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Statement by Mr. Polak on Romania
Executive Board Meeting
December 20, 1982

The Board discussed Romania as recently as six months ago--on June 21 of this year--when it considered at the same time 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 about the progress achieved with 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.

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 (had) 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. In view of the fact that 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 down payment 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 down payment; 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 governmental 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 stop-gap measures.

I would like to commend the staff for the very careful analysis they present in Annex II 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." (EBS/82/218, p. 37). 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 on 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 allowed 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 in 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 of 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.