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September 30, 1991

To: Members of the Executive Board

From: The Acting Secretary

Subject: Exceptional Balance of Payments Assistance for Central and Eastern European Countries - Review of Experience in 1991 and Preliminary Estimates of Financing Needs for 1992

Attached for the information of Executive Directors is a paper, prepared jointly by the Fund staff and the staff of the Commission of the European Communities, on exceptional balance of payments assistance for Central and Eastern European Countries.

Mr. Deppler (ext. 4610) is available to answer technical or factual questions relating to this paper.

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MANAGING DIRECTOR

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To: Members of the Executive Board September 30, 1991

From: The Managing Director

Subject: Exceptional Balance of Payments Assistance for Central and Eastern Europe

The attached note, prepared jointly by the Fund staff and the staff of the Commission of the European Communities, reviews the experience with mobilizing financial assistance in 1991 and presents preliminary estimates of financing needs for 1992. The note was prepared for the meeting of senior Finance Ministry officials of the Group of 24 industrial countries and representatives of international financial institutions to be held in Bangkok, October 16, 1991.

Commission of the
European Communities

International Monetary Fund

Exceptional Balance of Payments Assistance for Central and Eastern European Countries: Review of Experience in 1991 and Preliminary Estimates of Financing Needs for 1992

September 23, 1991

Paper prepared for meeting of senior Finance Ministry officials of the Group of 24 industrial countries and representatives of international financial institutions to be held in Bangkok, October 16, 1991.

Concerted support for the countries of Central and Eastern Europe in their efforts to advance political and economic reforms was launched at the economic summit in Paris in July 1989. From the outset, the initiative, which was joined by 24 countries (G-24) under the coordination of the European Commission, 1/ attached both political and economic conditions to the provision of assistance. The political conditions included the rule of law, the respect of human rights, the introduction of multiparty parliamentary systems, and the holding of free and fair elections; the economic conditions were the adoption of appropriate macroeconomic policies and structural reforms to promote economic transformation and rapidly establish market economies. The concerted effort was initially confined to Hungary and Poland, but was soon broadened to cover most countries of Central and Eastern Europe as they began to meet these conditions. 2/

The G-24 initiative comprises a broad range of support schemes, with the early emphasis on humanitarian and technical assistance. During the course of 1990, it was increasingly recognized that severe financial difficulties were emerging which threatened the economic and political transformation process that had been initiated. Risks of delays in the unification of exchange markets and introduction of currency convertibility for current account transactions--crucial elements in the transition to a market economy--were particularly important considerations. The coordinated assistance was consequently broadened to include exceptional balance of payments support.

In the event, exceptional balance of payments assistance was considered for four countries, on a case-by-case basis, in step with the progress made in the negotiations of arrangements for the use of IMF resources. 3/ Total estimated financing shortfalls amounted to US$3.3 billion in 1991. To date, about US$2.8 billion has been pledged for 1991 by 21 members plus Kuwait and Saudi Arabia (the latter two for the Czech and Slovak Federal Republic only, see Table 1-5). The process led to relatively quick indications of commitments in the case of the Czech and Slovak Federal Republic and Hungary. In contrast, pledges of support still remain well below the identified financing gaps in the case of Bulgaria and Romania. In the

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1/ Several international organizations (BIS, EBRD, EIB, IBRD, and IMF) also participate in the work of the G-24.

2/ At the present time, the G-24 initiative covers Hungary, Poland, the Czech and Slovak Federal Republic, Yugoslavia, Bulgaria, Romania, and more recently Albania. No formal decision has been taken as yet with respect to Estonia, Latvia, and Lithuania, but their inclusion is expected to be discussed at a G-24 high level meeting in October.

3/ Czech and Slovak Federal Republic, Hungary, Bulgaria, and Romania. Poland has received substantial balance of payments relief in the form of a debt reduction agreement with Paris Club creditors, in addition to a US$1 billion currency stabilization fund established by G-24 countries for 1990 and subsequently renewed for 1991.

absence of a successful resolution of the burden-sharing issue among the G-24 countries, there is a serious risk that the actual assistance for these two countries could be well below the agreed targets. 1/

Notwithstanding the success of the initiative in mobilizing financial support, delays in fulfilling assistance pledges have significantly diminished the actual capital inflow compared with the identified needs. Thus, as of mid-September 1991, less than US$1 billion had been disbursed. The delays have necessitated several waivers or modifications of performance criteria with respect to the build-up of reserves stipulated in the arrangements with the Fund.

With respect to the modalities for the assistance that has been pledged, the G-24 have reached a broad consensus on a set of common guidelines. Key elements of the agreed guidelines are:

- The assistance will be provided as grants, official guarantees or loans, provided these are untied. Cofinancing of World Bank loans is also deemed to qualify for inclusion in the initiative.

- Loans are provided on a medium-term basis (minimums of five years) at an interest rate reflecting the creditor's own borrowing costs.

- The assistance is disbursed in one or several tranches subject to performance criteria. Macroeconomic performance criteria are exclusively those agreed with the IMF. 2/

The implementation of the balance of payments assistance is coordinated through an ad hoc group under the Brussels Network, including representatives of contributing G-24 and third countries and of the multilateral financial institutions.

The initial estimates of financing needs reflected the sharply higher oil prices projected for 1991 as a result of the Middle East crisis as well as the reform of the CMEA, including transition to world market prices. The decline of oil prices in early 1991 reduced the estimated financing needs by about US$1 billion. However, this was more than offset by the unexpectedly severe disruption of CMEA trade, notably with the U.S.S.R., and, in some cases, shortfalls of spontaneous capital inflows. As a result, initial

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1/ The European Community has pledged up to 50 percent of the identified financing gaps on the condition that other members of the G-24 and third countries provide matching amounts.

2/ The agreed guidelines are reproduced in Annex I.

projections of the exceptional financing needs of the countries of Central and Eastern Europe were maintained when reviewed at midyear, and have been revised only marginally since then (Tables 6 and 7). 1/

These relatively little-changed overall external financing requirements mask, however, a sharp deterioration in underlying economic developments with economic activity and import volumes in particular well below initial projections and unemployment substantially above. Estimates of the decline of gross domestic product during the two-year period since 1989 range from about 10 percent for the Czech and Slovak Federal Republic and Hungary, to about 20 percent for Poland and Romania, and as much as 40 percent for Bulgaria (Table 8), resulting in a cumulative drop for the region as a whole of 17 percent since 1989. During the same period, import volumes are estimated to have fallen by proportions ranging from 23 percent for Hungary to 59 percent for Bulgaria.

The reasons for this collapse of activity include the unexpectedly pronounced drop in CMEA trade, but also lesser adaptability of these economies to the reforms than had previously been thought the case. However, it is also clear that lack of foreign exchange and the resulting shortages of energy, other essential raw materials and imported inputs were important contributory factors in the case of Bulgaria and Romania--the two cases where the situation is particularly difficult and where the G-24 process has been less effective in mobilizing the agreed-upon financing in a timely manner.

These developments underline the crucial importance of carrying to a successful conclusion the assistance effort for 1991 as well as the need to continue the initiative during the period ahead with a careful evaluation of the needs of each country. In the first instance, this means following through promptly on existing pledges for 1991 and the rapid mobilization of remaining financing shortfalls for Bulgaria and Romania. Looking forward, it means continued financial assistance at a relatively high level in some cases in 1992 if the G-24 are successfully to support the transformation process in these countries and help governments retain popular support for reforms.

Needless to say, the formulation of programs of economic and financial policies and assessments of the need for additional financial assistance must reflect differences in the positions reached by individual countries and the likely availability of financing from private sources, including foreign direct investment. For several of the Central and Eastern European countries, however, private inflows must realistically be expected to remain modest in the foreseeable future.

1/ See, in particular, statement by the Fund representative at the G-24 Senior Officials Meeting of June 13, 1991; and "Financing of Programs in Eastern Europe", Memorandum from the Managing Director to members of the Executive Board, EBS/91/91, June 5, 1991.

The Czech and Slovak Federal Republic and Hungary have made considerable progress on the stabilization front. While further consolidation will be required, particularly in public finances, in order not to dissipate the gains achieved in narrowing domestic and external imbalances, it is expected that increasing attention will be given to strengthening the reform process. In Bulgaria and Romania, on the other hand, imbalances remain large due both to the fact that the initial domestic and external disequilibria were larger and to the particularly severe nature of the problems they faced in 1991. These countries therefore remain very much in the stabilization phase of their reforms and their need for support in 1992 remains correspondingly high. It is premature to attempt to quantify the possible financing needs of Albania and the three Baltic countries. The likely absence of private flows in the short-run, however, and the virtual absence of foreign exchange reserves suggest a likely substantial role for the G-24 in these countries. 1/

For the region as a whole, the contraction of economic activity is assumed to bottom out in 1992, but only a modest increase of output can be anticipated. This development would reflect a limited early response to the reforms already introduced, and to those envisaged for 1992. Even such weak levels of activity, however, would require an increase of import volumes, because shortages might otherwise intensify as initial inventories have been used up and also because investment is likely to involve a large import content in the early stages of transformation. With significant declines in real wages and absorption already in recent years, the scope for further reductions while retaining broad political support for reforms is likely limited. With respect to inflation, since most of the corrective price adjustments have already been implemented, a significantly more favorable performance is expected in 1992 than in 1991.

However, the risks would seem to be predominantly on the downside. A further decline of output in the U.S.S.R.--a distinct possibility in view of recent developments--would limit the recovery of exports to this important market for Central and Eastern Europe, with significant implications for economic activity and financing requirements. Also, the unprecedented nature and pace of the reforms being implemented make assumptions of the speed of responses to these changes highly uncertain. Should responses be slower than is now assumed, financing requirements may become larger in order to safeguard minimum levels of domestic consumption.

The estimates of financing needs for 1992 shown in Table 9 are preliminary projections prepared by the Fund staff, consistent with the path

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1/ For Albania, a first meeting of the G-24 (organized jointly by the European Commission and the UNDP) has been held, which focussed on the provision of near-term emergency assistance of food and of a humanitarian nature. It is envisaged that 1992 financing estimates for Albania will be available toward the end of 1991.

of medium-term adjustment and reform envisaged in the formulation of economic and financial programs for 1991, adjusted in light of developments since the beginning of the year. Present estimates suggest a reduction of overall financing needs of about US$3.0 billion compared to 1991 for the five countries included and a similar reduction of the size of exceptional financial assistance from the Fund and the G-24. The policies underlying these projections have been specified only in broad terms. These policies and more refined projections of the balance of payments for each country, possibly involving larger imports and financing gaps, will be given greater precision in the context of discussions with country authorities of programs for 1992.

For those countries that currently benefit from G-24 balance of payments assistance, the need for additional exceptional official assistance would be somewhat lower in 1992 than in 1991, because of progress made in adjustment as well as increases in private flows in some cases. Present estimates indicate that there would be no need for additional exceptional financial assistance for Hungary and Poland. For Hungary, this reflects in part the assumed disbursement in 1992 of the third tranche of the loan granted by the EC in February 1990 (prior to the G-24 initiative) and buoyant direct investment flows; 1/ and, for Poland, the substantial frontloading of cash flow assistance included in the reduction of official debt. For both Hungary and Poland, identified capital inflows also include disbursements from the Fund under the multi-year extended arrangements approved in 1991.

Preliminary estimates of financing gaps (after allowance for remaining disbursements under Fund arrangements now in effect and assuming full disbursement of G-24 assistance pledged for 1991) are estimated to range from US$0.6 billion for Czechoslovakia to US$0.8-0.9 billion for Bulgaria and Romania. Part of this could likely be met through disbursements under new arrangements from the Fund. However, this could only apply to part as the Fund could not be expected again to provide the exceptional access agreed to in 1991 stemming from the use of the oil element of the CCFF and the need to support the exchange rate stabilization of some programs. There will thus remain a critically important financing role for the G-24. 2/ However, the prospective magnitude of exceptional assistance from the G-24 will be significantly smaller than in 1991, consistent with the premise underlying the initiative that this type of assistance would be transitory.

1/ The 1990 EC loan amounted to Ecu 870 million, disbursed in three tranches.

2/ In addition a consultative group to channel external assistance has been proposed by Bulgaria, and efforts are under way with the World Bank coordinated with the European Commission for a first meeting later in the year.

Given the continued weakness of economic activity throughout the region (including the U.S.S.R.), the projections assume that growth can be supported and the size of current account deficits contained by expanding exports to alternative markets. This assumption in turn supposes access to these markets. Assumed increases in export volumes for 1992 range from 4-8 percent, in most cases well above the growth of demand in partners' markets. The access of exports of countries of Central and Eastern Europe to western markets has improved in recent years through the dismantling of selected import restrictions, the extension of most-favored-nation (MFN) treatment and generalized system of preferences (GSP) in some cases, and the relaxation of COCOM restrictions, with particularly strong increases of exports to markets of western Europe (Table 10).

Further improvements in market access could result in a substantially stronger performance of exports in some cases. Recognizing that the success of the countries of Central and Eastern Europe in transforming their economies depended also on their access to expanding markets for their exports, heads of state or government of the G-7 undertook in London to improve access to industrial country markets, including in these more sensitive areas. The relaxation of restrictions in these areas on a comprehensive basis is a central element of ongoing negotiations in the Uruguay Round. For countries of Central and Eastern Europe, early liberalization of imports in EC markets is being discussed in the context of association agreements with the EC. This could be of substantial benefit for these countries as the EC is these countries' main western export market.

The financing needs for balance of payments purposes have been a primary focus of G-24 financial assistance given the urgency of these needs in the early stages of stabilization and reform. However, the success of the transformation process will also require increasing support in the form of more project-oriented support and financing. Some of those, including technical assistance in a broad range of areas, involve only limited financial outlays. In addition, in some cases, limits on budget deficits in order to reduce inflationary pressures and the need to contain domestic demand, consistent with the maintenance of uninterrupted debt service or other perceived external constraints, severely restrict resources available in the reforming countries. This particularly hampers the funding of appropriate safety nets--exacerbating tensions created by a more rapid pace of transformation--and investments in infrastructure, including credit and services which would promote a more rapid expansion of private sector activities. In those cases, larger financial assistance including from bilateral sources to support specific projects, which cannot now be financed from domestic budgets, could help facilitate an acceleration of reforms.

Main Issues for Discussion

In commenting on the experience in 1991 and the outlook for 1992 participants in the meeting may wish to address the following issues in particular:

(i) Delegates may wish to comment on possible means to speed up disbursements of pledges of assistance for 1991, and discuss how delays encountered in 1991 could be avoided in 1992.

(ii) Delegates may wish to comment on how the remaining financing needs for 1991 of Romania and Bulgaria can be covered.

(iii) Delegates may wish to comment on prospects for exceptional balance of payments assistance to Eastern Europe in 1992. The level of Fund involvement in 1991 was exceptional; it reflected both disbursements under the oil facility and the unusually high access levels agreed for some countries in support of the transition to convertibility. With a return to normal levels of Fund access in 1992, the estimated financing needs for 1992 point clearly to a continuing role for the G-24 process in the case of Bulgaria, the Czech and Slovak Federal Republic and Romania. Delegates may wish to comment on the likely scale of G-24 support in 1992 in these cases in advance of the formulation of economic and financial programs. Financial needs will also likely arise for Albania and the Baltic countries.

Table 1. G-24 Balance of Payments Assistance
to Central and Eastern Europe in 1991

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

	Czechoslovakia (US$1,000 million)		Hungary (US$500 million)		Bulgaria (US$800 million)		Romania (US$1,000 million)	
	Contribution	Percent Share of Total Effort	Contribution	Percent Share of Total Effort	Contribution	Percent Share of Total Effort	Contribution	Percent Share of Total Effort
Community	500	50	250	50.0	400	50.0	500	50.0
Japan	200 2/	20	150 2/	30.0	100 2/	12.5	100 2/	10.0
Austria	50	5	20	4.0	20	2.5	25	2.5
Finland	15	1.5	10	2.0	10	1.3	pos. indic.	
Norway	16	1.6	15	3.0	13	1.6	15	1.5
Sweden	25	2.5	20	4.0	20	2.5	25	2.5
Switzerland	40	4.0	30	6.0	32	4.0	40	4.0
Turkey	1	0.1	1	0.2	unlikely		unlikely	
Canada	25	2.5	12.5	2.5	9	1.1	22	2.2
United States	15	1.5	10	2.0	10	1.3	unlikely	
Iceland	--	--	pos. indic.		pos. indic		pos. indic.	
Saudi Arabia	60	6.0						
Kuwait	50	5.0						
Total	997	99.7	518.5	103.7	614	76.8	727	72.7

Source: European Commission.

1/ Dollar amounts are approximate. Where pledges have been formulated in national currency or in ecu, conversion rates are based on rates of exchange prevailing at the time the request for assistance was first considered by the G-24.
2/ Cofinancing of World Bank SAL.

Table 2. G-24 Financial Assistance to Bulgaria
Review of Individual Arrangements

(Status as of September 20, 1991)

Country	Amount	Loan/Grant	Duration	Tranches	Disbursements	Conditionality
EC	Ecu 290 million	Loan	Maximun 7 years	2	August 1991: Ecu 150 million	EC memorandum/IMF
Japan	US$100 million 1/	Loan	n.a.	n.a.	Agreement expected November 1991	World Bank
Austria	S 210 million	Loan	Maximum 7 years	2	1st tranche expected 4th quarter 1991	IMF
Finland	US$10 million	Loan	Maximum 7 years	2	1st tranche expected end-1991	IMF/G-24 guidelines
Norway	US$13 million	Loan	n.a.	n.a.	n.a.	IMF/G-24 guidelines
Sweden	US$20 million	Loan	Maximum 7 years	2 EC loan pattern	1st tranche expected end-1991	IMF
Switzerland	US$32 million	Loan	Maximum 7 years	n.a.	Expected end-1991/early 1992	n.a.
Canada	CAN$10 million	Loan	Maximum 7 years	2	1st tranche expected end-1991	IMF
United States	US$10 million	Grant	--	1	November 1991	World Bank

Source: European Commission.

1/ Cofinancing of World Bank SAL.

Table 3. G-24 Financial Assistance to Hungary
Review of Individual Arrangements

(Status as of September 20, 1991)

Country	Amount	Loan/Grant	Duration	Tranches	Disbursements	Conditionality
EC	Ecu 180 million	Loan	Maximun 7 years	2	August 1991: Ecu 100 million	EC memorandum/IMF
Japan	US$150 million 1/	Loan	n.a.	n.a.	Agreement signed on 8/8/91	World Bank
Austria	S 210 million	Loan	Maximum 7 years	2	1st tranche expected October 1991	IMF
Finland	US$10 million	Loan	n.a.	2	1st tranche expected Autumn 1991	IMF/G-24 guidelines
Norway	US$15 million	Loan	Maximum 7 years	n.a.	Agreement expected October 1991	IMF/G-24 guidelines
Sweden	US$20 million	Loan	Maximum 7 years	1	Agreement expected end-October 1991	IMF
Turkey	US$1 million	Grant	--	1	n.a.	None
Switzerland	US$30 million	Loan	Maximum 7 years	1	Expected Autumn 1991	IMF
Canada	US$12.5 million	Loan	Maximum 7 years	2	1st tranche expected end-1991	IMF
United States	US$10 million	Grant	--	n.a.	October 1991	World Bank

Source: European Commission.

1/ Cofinancing of World Bank SAL II.

Table 4. G-24 Financial Assistance to Romania
Review of Individual Arrangements

(Status as of September 20, 1991)

Country	Amount	Loan/Grant	Duration	Tranches	Disbursements	Conditionality
EC	Ecu 375 million	Loan	Maximun 7 years	2	1st tranche expected November 1991; bridge loan Ecu 180 million: September 1991	EC memorandum/IMF
Japan	US$100 million 1/	Loan	n.a.	n.a.	n.a.	World Bank
Austria	US$25 million	Loan	n.a.	2	1st tranche expected 4th quarter 1991	IMF
Finland	pos. indic.	n.a.	n.a.	n.a.	n.a.	n.a.
Norway	US$15 million	Loan	n.a.	n.a.	n.a.	IMF/G-24 guidelines
Sweden	US$25 million	Loan	n.a.	2	n.a.	n.a.
Switzerland	US$40 million	Loan	n.a.	n.a.	n.a.	n.a.
Turkey	unlikely	--	--	--	--	--
Canada	US$22 million	Loan	Maximum 7 years	2	1st tranche expected November/ December 1991	IMF
United States	unlikely	--	--	--	--	--

Source: European Commission.

1/ Cofinancing of World Bank SAL.

Table 5. G-24 Financial Assistance to Czech and Slovak Federal Republic
Review of Individual Arrangements

(Status as of September 20, 1991)

Country	Amount	Loan/Grant	Duration	Tranches	Disbursements	Conditionality
EC	Ecu 375 million	Loan	Maximun 7 years	2	August 1991: Ecu 185 million	EC memorandum/IMF
Japan	US$200 million 1/	Loan	10 years	n.a.	Negotiations ongoing	World Bank
Austria	S 500 million	Loan	7 years	2	1st tranche expected October 1991	IMF
Finland	US$15 million	Loan	Maximum 7 years	2	1st tranche expected end-1991	IMF/G-24 guidelines
Norway	US$16 million	Loan	5-7 years	1	Agreement expected October 1991	IMF/G-24 guidelines
Sweden	US$25 million	Loan	Maximum 7 years	1	Agreement expected October 1991	IMF
Switzerland	US$40 million	Loan	7 years	1	Agreement expected October 1991	IMF
Turkey	US$1 million	Grant	--	1	Expected October 1991	None
Canada	US$25 million	Loan	7 years	2	1st tranche expected Autumn 1991	IMF
United States	US$15 million	Grant	--	1	Expected Autumn 1991	World Bank
Saudi Arabia	US$60 million	n.a.	n.a.	n.a.	No date for disbursement available	n.a.
Kuwait	US$50 million	Loan	5 years	2	Agreement expected October 1991	EC memorandum

Source: European Commission.

1/ Cofinancing of World Bank SAL.

Table 6. Eastern Europe: Revised Balance of Payments Outlook and Financing Needs, 1991

(In billions of U.S. dollars)

	Bulgaria		Czechoslovakia		Hungary		Poland		Romania	
	Initial	9/91	Initial	9/91	Initial	9/91	Initial	9/91	Initial	9/91
Current account	-2.0	-2.0	-2.5	-1.5	-1.2	-0.8	-2.7	-3.7	-1.7	-2.4
Other capital 1/	-1.0	-0.9	0.4	-0.6	-2.7	-2.5	-4.6	-5.9	-0.3	0.1
Reserve change (increase -)	-0.5	-0.5	-1.6	-1.1	-0.9	-0.9	-0.7	1.1	-0.7	-0.5
Elimination of arrears	-0.4	-0.4	--	--	--	--	--	2.2	--	--
Financing requirements	3.9	3.8	3.7	3.2	4.8	4.2	8.0	6.3	2.7	2.8
Financing	3.9	3.8	3.7	3.2	4.8	4.2	3.7	6.3	2.7	2.8
Private capital 2/	1.6	1.6	1.0	0.9	2.1	1.9	0.3	0.3	0.5	0.6
Of which:										
Direct investment	(0.1)	(0.1)	(0.4)	(0.6)	(0.6)	(0.7)	(0.3)	(0.1)	(0.1)	(0.1)
Debt relief	(1.5)	(1.5)	--	--	--	--	--	(--)	--	--
Official capital	2.3	2.0	2.7	2.3	2.7	2.3	3.4	6.0	2.2	2.2
World Bank and parallel financing 3/	0.3	0.2	0.3	0.2	0.5	0.5	0.6	0.4	0.3	0.3
EC (outside G-24) 4/	--	--	--	--	0.4 5/	0.4	...	0.1	--	--
G-24 6/	0.8	0.6	1.0	0.8	0.6	0.4	--	--	1.0	0.7
Debt relief	0.7	0.9	--	--	--	--	1.9	5.0	--	--
Use of Fund resources	0.5	0.4	1.4	1.3	1.2	1.0	0.9	0.5	0.8	0.8
Remaining financing gap	--	0.2 7/	--	--	--	--	4.3	--	--	0.3 7/8/

Sources: "The Role of the Fund in Assisting Eastern European Countries," SM/91/46 and update 3/8/91; and IMF staff estimates.

1/ Includes amortization (including Fund repurchases); short-term trade credit; and utilization of CMEA balances accumulated under the CMEA trading system.
2/ Includes officially supported export credits.
3/ Excludes parallel financing that is part of G-24 process.
4/ PHARE and other asistance is included in the capital account.
5/ Second tranche of loan approved February 1990. Does not include additional contribution to 1991 financing.
6/ Includes parallel financing of World Bank loans when part of G-24 process.
7/ Noncommitted assistance (as of mid-September 1991) being sought from the G-24.
8/ With recent developments in Romania, the financing gap could be larger. In particular, discussions for the World Bank SAL could be delayed which would delay disbursement of the first tranche of the SAL and of cofinancing from Japan.

Table 7. Eastern Europe: Estimated Current Account Balances, 1991 1/

(In billions of U.S. dollars)

	Bulgaria		Czech and Slovak Federal Republic		Hungary		Poland		Romania	
	Initial	9/91	Initial	9/91	Initial	9/91	Initial	9/91	Initial	9/91
Exports	6.6	4.2	12.6	10.7	12.6	10.8	15.0	13.7	5.4	3.9
Imports	-8.0	-5.5	-14.9	-12.0	-12.1	-10.9	-15.0	-14.4	-7.0	-6.2
Trade balance	-1.5	-1.3	-2.3	-1.3	0.5	-0.1	0.0	-0.7	-1.6	-2.3
Services and transfers, net	-0.5	-0.8	-0.2	-0.3	-1.7	-0.7	-2.7	-3.0	-0.1	-0.1
Of which:										
Net interest payments 2/	-1.0	-0.9	-1.0	-0.9	-1.8	-1.6	-4.0	-3.6	-0.1	-0.1
Current account balance	-2.0	-2.0	-2.5	-1.5	-1.2	-0.8	-2.7	-3.7	-1.7	-2.4

Source: IMF.

1/ **Numbers may** not add up **precisely** due to rounding.
2/ For **Bulgaria**, **interest** payments due.

Table 8. Eastern Europe: Economic Activity, Domestic Demand and Imports, 1991

(1989=100)

	Bulgaria	Czech and Slovak Republic	Hungary	Poland	Romania
GDP	59	87	91	79	83 1/
Domestic demand	...	...	89	79	...
Imports	41	62	77	103	70
Of which:					
CMEA	(28)	(35)	(40)	(35)	(20)
Non-CMEA	(71)	(106)	(119)	(168)	(143)

Sources: Data provided by national authorities and IMF staff estimates.

1/ A decline of 5.8 percent had already taken place in 1989, bringing the cumulative decline since 1988 to 21 percent.

Table 9. Eastern Europe: Preliminary Balance of Payments Outlook and Financing Needs in 1992 1/

(In billions of U.S. dollars)

	Bulgaria	Czech and Slovak Republic	Hungary	Poland	Romania
Current account	-1.7	-1.5	-0.4	-0.9	-1.8
Other capital 2/	-0.7	-0.2	-2.7	-1.9	-0.2
Reserve change (increase -)	-0.3	-0.6	-0.6	-0.2	-0.3
Elimination of arrears	--	--	--	-2.9	--
Financing requirements	2.7	2.3	3.7	5.9	2.3
Financing	2.7	2.3	3.7	5.9	2.3
Private capital 3/	1.3	0.9	2.2	3.9	0.9
Of which:					
Direct investment	(0.1)	(0.6)	(0.8)	(0.2)	(0.2)
Debt relief	(1.1)	(--)	(--)	(3.3)	(--)
Official capital	0.5	0.8	1.4	2.3	0.6
Of which:					
World Bank	(0.1)	(0.3)	(0.4)	(1.1)	(0.3)
EIB/EBRD	(0.1)	(0.1)	(0.2)	(0.3)	(0.1)
EC (outside G-24)	(--)	(--)	(0.3) 4/	(--)	(--)
Program spillovers (G-24) 5/	(--)	(0.2)	(0.1)	(--)	(--)
Debt relief	(0.3)	(--)	(--)	(--)	(--)
Use of Fund resources 6/	(0.1)	(0.1)	(0.4)	(0.6)	(0.1)
Remaining financing gap 7/	0.9	0.6	--	--	0.8

1/ Components may not add to total due to rounding.
2/ Includes amortization (including Fund repurchases); short-term trade credit; and utilization of CMEA balances accumulated under the CMEA trading system.
3/ Includes officially supported export credits.
4/ Third tranche of loan approved February 1990.
5/ Amounts committed in 1991 known not to be disbursed until 1992. Other (unprogrammed) spillovers would lower imports or reserves in 1991, which would need to be reversed in 1992, and thus would not lower 1992 financing requirements.
6/ Existing commitments only.
7/ Before new arrangements from the Fund and disbursements from the G-24.

Table 10. Evolution of Trade Flows from and to Central and Eastern Europe 1/

(In millions of U.S. dollars)

	1989	1990	Percent Change
		Total Exports	
To:			
EEC	20,989	26,215	24.9
EFTA	4,086	4,769	16.7
USA	2,012	1,895	-5.8
Japan	690	633	-8.3
Canada	347	353	1.8
		Total Imports	
From:			
EEC	20,371	26,044	27.8
EFTA	4,847	6,151	26.9
USA	1,424	1,671	17.4
Japan	759	1,068	40.7
Canada	132	146	10.6
		Trade Balances	
With:			
EEC	618	171	
EFTA	-761	-1,382	
USA	588	224	
Japan	-69	-435	
Canada	215	207	

Sources: National sources, OECD, and Eurostat.

1/ Bulgaria, CSFR, Hungary, Poland, Romania, Yugoslavia.

ANNEX I

COMMISSION
OF THE EUROPEAN
COMMUNITIES

Directorate-General
for Economic and Financial Affairs

Brussels, 14 June 1991
DOC II/056/91

COMMON GUIDELINES FOR COORDINATED G-24

EXCEPTIONAL BALANCE OF PAYMENTS ASSISTANCE TO

CENTRAL AND EASTERN EUROPE*

* The attached document reflects the text endorsed by the majority of G-24 members at the High Level meeting on 13 June 1991.

14 June 1991

COMMON GUIDELINES FOR COORDINATED G-24 EXCEPTIONAL BALANCE OF PAYMENTS ASSISTANCE TO CENTRAL AND EASTERN EUROPEAN COUNTRIES

1. Objectives

The G-24 medium term balance of payments assistance is subject to the general political and economic conditions attached to the overall G-24 concerted action in favour of the Central and Eastern European countries (CEEC). The common goal for this financial assistance is to provide support for the balances of payments of these countries with a view to ensuring a sustainable financial situation that will allow for the continuation of the political and economic reform process towards the establishment of democracy and market oriented economies and ultimately lead to a rapid transition to reliance on financing from private sources.

The balance of payments assistance complements resources from the IMF, the World Bank and other multilateral financial institutions that are being mobilised to help the CEEC confront the immediate problems of the difficult external environment in 1991, including a large terms of trade loss vis-à-vis the Soviet Union, a sharp contraction of intra-CMEA trade and the Gulf crisis, together with the need to strengthen the level of international reserves in order to facilitate the introduction of currency convertibility.

The assistance is exceptional in nature and transitional. For 1991, balance of payments assistance is considered within the frame of reference of the $4 billion that potentially would be required according to estimates by the IMF and the European Commission, as discussed by the European Council in December 1990 and the High Level meeting of the G-24 in January 1991. An assessment of the financing outlook for 1992 will be presented to the G-24 in the fall of 1991 by the European Commission on the basis of estimates to be provided by the IMF.

2. Criteria for Financial Support

Requests for G-24 balance of payments assistance are assessed on a case by case basis, taking into account the specific circumstances of the countries concerned. The basic criterion for complementary assistance is the implementation of a strong economic programme of stabilisation and comprehensive reforms aimed at establishing open market-based economies together with the existence of a residual financing gap that cannot be covered through other sources of financing. The policy programme must be agreed and supported by the IMF and other multilateral financial institutions. The assessment of the financing gap is made on the basis of estimates provided by the IMF.

In addition, any complementary financing under consideration should take account of the scope for adjustment under the arrangements with the IMF as well as the outlook for non-debt creating flows, official multilateral financing (World Bank, EBRD, EIB and the IMF), bilateral official grants and credits, including export credits, debt restructuring agreements with both official and private creditors. It should also take into account the pre-eminent role of private sector finance in the medium to long term, including borrowing from commercial banks and international credit markets. G-24 balance of payments assistance should not be available to finance private sector outflows or government budget deficits.

3. Modalities

The coordinated G-24 balance of payments assistance includes grants, official guarantees or loans, provided these are untied; trade credits would not meet the primary need of covering a financing gap.

Loans (or official guarantees) are provided on a medium-term basis (minimum of 5 years). The interest rate on the loans should reflect the cost of borrowing on the capital markets, of the

European Community and the contributing G-24 countries. The loans can be disbursed in tranches subject to compliance with performance criteria.

The macroeconomic performance criteria will be exclusively based on the conditionality agreed with the IMF. Non-economic and structural adjustment criteria may be included to the extent that these are fully consistent with the agreements reached between the IMF and the World Bank, and the borrowing countries.

Untied parallel financing by G-24 countries of World Bank structural adjustment loans to the CEEC is also considered to be part of the overall G-24 medium-term financial assistance. In this case the conditionality will be based on the World Bank's performance criteria.

In servicing the G-24 balance of payments assistance, the borrowing countries will be expected to provide equal treatment to members of the G-24, the European Community, and other third countries participating in this effort.

4. Coordination and decision-making

The evaluation of requests for G-24 balance of payments assistance takes place at the level of the Brussels Network, including as appropriate financial experts from contributing countries, and in coordination with the appropriate international bodies. The IMF and the other multilateral financial institutions should take part in this work. This forum and the G-24 High Level Group will also contribute to the discussion of issues relevant to equitable burden-sharing among G-24 countries. After full evaluation based on the provision of adequate data, precise and separate decisions on financial assistance will be taken by the appropriate authorities of G-24 participants and communicated to others in the Brussels Network. The European Commission will ensure that potential donors outside the G-24 are invited to participate in the initiative.

The implementation of the G-24 assistance will be coordinated by a monitoring group of Financial Counsellors or other representatives of contributing G-24 and other third countries. This group, chaired by the European Commission, will monitor the implementation of the common guidelines and the disbursement of funds. It will also exchange information on the implementation of the economic reform programmes and assess the impact of G-24 medium-term financial support previously extended, to ensure that its objectives have been achieved.

THE COMMUNITY'S POLICY ON FINANCIAL ASSISTANCE TO CENTRAL AND EASTERN EUROPE

The Commission, drawing on work carried out in close collaboration with the Fund and the World Bank, presented in December 1990 an estimate of the complementary financing needs of the Central and Eastern European countries in 1991 of around $ 4 billion. This amount was endorsed by the European Council in Rome as an order of magnitude of the financial assistance which the Community would seek to provide together with other members of the Twenty-Four and other third countries.

Following this decision, the Commission, as coordinator of the Twenty-Four and in close cooperation with the IMF, has presented four proposals for EEC/G-24 financing packages (Czechoslovakia, Hungary, Bulgaria and Romania) designed to complement the resources that will be provided by the IMF, the World Bank and official bilateral creditors. In each of these cases, the Community has indicated its willingness to contribute up to 50 percent on a matching basis.

Developments and Projections for Individual Countries

For the Czech and Slovak Federal Republic, an important consideration underlying the initial request for financial assistance was the perceived need for an early bolstering of reserves to support the program of stabilization and transformation, which relied importantly on a major up-front liberalization of prices and trade and the maintenance of a fixed exchange rate for the koruna. Prudent financial and incomes policies contained the initial price increase and balance of payments pressures, and early indications that the financial assistance requested would be provided may also have bolstered confidence that all elements of the program, including the fixed exchange rate for the koruna, would be sustained. However, smaller-than-expected inflows of private capital, including withdrawals by banks of short-term deposits and credit lines, and delays in disbursements of the official financial assistance resulted in a weaker-than-expected performance of the capital account of the balance of payments. While this was partly offset by a smaller current account deficit, which reflected in part lower oil prices and weaker domestic demand, gross official reserves remained very low through the first half of 1991. Despite recourse to gold swaps and bridging loans, reserves remained in the range US$1.2-1.7 billion during the first half of the year, equivalent on average to only 1.4 months of imports. Such reserves clearly would not have been sufficient to defend the exchange rate, a core element of the stabilization program, had external developments and expectations been less favorable. Reserves are now projected to increase to US$2.3 billion during the second half of 1991, still below the initial target.

For 1992, the projections assume increases in the volumes of exports and imports of, respectively, 8 percent and 10 percent. Given the depressed level of output and the large decline in the volume of imports in 1991, the projected level of imports would be essential to support a minimal recovery in economic activity in 1992. In addition, the impact of import liberalization may be felt with a lag as was the case in Poland. The current account deficit for 1992 is therefore projected at US$1.5 billion--a level unchanged from the estimate for this year. With regard to international reserves, the projections for 1992 mostly foresee making up the reserve build-up initially targeted for 1991. In the period ahead, the liberalized import and exchange system introduced under the program would be further tested and it would be important to have an adequate level of reserves to underpin the open trade and exchange environment and the fixed exchange rate peg.

For Hungary, major concerns underlying the initial request for financial assistance were the need to rebuild the confidence of private financial markets and to finance a sharply wider current account deficit due to terms of trade losses from the transformation of the CMEA and high oil prices. Because of fears that the latter could further undermine perceptions of Hungary's creditworthiness on financial markets, substantial financial support from official sources was hoped for at an early stage. Gross official reserves, at US$1.2 billion at end-1990, were equivalent to only about one month of imports and interest service obligations. This situation has since improved substantially, with reserves increasing to US$1.6-2.0 billion even while short-term liabilities were reduced. This favorable external performance reflected a much stronger-than-expected current account balance early in the year as a result both of temporary factors (notably an unwinding of leads and lags following the depreciation of the forint in January) and also underlying strength, including a strong growth of exports to western markets. The evidence of favorable early performance and the build-up of reserves from their very low level since early 1990 are having positive early effects on market perceptions of Hungary's creditworthiness. For 1991 as a whole, a stronger performance of the current account than initially projected is expected to be sufficient to offset shortfalls in capital inflows from both official and private sources and support achievement of the initially targeted increase of reserves to US$2 billion by end-1991, equivalent to 1.9 months of imports and interest servicing obligations.

Projections for 1992 are broadly in line with those underlying the Government's medium-term program published in 1991, which has as one of its main objectives arresting the growth of external debt. A modest recovery of GDP is assumed, with increases of the volume of imports and exports of, respectively, 4-5 percent and 7 percent. Capital inflows from private sources are also projected to be somewhat larger than in 1991 reflecting both the strong performance of foreign direct investment and improved access to capital markets as perceptions of creditworthiness continue to improve. Holdings of reserves at the end of 1992 would be equivalent to about 2.5 months of imports.

For both Bulgaria and Romania, in addition to the uncertain impact of major liberalization of prices and trade, estimates of financing requirements also had to take into account large initial excess demand conditions (repressed in the case of Romania) and virtually negligible levels of reserves. In both cases, the programs continue to be implemented in a most difficult domestic and external environment, including severe shortages of energy, other essential raw materials and imported inputs which are also in part responsible for the fall in output. Exchange rates have overshot, contributing to the excess of inflation over initial projections. The delays in mobilizing sufficient financial support has thus contributed to the increasingly difficult situation facing these two countries.

The output decline in Bulgaria (23 percent in the first half of the year) has been much larger than initially expected. With each passing month, the economic situation appears more difficult. As elsewhere, the main factor is the much greater than anticipated fall in trade with the U.S.S.R. (with the U.S.S.R. accounting for a larger share of Bulgaria's trade than any of the other countries of Central and Eastern Europe). In addition, severe financing constraints--including the virtual absence of trade financing--have greatly complicated economic management. Through June, notwithstanding a large decline of imports and the persistence of a more depreciated exchange rate than would be expected from a comparison of labor cost differentials, it has not been possible to build-up holdings of reserves beyond US$300 million, equivalent to less than one month of imports. Significant uncertainties remain concerning both the size and timing of official financial assistance and, thus, also the possibility of alleviating the most pressing shortages while allowing for an even minimal increase of reserves.

Against the difficult background of 1991, the preliminary projections for 1992 assume some pick-up of activity, with increases in the volume of non-oil imports and exports in the range of 3-4 percent. The agro-based sector is expected to play a major role in this modest recovery, together with the--hoped for--partial alleviation of external financing constraints. In the capital account, a concerted approach to debt issues will continue to be necessary. Bulgaria is expected to approach the Paris Club again for another rescheduling, and a further roll-over of debt service payments to commercial banks has been assumed. Against the background of the debt moratorium and Bulgaria's severely constrained capacity for debt service payment, negotiations with commercial banks on a medium-term resolution of the problem of private indebtedness are likely to be protracted. As a result, trade finance is not expected to be restored quickly, and its absence will continue to shackle the recovery. The projections for external financing are the basis for the expectation of some positive growth (about 1 percent) in 1992. Were financing availability to be restricted below these projections, Bulgaria will almost certainly experience another year--the third--of negative growth. Such a development would likely erode popular support for Bulgaria's bold reform program.

Economic activity in Romania has also been well below expectations, owing mainly to the significantly worse-than-anticipated external environment and shortfalls of external financing. With official foreign exchange reserves down to US$135 million in July, the weak financial position has contributed to a climate of uncertainty that is proving inimical to potential inflows from private sources (and contributing to domestic capital flight) and to private sector activities. As in the case of Bulgaria, the weak financial position has contributed to a more depreciated exchange rate than anticipated initially, which has further exacerbated already substantial increases of domestic prices. Again, as in the case of Bulgaria, significant uncertainties remain concerning the size and timing of official financial assistance. Balance of payments estimates for 1991 in Table 6 are those considered by the Executive Board of the IMF in early August 1991 in the context of the review of the stand-by arrangement for Romania. These estimates are still based on the assumption that the full amount of financial assistance requested from the G-24 would be forthcoming in 1991. As of now, however, this appears increasingly unlikely. Given the already precarious situation, substantial delays or shortfalls of financial assistance appear to threaten to a greater extent than in any other case the sustainability of the design of the program implemented so far, in particular in the areas of trade and domestic price liberalization.

At present, preliminary indications suggest that the authorities will need about US$0.8 billion of financing from the G-24/IMF in 1992. With this amount of financing, and despite an assumed increase of 7 percent in the volume of exports, Romania will only be able to finance a small increase in its net international reserves and a 3-4 percent rise in the volume of imports. It is essential that Romania at least partially reverse the decline in international reserves that occurred in 1991 in order to reduce the climate of uncertainty and to attempt to stabilize the external situation.