidence of the international financial markets--was very fragile, Mr. Joyce went on, and the most essential task facing the Romanian authorities was to restore it as quickly as possible. The determination that the authorities had shown and the actions that they had taken would undoubtedly help to restore confidence. Indeed, anything that the authorities could do to reduce the existing degree of uncertainty would be welcome. For instance, they should provide additional information as quickly as possible and settle certain outstanding issues, such as the degree to which further debt rescheduling would be needed in 1983.

The undertakings that the authorities had given with respect to the unification of the exchange rate, the further adjustment of the commercial exchange rate, and the change in the method of determining the rate were welcome, Mr. Joyce commented. That some of those actions were to be taken as soon as January 1, 1983 was in itself commendable. However, he, like Mr. Dallara, was worried that some of the needed changes had been put off, probably longer than was advisable, particularly in the light of the wish of the authorities to signal the markets that basic changes in economic policy were being made. The overvaluation of the exchange rate that would persist for some time under the authorities' present timetable was worrying.

Commenting on monetary policy, Mr. Joyce said that he welcomed the steps that the authorities had taken to increase the effectiveness of the restrictions on credit expansion, and particularly the introduction of the reserve requirement on enterprise deposits. The authorities' intention to address the level of interest rates was also welcome, but he, like Mr. Dallara, was worried about the delay in making the needed adjustments. The authorities planned to conduct a study with the assistance of the Fund, but it was unclear to him why it was expected to take six months to complete. Quick action in the interest rate field would help to reduce uncertainty by giving appropriate signals to the market, and more important, it would provide a better basis for the future operation of the economy, and particularly for the domestic pricing of Romanian products.

In the fiscal policy area, Mr. Joyce remarked, there had been a fairly substantial effective reduction in the rate of subsidization in 1982 compared with 1981, mainly as a result of the unification of the exchange rate for crude oil and refined petroleum products. He wondered whether the staff had any further information on the steps that the authorities were likely to take in 1983 to reduce subsidies further.

It was true, Mr. Joyce said, that some important price reforms had been introduced and that the authorities intended to try to align domestic prices with international prices, but a number of prices in Romania were still seriously out of line, and the authorities should be urged to act quickly, rather than slowly. The recent increases in the price of crude oil were welcome, but the scheduled introduction of higher prices for natural gas was not as rapid as seemed desirable.

He, like the staff, Mr. Joyce continued, was worried that the policies that the authorities had had to maintain in the short run might inhibit appropriate investment decisions, thereby mortgaging the future growth of the economy. That the authorities were committed to the development of new energy sources, and particularly nuclear energy, was welcome. In the agricultural sector, Romania had enjoyed a good harvest and would probably be able to reduce its imports of agricultural products, but the authorities seemed to be reluctant to devote more resources to agriculture; a significant increase in output apparently could be achieved through greater use of fertilizers and other chemical inputs. Agriculture was expected to account for 14 per cent of total investment in 1983, compared with 17 per cent in 1982, and he wondered whether the authorities might not have been cutting back somewhat too sharply on investment in the sector.

The proposed decision was acceptable, Mr. Joyce stated. The authorities were to be commended for the courageous steps that they had taken and for the success that they had achieved, particularly in the balance of payments area. On the other hand, an acceleration of the implementation of the structural elements of the program would clearly be in the best interests of Romania.

Mr. Grosche remarked that Romania had undertaken a strong adjustment program and had made remarkable progress in intensifying the implementation of adjustment measures. As a result, all the performance criteria for the domestic economy had been observed thus far. The trade surplus in convertible currencies was expected to overshoot the target substantially in 1982, although mainly as a result of the disappointing performance of exports and the vigorous cutback of imports. In June 1982 the staff had concluded that the extra output provided by a good harvest could be used to increase exports. In fact, despite a very good harvest, Romania had not succeeded in boosting agricultural exports. Supplement 1 to EBS/82/218 provided highly aggregated export figures, and further information on the export performance would be useful. The 17 per cent reduction in imports from the convertible currency area in 1982 was very impressive. Such results were probably attainable only in an economy that was as tightly controlled as that of Romania, and he doubted whether the decline in the current account deficit indicated that a major step forward in fundamental adjustment had been made. Mr. Polak had said that the expected improvement in the current account in 1982 and 1983 did not rely in a major way on stopgap measures, but the staff seemed to be less certain of that. It would be difficult even in a highly flexible economy to maintain the level of industrial production by substituting domestically produced goods for imported inputs in a short time. He agreed with the staff that the forced decline in imports in Romania could cause bottlenecks, particularly in energy supply, although he recognized that there was a tendency to use foreign imports more efficiently than in the past.

The present policy stance in Romania had been the necessary response in the short run to the serious liquidity crisis, Mr. Grosche commented, and the policies aimed at achieving balanced economic development in the longer run were welcome. However, Romania's external financial position was far from being a settled one, despite the progress that had been made in the trade account.

In June 1982, Mr. Grosche recalled, the Executive Board had decided that purchases by Romania in excess of SDR 10 million under the existing stand-by arrangement should be made only if satisfactory arrangements had been made for the rescheduling of outstanding payments arrears and debts falling due in 1982. The staff had concluded that that condition had been met, but in his view that interpretation seemed to be slightly generous. It was mentioned on pages 34 and 35 (EBS/82/218) that the settlement of official short-term debts was expected to be fully completed by end-December 1982, but there was no certainty that the payments due to Germany would be made on time. Moreover, the Romanian authorities were still engaged in discussions with suppliers. Those examples indicated that the negotiations and arrangements had not been fully completed, and it might be useful to revise the proposed decision accordingly.

Romania's external situation would undoubtedly remain very delicate in 1983, Mr. Grosche commented. The foreign financing gap was estimated at $550-650 million, and the authorities should be encouraged to implement without delay the policy actions described in Section IV of the staff paper. He attached particular importance to the proposed change in the peg of the leu away from the U.S. dollar, in favor of a basket of currencies, and to the taking of further steps toward the unification of the exchange rates. He strongly favored greater use of interest rates and a larger role for individual enterprises in the selection of investment projects. Both measures would increase the efficiency of the companies concerned. Finally, he agreed with the general thrust of the staff appraisal and could accept the proposed decision with the modification that he had mentioned.

Mr. Taylor said that he welcomed the opportunity to review developments in the Romanian economy in the light of the proposed program for the second year of the stand-by arrangement. In addition, it was an appropriate time to take a first look at the prospects for 1983 and at the further measures that might be needed.

He was pleased, Mr. Taylor went on, that the authorities appeared to have a more realistic appreciation of the difficult economic situation in Romania, and their actions on a number of fronts were commendable. Their determination to tackle the problems facing the economy had never been in doubt, and they appeared to be introducing more effective policies than hitherto, particularly in the areas of domestic pricing, subsidies, exchange rates, and demand management. However, it was still apparent that the restoration of external confidence was proving a longer and more complicated task than had been envisaged at the beginning of the program. The economic situation was still critical, and the authorities would have to maintain and strengthen still further the thrust of the stabilization policies while continuing to introduce the greatly needed structural adjustments.

The outline of proposed structural adjustments specifically to restore market incentives, presented on pages 30-31 of the staff report, seemed particularly appropriate, Mr. Taylor commented. The authorities should be encouraged to act vigorously to complete the proposed policy studies soon, and to move as quickly as possible to adjust interest rates, introduce reserve requirements in the banking system, institute a more flexible and comprehensive control of domestic liquidity, and reform the exchange rate system by, inter alia, introducing a new system for pegging the exchange rate. If effectively implemented, such reforms could have important consequences for the general efficiency of the economy.

Commenting on the balance of payments, Mr. Taylor said that the authorities' success in improving the convertible currency trade surplus and in achieving a surplus on the convertible currency current account was certainly commendable. It would of course be essential for that progress to be maintained, and the actions that were being taken to secure a competitive exchange rate and to ensure that the competitive advantage was not eroded in the future were welcome. However, given the substantial appreciation of the real exchange rate since 1980, the proposed depreciation might not go far enough. Romania certainly could not afford an exchange rate that reduced export incentives, and he doubted whether the improvement in the trade and current accounts in 1982 was likely to prove to be sustainable in 1983. Restraint of domestic absorption had certainly played a part in the improvement in the external accounts in 1982, and much of the improvement had resulted from severe import restrictions in particular. Import cutbacks were likely to bear particularly heavily on output in 1983. It was difficult to believe that the projected 60 per cent reduction in oil imports for domestic use would permit output growth on the planned scale, even if imports of coal replaced oil to some extent. The depreciation of the leu would be of little benefit if additional demand for exports could not be met, and the achievement of the trade target would depend on a continuation of strong domestic restraint and on further relative price adjustments, particularly in the energy field.

He agreed with the staff, Mr. Taylor continued, that there was an urgent need for domestic energy prices to be brought closer to world market levels. Energy conservation and the development of domestic sources of energy would be achieved most effectively by appropriate further price adjustments and other commercial incentives rather than by the imposition of ever tighter import ceilings. In that connection, the measures taken by the authorities to ensure that oil imports for processing and re-export were handled on a more profitable basis than hitherto were in the right direction.

In the fiscal area, Mr. Taylor noted, the projected moderate overall public sector surplus was likely to be broadly achieved, although both revenue and expenditure would be lower than had been expected. The declining trend of budget subventions to finance investment projects and the intention to introduce a tax on capital were particularly welcome. Those measures, together with the promised interest rate adjustments, should help to improve investment project selection and to increase the efficiency of project implementation. The authorities had wisely decided to undertake a thorough examination of the investment program with a view to its rationalization, even if a delay in disbursements was involved. If rationalization was accompanied by a decision to give enterprises more flexibility in the selection of projects and more exposure to foreign markets, the benefits would be very significant in due course.

The increase in the restrictiveness of monetary policy through a tightening of enterprise liquidity and a rise in the cost of credit to more realistic levels should help to improve efficiency, Mr. Taylor remarked. He agreed with previous speakers that the authorities should be urged to increase interest rates to positive levels in real terms as soon as possible. Such a move would assist demand management by counteracting the tendency for personal consumption to be maintained through a running down of savings balances.

While there had been some progress in the rural economy, Mr. Taylor commented, it was evident that the rescheduling of debt had been going less smoothly than had been hoped. Agreements on the rescheduling of the debt to commercial banks had taken longer than had been expected, and the terms of the rescheduling seemed to have been considerably less favorable than the authorities had hoped. The rescheduling of suppliers' credits had proved to be particularly difficult. Unfortunately, some commercial banks and suppliers had not been prepared to participate in the rescheduling arrangements and some creditors had in effect been repaid at the expense of other, more patient, ones. There had been some discrimination even among participants in the rescheduling arrangements, as some downpayments had already been paid, while others had been deferred until 1983. In particular, downpayments to IBEC had received priority over the downpayments to other claimants. Such discrimination was unfair and seemed to cut across the thrust of the adjustment effort. He wondered whether the staff was aware of the discrimination and, if so, whether it was compatible with the guidelines under the stand-by arrangement.

It would be useful to have further information about the progress that had been made in rescheduling suppliers' credits, Mr. Taylor said. Would satisfactory agreements be concluded with virtually all suppliers by the end of 1982? It looked as though the amount of debt relief in 1982 would be some $700 million less than had been originally expected. The unexpectedly unfavorable outturn on the capital account had had to be compensated by a much improved current account, and, since exports had performed less well than had been anticipated, there had had to be a massive cutback in imports from the convertible currency area. Further major debt rescheduling would be needed in 1983 if further sweeping import cuts were to be avoided.

In the circumstances, Mr. Taylor commented, and particularly in view of the constructive policies that the authorities had maintained and were cosidering, the draft decision should be approved. The proposed somewhat more gradual use of Fund resources under the stand-by arrangement was acceptable; it reflected the continued difficult external position and the longer adjustment period that now seemed required. If there was still some way to go in rescheduling suppliers' credits, it might be best, as Mr. Grosche had suggested, to redraft the proposed decision to reflect that fact.

Miss Le Lorier observed that the current account in convertible currencies was expected to move into a surplus of about $300 million, representing an improvement over 1981 of roughly 2.3 per cent of GDP; and the programmed deficit of the nonconvertible current account was not expected to be exceeded. GDP growth was expected to be of the order of 4.3 per cent in 1982, while real domestic demand was estimated to increase by only 2 per cent. An analysis of the factors underlying those results had led her to the same conclusion as Mr. Polak in his opening statement, that "the current account improvement that the staff foresees for 1982 and 1983 does not in a major way rely on stopgap measures." She agreed with the analysis in Annex II of the staff report.

A number of detailed developments were worth underscoring, Miss Le Lorier considered. The decline in consumption had not been associated with a rise in forced savings, as some Executive Directors had feared during the previous discussion of the Romanian economy. In fact, net savings were estimated to have declined by 2 per cent in 1982. However, the staff had noted that there had been shortages of some basic commodities, reflecting the authorities' unwillingness to rely exclusively on prices to ration purchases of basic commodities, supplies of which had been diverted to exports. The staff's use of the words "to ration" as well as the list of commodities it had mentioned on page 10 (EBS/82/218) were a reflection of the stringency of the present adjustment effort in Romania. The staff appraisal contained a rather unusual sentence by normal Fund standards: "The Romanian authorities should be commended for this [adjustment effort], even though the severity of this delayed adjustment might disrupt the normal functioning of the economy, and create regional and social problems." That concern could not be defused by a resort to price increases alone.

It was reassuring--although slightly less so in the light of the opening statement by the staff representative--that industrial output had continued to grow, albeit slowly, in the first three quarters of 1982, Miss Le Lorier continued. Structural adjustments seemed to be under way; the import component of output had been reduced without disruptions in the production process. The increase by some 9 per cent in 1982 of non-oil, nonfood, and noninvestment imports had certainly been essential, and it was indeed worrying that inadequate energy supplies could constrain industrial growth and exports in the near future. The price mechanism could play a greater role than hitherto by providing an alternative to the recently introduced ceilings on crude oil imports; a sizable gap remained between domestic and international energy prices despite the significant price adjustments that had been made in 1982. A further comment on that matter would be welcome. She particularly wondered whether, given the scarcity of available foreign exchange, new domestic price increases would significantly lessen the risk of energy shortages.

The prospects for 1983 were not very reassuring, Miss Le Lorier commented. Total non-oil imports were expected to rise by 4 per cent, an increase that, in the staff's view, would be just consistent with the projections for domestic economic activity and for exports. As for the appropriate policy measures for 1983, she had no difficulty in accepting the staff's recommendation to continue with restrictive demand management and to accelerate and augment structural policies. She fully appreciated the difference between the two parts of that statement; it would effectively be very difficult, and even undesirable, to tighten further demand management.

Commenting on the various policy instruments used by the authorities, Miss Le Lorier said that the authorities were to be warmly commended for the advance they had made in the scheduled unification of the exchange rates. She greatly welcomed their recognition of the need to shift from the peg to the U.S. dollar to a basket of currencies, but it was unclear to her why the authorities felt that it was necessary to fix the scale of the depreciation of the leu so far in advance of its effective date in July 1983. It was difficult to assess the correct exchange rate level for a distant date, especially when the appropriate indicators, such as price competitiveness, were of limited relevance in a planned economy. Would it not have been conceivable simply to provide that in July 1983 the leu would be pegged to a basket of currencies and its level continuously reviewed thereafter? She also wondered whether an acceleration of the unification of the noncommercial and commercial exchange rates had been considered by the authorities.

In the monetary policy area, Miss Le Lorier remarked, the decline in the real value of the outstanding stock of financial assets held by households reflected the rigorous demand management. On the other hand, the stock of enterprise deposits had continued to grow, although at a moderate pace, and appeared excessive to the staff. Monetary policy appeared to have remained tight, but she wondered why the authorities were considering introducing a reserve requirement on enterprise deposits rather than more direct sterilization measures, such as the issuance of interest-bearing instruments, the proceeds of which would be temporarily frozen or used to finance high-priority investments. In that connection, some features of the present Hungarian program seemed relevant, particularly in view of the Romanian authorities' intention of providing a much needed increase in the autonomy of enterprises. The steps that the authorities planned to take in the area of interest rates certainly seemed in the right direction, but they would perhaps be more effective if they were associated with an increase in the diversification of financial instruments.

The main developments in the fiscal policy area, Miss Le Lorier considered, were the large decline in subsidies and the continued retrenchment of the budget away from enterprise financing, which she endorsed. As for incomes and prices, it would be essential to allow a full pass-through to domestic prices of the effects of the depreciation of the exchange rate. That the staff had taken into account the need for some compensation for lower-income earners as a result of the large consumer price increases in 1982 was welcome. She agreed with the staff that continued wage restraint should not cause a major decline in real consumption; such a decline would probably prove to be unbearable.

Unfortunately, Miss Le Lorier continued, the staff's discussion of structural reform contained no comment on the agricultural sector, which could well be a major reservoir of increased productivity. The close collaboration with the World Bank in planning structural reform was certainly essential, and she hoped that the present appraisal of projects would be completed soon.

In the case of Romania, Miss Le Lorier said, there were three separate issues bearing on the role of the Fund. First, it would be essential for commercial banks to be kept fully informed of the magnitude of the adjustment effort that the authorities were undertaking and the results that had already been achieved. Keeping their creditors well informed of those developments was a primary responsibility of the Romanian authorities, but the Fund also had an important role to play, especially in the light of the financing gap forecast for 1983 and of the shortfall in capital inflows in 1982. The Government would have to avoid the risk of an excessive and self-destructive adjustment effort. A precondition for avoiding that risk was that the authorities should enter the debt rescheduling process for 1983 at a very early stage and make every effort to conclude it as quickly as possible. However, it was difficult to rule out the possibility that some fresh funds would be needed and, in that connection, the Fund might have an essential role to play through its relationship with the commercial banks.

The second issue concerning the role of the Fund, Miss Le Lorier continued, had to do with the proposed use of the institution's resources. She had no difficulty in accepting the proposed decision, which provided for a bulk purchase of SDR 300 million and for carrying over to 1983-84 the amounts that had been unused in 1981-82. The staff proposal for stretching the arrangement to the end of 1984 was fully acceptable, but she was not convinced of the logic of providing only 100 per cent of quota in 1983, thereby leaving 77 per cent of quota--the equivalent of SDR 285 million--for the first half of 1984. It was likely that 1983 would be a rather difficult year for Romania, while the country presumably would not need to resort to any debt rescheduling in 1984. It would be useful to have a further comment on the legal implications of providing more than 100 per cent of quota in 1983, bearing in mind that a new arrangement might be needed in order to permit the Fund to extend its collaboration with Romania until the end of 1984. Such an option might provide an opportunity to enhance the structural element of Romania's adjustment effort.

The third issue had to do with the proposed performance criteria, Miss Le Lorier said. She had no difficulty in accepting the proposed waiver of the performance criterion on the minimum level of reserves at end-1982. With the benefit of hindsight, the Fund had correctly opted for flexibility in avoiding quarterly targets on the level of reserves in 1982, although such targets would have had no concrete implications with respect to the right of Romania to draw on Fund resources. While she was strongly convinced of the need to rebuild reserves in 1983, she expected the Fund to maintain the same pragmatic approach that it had used in 1982. However, the question of the pace at which the rescheduling negotiations would take place still remained. Therefore, she wondered whether it would not be conceivable to have the staff and the authorities agree--in the framework of an indicative scenario for the growth of reserves--on the level of reserves on the occasion of each of the three scheduled reviews of the arrangement, rather than assign quarterly performance criteria for reserves in 1983.

Mr. Zhang stated that the proposed decision should be approved. Given the very unfavorable external conditions, Romania had made remarkable progress in 1981 and 1982 in the external current account and in the budget, for which a large surplus was estimated in 1982. The Government had already successfully implemented a wide range of adjustment measures under the stand-by arrangement and was committed to adopting further measures, if necessary. In the circumstances, it would be inappropriate to encourage Romania to accelerate the pace of adjustment. Interest rates had been raised, and he doubted whether it was necessary to increase them further. Had the staff made an in-depth analysis of the possible effect of high interest rates in the present economic circumstances of Romania? During their recent discussion on interest rates, Executive Directors had been divided on the effects of interests rates and on the appropriate interest rate policy for different kinds of economies.

Mr. Salehkhou commented that the gradual progress that the authorities had made under the stand-by arrangement had been hampered by a series of exogenous developments and the external debt burden. Despite the external debt rescheduling arrangements in 1982, there was a need for preliminary measures aimed at further debt rescheduling in 1983 and, perhaps, beyond.

The Government had introduced bold measures to alleviate the problems facing the economy, Mr. Salehkhou noted, and with minor exceptions all the performance criteria for 1982 had been observed. The need for continued scrupulous observance of the provisions of the financial program remained. There had been a marked improvement in the external sector; a small current account surplus was now forecast, instead of the deficit that had previously been projected, and the trade account was expected to show a sizable surplus in 1982. However, the pressure on reserves was evidence of the need for further improvement in the external sector.

He fully agreed with the thrust of the staff appraisal, Mr. Salehkhou said. The authorities had introduced important measures to control aggregate demand, and they were aware of the severity of the remaining problems and of the need for continuous monitoring of the key economic variables. The 1982 financial policies and the monetary and budget projections seemed appropriately tailored to the present needs of the economy. However, the importance of continuing the structural reforms, particularly those having to do with prices and exchange rates, could not be overemphasized. As the staff had concluded, increasing the enterprises' freedom to set prices, implementing a more active monetary policy than hitherto, introducing a reserve requirement on enterprise deposits, and other measures to restore market incentives would be helpful. The determination of the authorities to adopt the necessary measures was commendable, and the proposed decision was fully acceptable.

Mr. Morrell stated that he could support the proposed decision. The performance of the Romanian economy under the 1982 financial program had been satisfactory, with the exception of the level of reserves at the end of the year. However, a waiver of the performance criterion for reserves was warranted.

At end-December 1981, Mr. Morrell continued, the volume of external payments arrears in convertible currencies had exceeded $1.1 billion, and the authorities' intention had been to resort to rescheduling to eliminate all of the arrears by the end of 1982. Good progress had apparently been made, but the staff reports and the discussion thus far suggested that there were still a number of loose ends. The authorities' letter of intent indicated that a comprehensive rescheduling agreement with the commercial banks was to have been signed by the end of November 1982, and it would be useful to know precisely how much progress had actually been made. The letter of intent also indicated the authorities' firm desire to complete discussions on rescheduling of more than $800 million in arrears of suppliers' credits, and a further comment on the progress of those discussions would also be helpful.

At the end of 1982, Mr. Morrell noted, the outstanding external debt in convertible currencies would still be some $10.1 billion, and projected debt service payments in 1983 would exceed $2 billion. It seemed likely, as the staff had suggested, that further debt rescheduling would be necessary in 1983, and he agreed with the staff that work on it should start as soon as possible. He was glad that Mr. Polak had been able to say that the initial steps had already been taken.

The rescheduling negotiations and the unfavorable attitude of the suppliers and commercial banks meant that the adjustment in 1982 had had to be quicker than had originally been anticipated, Mr. Morrell went on. The authorities were to be commended on the firm restraint on domestic demand that had been maintained thus far and that was to be continued under the program for 1983. Other measures that the authorities had already adopted or planned to introduce, and particularly those in the areas of the exchange rate, consumer subsidies, and interest rates, were additional evidence of the authorities' firm commitment. Increasing the ability of the enterprises to make pricing and investment decisions would have important longer-term implications for efficiency, and the authorities should be encouraged to maintain that policy to the extent possible.

The planned studies of the exchange rate system and interest rates were welcome, Mr. Morrell remarked, but he wondered why they were so time-consuming. Those instruments might well have been underutilized in the past partly because of what had been thought to be their inherently limited role in a centrally planned economy. As Mr. Zhang had noted, the Executive Directors had not reached a definite conclusion on the appropriate role of interest rates in a centrally planned economy, and he hoped that the basic conclusions of the study that the Romanian authorities were undertaking would be reported to the Executive Board.

Given the uncertainty about debt rescheduling, Mr. Morell said, he attached particular importance to the proposed reviews of the progress under the stand-by arrangement. Further information on the rescheduling negotiations would be welcome.

The staff representative from the European Department commented that until recently the authorities had believed that their policies concerning the control of enterprise liquidity, interest rates, and the exchange rate system were adequate. During 1982, however, it had become obvious to them that the economic situation had become much more serious than they had anticipated and that a fresh look at various economic policies was required. The staff had discussed at considerable length the timetable for those examinations during its meetings in Bucharest and in Washington with the Romanian authorities. The authorities had agreed with the staff that action was needed as quickly as possible. However, both the established method of planning, under which most important policies were decided for the coming 12-month period and changes in policies during the course of a year were difficult to make, and the timing of the staff's discussions with the authorities had made it difficult for the authorities to agree to make the policy adjustments favored by the staff as early as January 1983. The authorities had felt that it would be wrong for them to make decisions quickly; they preferred to conduct the studies that the staff had described and to make the relevant decisions during 1983.

The staff had felt that the letter of intent should contain specific dates for the actual implementation of the policy measures that the authorities were studying, the staff representative continued. The staff fully understood the wish of the Executive Board to have the appropriate policies implemented as quickly as possible. The staff also felt that a reasonably satisfactory compromise had been reached: some of the needed policies were to be introduced on January 1, 1983, and the authorities had given their assurance that the remaining policy changes would be made during the year and, in most cases, by the beginning of the second half of the year.

Commenting on the present stage of the debt rescheduling negotiations, the staff representative explained that the staff had received additional information during its most recent visit to Romania. At that time, the authorities had said that the main agreement with the commercial banks had been signed on December 7, 1982. The downpayments under the agreement were to be made in two installments, on January 31 and March 31, 1983. Hence, with respect to the commercial banks, it seemed fair to conclude that the Fund had the assurances that were required under the decision on Romania adopted by the Executive Board in June 1982. In addition, as of December 9, 1982 bilateral agreements under the Paris Club had been signed with all the countries concerned except Japan, Canada, the United States, and Germany. At that time, delegations had been traveling from Romania to Japan and Canada for the purpose of signing agreements with the authorities, and both signings were expected by the Romanian authorities to take place without difficulty. The unresolved issue with respect to the negotiations with the United States had to do with interest rates. However, the Romanian authorities had expected to reach an agreement with the U.S. authorities in the near future and, in any event, by the end of 1982. Following discussions in Bonn in November 1982, the German authorities had requested that the signing of their agreement with Romania be delayed until early January 1983. Nevertheless, to comply with the Paris Club agreement, the Romanians intended to make a 20 per cent downpayment to Germany before the end of December 1982.

Of the $750 million in suppliers' credits that still needed rescheduling as of end-September 1982, some $535 million had already been disposed of by the time of the staff visit to Romania in December 1982, the staff representative continued. The Romanian authorities expected to sign agreements covering the remaining $215 million by end-December 1982. The $64 million of arrears to smaller suppliers, which had been excluded from the rescheduling agreements with larger suppliers, also were to be paid by end-December 1982. The evidence, as provided by the Romanian authorities, seemed to justify approval of the decision proposed by the staff in EBS/82/218. It was of course conceivable that disputes would arise with respect to individual suppliers' credits but, on the basis of the evidence available to the staff, the number of such disputes outstanding at end-1982 would probably be very small. There were often disputes about whether or not conditions of suppliers' contracts had been fully met and, unless there was clear evidence of payments arrears, the staff doubted whether it would be appropriate to create a precedent in the treatment of suppliers' credits in the present case of Romania.

Debt rescheduling in 1983 had been discussed during the signing of the rescheduling agreements with the commercial banks in London in 1982, the staff representative explained. The Romanian authorities had told the staff of their intention to send a telex either in the final days of 1982 or in the first days of 1983 both to commercial banks and to official creditors declaring a moratorium on 1983 payments pending a formal request for rescheduling.

The size of the debt rescheduling in 1983 was unlikely to be as large as that of 1982, the staff representative went on. The authorities and the creditors should be able to take advantage of the recent experience in rescheduling to finalize the agreements for 1983 much more quickly than they had completed the negotiations in 1982. No rescheduling with suppliers would be required in 1983, as the only outstanding suppliers' credits were short-term ones. Hence, given the facts available to the staff, there were at least reasonable grounds for the Executive Board to assume that a satisfactory stage in the reschedulings had been reached. The rescheduling situation was much better than it had been at the beginning of 1982.

Presumably there was widespread agreement, the staff representative said, that, whether the Romanian system of decision making became completely market oriented or retained a reasonable element of centralism, decisions on investment would be much more efficient than hitherto if the decision makers had at their disposal appropriate prices, including the exchange rate and interest rates. Investment decisions were never perfect, no matter what economic system was used, and the staff did not assume that all the decision makers in the investment field in Romania would be able to change their pattern of thinking in a short time. On the other hand, it was clear that the policies that the authorities had introduced implicitly assumed that future decisions concerning investment, foreign trade and other key economic matters would have to be guided by factors that decision makers had not been obliged to consider to the same extent in the past. Decision makers should be expected to react properly to the economic signals they received, and the staff hoped that the directors of the enterprises in Romania would take full account of both the instructions they received from the economic authorities and the signals they received through the workings of the various sectors of the economy.

The projections for the balance of payments in 1983 included a range of figures for the level of reserves, the staff representative commented. The staff had consistently felt strongly that the level of reserves in Romania in the past had been much too low, and that it had clearly been one of the factors that had contributed to the loss of confidence. The staff had strongly encouraged the authorities to increase the level of reserves in 1983, not only because of the likely increase in the volume of international transactions, but also because there had been a fundamental weakness in the level of reserves in the past. The staff would wish to discuss the precise rate at which reserves should be increased in 1983 during the next mission to Romania. That subject would be dealt with in the context of the overall expectations for the balance of payments in 1983 and, in particular, of the amount of new foreign borrowing that could be undertaken. The staff agreed with Miss Le Lorier that it would be useful to consider whether there should be quarterly targets for reserves specified in advance, or whether the Fund should have a more flexible system of establishing either something less than a performance criterion for reserves, or a performance criterion not for a full year but rather in stages linked to the scheduled reviews of the country's performance under the stand-by arrangement.

The staff had discussed at length with the authorities their proposal for establishing the commercial exchange rate at lei 17.5 per U.S. dollar on July 1, 1983, the staff representative remarked. It was, of course, difficult in any country to know exactly what the appropriate exchange rate was at any given time. In Romania, the difficulty was increased by the large depreciation that had taken place on January 1, 1981. The authorities felt that the adjustment had not only compensated for previous price movements, but had also resulted to some extent in an overdepreciation that had given them some room for maneuver in the period following January 1, 1981. Any assessment of the appropriate exchange rate at the present stage had to take into account price developments in Romania and abroad since January 1, 1981 and likely developments in the coming period. The study that was to be undertaken in the first half of 1983 with the participation of the Fund staff would undoubtedly look at a number of issues concerning the exchange rate system, including the appropriate absolute level of the exchange rate and the best process for adjusting the rate in the future. The important issue of the exchange rate system would undoubtedly be a topic for discussion in the coming months.

In his letter of intent, the staff representative observed, the Minister of Finance had clearly stated that the increases in import prices following depreciations of the exchange rate would be directly passed through to domestic prices in Romania. Moreover, in at least some cases, enterprises would be given authority to make those price adjustments without having to consult the central authorities. In practice, there would probably be discussions between enterprises and the central authorities on price adjustments for at least some commodities, but the principle of passing through increased import prices had been established in the letter of intent to the satisfaction of the staff.

There had clearly been a substantial reduction in imports in the Romanian economy, the staff representative explained, and it had obviously had some effect on the country's ability to maintain the planned level of production. In its report the staff had questioned whether the proposal for severely limiting imports of petroleum was consistent with the rates of growth planned for the remainder of 1982 and for 1983. The industrial production figures that he had mentioned at the beginning of the discussion were an indication that the authorities might have been overoptimistic about the extent to which they could reduce imports of some key products--especially crude petroleum--without adversely affecting the domestic economic activity. There was still a strong need to improve the current account of the balance of payments, and industry and consumers would certainly have to face the problems that would be created by a decline in the availability of foreign exchange to purchase imports. At the same time, the staff agreed with Executive Directors who had said that the policies that were clearly needed in the short run might well have an adverse effect on the economy later in the 1980s. The authorities had to take the necessary steps in the short run and hope that, when the worst balance of payments problems had been ameliorated, they could take compensating action, particularly in the investment field, to offset most of the damage to the economy.

It was impossible, the staff representative said, to give identical treatment in the rescheduling exercise to official lenders, commercial banks, and suppliers. The terms that had been agreed between Romania and the official lenders were not identical to those that had been agreed between the authorities and the commercial banks but, for all practical purposes, they were quite similar. The maturities for suppliers were likely to be shorter than those for the banks and official creditors. It was possible that, in return for accepting terms that appeared to be relatively favorable, some suppliers would undertake to make new credits available, something that had not occurred under the negotiations with either official lenders or commercial banks. On the basis of available information, the staff believed that the various creditors were satisfied that the rescheduling terms were comparable.

The authorities intended to introduce a tax on capital to be paid by enterprises that used the budget as a source of investment funds, the staff representative commented. The staff had told the authorities that it felt strongly that in setting prices enterprises should take into account the full value of all the capital they used. Enterprises would soon have to pay real positive interest rates on credit obtained from banks. In the past, the enterprises had received grants of investment resources from the budget; there had been no charges, and no repayment had been required. It was on the basis of the staff's strong feeling that an adequate cost should be attached to the enterprises' budgetary sources of capital that the authorities intended to introduce a capital tax. The tax should be seen as the normal cost of capital, similar to interest paid on bank credit.

The domestic price of natural gas was still considerably below the international price, the staff representative explained, and the staff fully agreed with Executive Directors who felt that the domestic price should be brought up to the international level as soon as possible. In that connection, however, the authorities faced the problem that, as a result of the substantial increases in the domestic price that had already occurred in the previous 18 months, natural gas already accounted for some 45 per cent of many household budgets in the winter. Still, the authorities had agreed to an additional substantial increase in 1983 and to study the matter further. As for crude oil pricing, it was important to note that the prices paid for final products--gasoline and other refined products, with the exception of heavy fuel oil and some diesel oil--were already at world levels, even though the price of crude oil imports was below world prices. The Government had placed an excise tax on final oil products to ensure an appropriate final price. The staff continued to feel that the prices of all oil products in Romania should be brought up to world levels as quickly as possible to encourage their efficient use.

In the past, the staff had carefully examined the countertrade involving Romania to determine whether it constituted an exchange restriction, the staff representative said. The matter was a difficult one, and having examined all the available evidence, including the relevant legislation and other information provided by the authorities concerning the actions of enterprises, it had concluded that the countertrade did not constitute an exchange restriction. Hence, any increase in the tendency of enterprises to insist on countertrade presumably did not involve an intensification of a restriction for balance of payments purposes. It was very difficult for the staff to obtain evidence of an increase in the demand for countertrade, but the staff felt that Romanian enterprises probably had increased their emphasis on countertrade arrangements. The Romanian enterprises themselves tended to downplay the extent to which they requested countertrade, while the foreign enterprises involved were often quite vocal about the requests for countertrade that they received. The staff would discuss the matter with the authorities in greater detail during future missions and report its findings to the Executive Board.

The staff continued to feel that the upper limit of the projected range for the balance of payments in 1983 was reasonable, the staff representative remarked. Within the context of the projections for the domestic economy, the upper limit of the projections for the balance of payments would permit an adequate improvement in the current account in 1983.

It was the staff's understanding, the staff representative went on, that IBEC banks would be paid on the same terms as official creditors and would therefore receive a 20 per cent downpayment before the end of 1982. The staff was unaware of any preferential treatment for IBEC banks. In addition to the shortfall in the expected debt rescheduling in 1982, there had been a $150-200 million shortfall in new officially guaranteed borrowing and an additional shortfall in medium-term and long-term credits.

The staff believed, the staff representative stated, that the commercial and noncommercial exchange rates should be unified as quickly as possible. The authorities felt that they could not unify the rates as early as January 1, 1983 but they had given their assurance that there would be no increase in the differential between the rates. The study of the exchange rate system would certainly include the relationship between the commercial and noncommercial exchange rates.

The staff had stated its preference for an increase in interest rates before the present planned date of July 1, 1983, the staff representative remarked. The authorities had said that they felt strongly that they would not have enough time under their planning system to decide on an increase in interest rates as early as January 1, 1983. The staff hoped that Executive Directors would feel assured by the undertaking given in the letter of intent to modify the interest rates on July 1, 1983 to the extent needed to establish positive real interest rates. In the staff's view, that statement constituted a clear-cut indication of the authorities' intentions. The increases in interest rates that were to take effect on January 1, 1983 would not be sufficient to establish real positive interest rates, but they should provide a clear indication of the authorities' firm intention to push interest rates up and to make them an effective economic policy tool in Romania.

The good harvest in crop year 1982 had been the main reason why the authorities had been able to come as near their growth targets as they actually had, the staff representative explained. The impact of the crop on the balance of payments would initially be on the import side, as most of the exporting of agricultural goods from the 1982 crop year would take place in the first half of 1983. Tables 25-27 (EBS/82/218, Sup. 1) showed that imports of raw materials for foodstuff production had fallen from $821 million in 1981 to an estimated $420 million in 1982. The bulk of the improvement had occurred in the convertible currencies area.

The lack of current data made it difficult for the Fund and the World Bank staff to judge precisely what was happening in agricultural investment, the staff representative from the European Department said. In their desire to stop wasting investment resources, and because investment was a particularly import-intensive item of expenditure, the authorities had severely cut current investment and had decided not to undertake new investment projects until a complete review could be made to ensure that correct investment decisions were being taken. The staff had been unable to make a full and detailed review of the present investment distribution; the figures for 1982 were not yet available, and the staff had not been in a position to provide a more detailed description than the one that had been given in June 1982. However, the World Bank staff apparently agreed with the Fund staff that the authorities were well aware that agriculture was a particularly important sector. In the future, the authorities intended to emphasize agricultural investment, and the World Bank apparently stood ready to provide substantial financial support for agricultural investment projects. It was certainly desirable for the authorities to complete their own project evaluations and those that were taking place in conjunction with the World Bank so that agricultural investments could be undertaken; both the Fund and the World Bank staff had strongly stressed that point in their separate discussions with the Romanian authorities.

Mr. Dallara said that he fully understood the difficulty in ascertaining whether present and past trade practices conflicted with the performance criterion concerning trade restrictions for balance of payments purposes. He welcomed the staff's intention to look into the matter further.

Mr. Grosche remarked that the proposed decision seemed to anticipate something that the staff and the authorities hoped would occur by the end of 1982--the completion of the external debt renegotiations for 1982. It was on that expectation that he could accept the proposed decision as it stood.

Mr. Polak commented that the process of transformation in the Romanian economy, under which the incentive mechanism would play a much larger role than hitherto, had clearly begun. Indeed, the letter of intent in EBS/82/218 contained many statements that were surprising at present and that could not have been made one or two years earlier by any of the centrally planned economies. In Romania, prices, the exchange rate, and interest rates clearly played a much greater role than they had in the past, and the authorities fully agreed with Executive Directors who had said that further steps in that direction should be taken in the coming period. The authorities' own intention in that respect had been captured in the term "study" used in the letter of intent. The authorities had good reason to make their advance commitment in the form of studies because some of the important elements needed to make correct decisions were unknown at the present stage. For instance, during the most recent discussions between the authorities and the staff there had been substantial uncertainties about what should be considered the world price level for natural gas; that was one of the matters that would be studied in the coming months. It was difficult to determine the correct exchange rate and the appropriate composition of a currency basket six months in advance, and he agreed with Executive Directors who had said that it was awkward for Romania to commit itself to a particular exchange rate six months in advance. However, that commitment should be seen in the context of the negotiations with the staff: it had been better for the Fund to obtain a commitment for six months in advance rather than no commitment at all, and it had been more feasible for the authorities to make a commitment for a period six months in the future than to make a commitment that would have to be met immediately. Given the particular working of the Romanian system, the advance announcement of the exchange rate should not have a significant adverse effect.

A number of Executive Directors seemed to believe that the authorities should introduce measures rather than merely promise to study them, Mr. Polak said. In fact, the authorities had announced major adjustments on all policy fronts: exchange rate--a major simplification of the exchange rate system had occurred, although, as Mr. de Groote had noted, three different rates could still be recognized--energy prices, and interest rates. Any government found it difficult to adopt measures that were not usually characteristic of its basic economic system; the Romanian authorities had only recently recognized the value of the price mechanism. In the circumstances of Romania, one ought to be pleased that the glass was three quarters full rather than to regret that one quarter remained to be filled. That image seemed to capture the different opinions that had been expressed by Executive Directors during the present discussion.

When they had undertaken debt rescheduling discussions with the German authorities in November 1982, Mr. Polak explained, the Romanian authorities had intended to bring the discussions to a quick conclusion. In fact, at the request of the German authorities the discussions had been interrupted and were to be resumed sometime after January 1, 1983. The plans were satisfactory to the German authorities, and the draft decision as it stood properly reflected the present situation.

Mr. Grosche said that it was useful to distinguish between the official credits <u>in toto</u> and the short-term official credits that would not be included in the agreement that was to be reached between the Romanian and German authorities.

The Executive Board then turned to the proposed decision, which it approved.

The decision was:

1. Romania has consulted with the Fund in accordance with paragraph 5(b) 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 review developments under its economic program and reach understandings regarding the circumstances in which further purchases can be made.

2. The attached letter from the Minister of Finance dated dated November 9, 1982 setting forth the objectives and policies which the Government of Romania will pursue during 1982, shall be annexed to the stand-by arrangement for Romania and the letters of May 26, 1981 and April 20, 1982 shall be read as supplemented and modified by the letter of November 9, 1982.

3. The Fund decides, pursuant to paragraph 6 of Executive Board Decision No. 7144-(82/86), that satisfactory arrangements have been made for the rescheduling of outstanding payments arrears and debt payments falling due in 1982.

4. The Fund notes the limit on the trade balance in convertible currencies, and the limit on net domestic assets of the banking system, for December 31, 1982 referred to in paragraphs 2 and 9, respectively, of the attached letter of November 9, 1982.

5. In light of paragraph 2 of the attached letter of November 9, 1982, the limit on gross convertible international reserves referred to in paragraph 5(c)(i) of Executive Board Decision No. 7144-(82/86) shall be amended as specified in paragraph 2 of the letter of November 9, 1982.

6. Purchases under the stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 450 million through December 31, 1982 nor the equivalent of SDR 817.5 million through December 31, 1983. At the same time of the review referred to in the final clause of the second sentence in paragraph 19 of the letter of April 20, 1982 the Fund will establish the phasing for 1983.

Decision No. 7277-(82/164), adopted
December 20, 1982

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/82/163 (12/20/82) and EBM/82/164 (12/20/82).

2. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the appointment set forth in EBAP/82/437 (12/16/82).

Adopted December 20, 1982

APPROVED: May 23, 1983

LEO VAN HOUTVEN
Secretary