

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR
AGENDA

MASTER FILES

ROOM C-120

01

SM/86/224

CONTAINS CONFIDENTIAL
INFORMATION

August 28, 1986

To: Members of the Executive Board

From: The Acting Secretary

Subject: Romania - Staff Report for the 1986 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1986 Article IV consultation with Romania. A draft decision appears on page 19.

This subject has been tentatively scheduled for discussion on Friday, October 10, 1986.

Mr. R. P. Hicks (ext. 7187) or Mr. Reitmaier (ext. 7186) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

ROMANIA

Staff Report for the 1986 Article IV Consultation

Prepared by the European Department

(In consultation with the Exchange and Trade Relations,
Legal, Research, and Treasurer's Departments)

Approved by L. A. Whittome and J. T. Boorman

August 26, 1986

I. Introduction

A staff team consisting of Messrs. Brehmer (EUR, head), Hicks (EUR), Kim (RES), Reitmaier (EUR), Op de Beke (EP, EUR), and Ms. Svenson (TRE) as secretary held Article IV consultation discussions in Bucharest from June 17 to June 30, 1986. The mission met with representatives of the Ministry of Finance, the State Planning Committee, the State Committee for Prices, the Ministry for Foreign Trade, the Statistical Office, and the Romanian Bank for Foreign Trade. The mission was received by the Minister and Deputy Minister of Finance, the Governor of the National Bank, and the Deputy Chairman of the Romanian Bank for Foreign Trade.

The three-year stand-by arrangement for Romania, approved in June 1981 for an amount of SDR 1.1 billion (300 percent of quota), was canceled on January 31, 1984, leaving an amount of SDR 285 million undrawn. Romania's repurchase obligations total SDR 199 million in 1986 and SDR 226 million in 1987. On August 25, 1986, Romania's arrears vis-à-vis the Fund were SDR 84.7 million.

Romania continues to avail itself of the transitional arrangements under Article XIV.

In the absence of new loan commitments since 1982, Romania received net disbursements from the IBRD of only US\$10 million in 1984 and made net repayments of US\$111 million in 1985. Due to arrears, the Bank suspended its loan disbursements to Romania from May 13, 1986. Even if Romania's arrears to the Bank, which amounted to US\$109.2 million on August 25, 1986, 1/ were to be settled and a livestock feeds project were to be approved, no disbursements could be expected in the remainder

1/ For obligations that are overdue for more than 30 days; only these are reported by the Bank to its Board.

of 1986. IBRD loan disbursements in 1986 will therefore not exceed US\$7 million, while repayment obligations to the Bank are estimated at US\$178 million.

During the 1985 Article IV consultation, most Directors, while noting the role of central planning in the Romanian economy, regretted the shift in recent years away from more flexible pricing policies and expressed concern about the negative implications this shift would have for economic efficiency, economic growth, and the standard of living. In this context, most Directors stressed the importance of basing policy decisions on domestic prices and an exchange rate that reflected resource scarcities. Accordingly, they criticized the large revaluation in November 1984, and the emphasis placed on administered prices when making investment appraisals which could lead to decisions that were not conducive to improvements in economic efficiency and better resource allocation. While Directors did not question the desirability of reducing foreign debt, several suggested that a more gradual than envisaged reduction might have less adverse effects on economic growth and the standard of living and would relieve the strains on Romania's external liquidity position. Directors thought it appropriate for Romania to rebuild reserves with the help of foreign borrowing which would provide greater protection against the risk of payments arrears and obviate the need for restricting essential imports.

II. The Economic Situation

1. Background

Economic policies since 1980 have been directed toward rapidly reducing foreign debt by maintaining a substantial surplus on convertible current account. To meet this objective, the authorities have relied mainly on restraining investment, administrative cuts of imports, and import substitution. From end-1981 to end-1985, total convertible debt was reduced by US\$3.5 billion to US\$6.6 billion (12 percent of GDP), although of this decline roughly US\$0.8 billion was due to valuation changes. Nevertheless, Romania's credit standing has remained poor.

In the early 1980s the authorities amended their stance of policy in an effort to improve economic efficiency. In particular, lines of production involving a substantial use of scarce inputs were reduced in scale, the norms prescribing the permitted use of material inputs were lowered, investment was increasingly directed toward the exploitation of energy and mineral resources, and emphasis was placed on the recycling of used materials. In 1981-82 (under the Fund arrangement), selected domestic price increases, particularly for energy use, were adopted in order to promote a more efficient resource allocation. Since 1983 wage increases have been tied to increases in labor productivity. More recent policy steps, however, have been less promising. The Government, dissatisfied with the resulting price increases, returned in early 1983

to the objective of strict price stability and, in November 1984, reversed the devaluations of the leu adopted under the last program supported by an arrangement from the Fund. Accordingly, the allocative role of prices was reduced in favor of increased central planning and control.

2. Developments in 1985

Romanian national accounts statistics indicate an expansion of real GDP by 5.8 percent in 1985 compared with 7.2 percent in 1984 (Table 1). This recorded rate of growth was more than twice that of Romania's chief trading partners and was achieved despite adverse weather conditions and a pronounced slowdown in the rate of growth in labor productivity. Strongest expansion was registered in industry where net output rose by 7.8 percent, continuing the favorable performance of the two preceding years. Agricultural output was marginally above the record level of the previous year, although crop production was adversely affected by the drought. Total domestic demand rose by 5 percent largely on account of increased consumer spending.

Despite the reported slowdown in growth, the official national accounts data for 1985 still appear to overstate output performance by a considerable margin. An indicator of marketable industrial output ^{1/} suggests a rate of increase in 1985 significantly slower than estimated in the national accounts, while agricultural production would seem hard-pressed to have exceeded the record level of 1984 in view of the adverse weather conditions.

Furthermore, a continuing large discrepancy between reported total output and identified demand casts doubt on the realism of the national accounts statistics. Final domestic demand explains 5 percentage points of the growth in output in 1985, stockbuilding is estimated to have had virtually no effect on growth, while the net foreign balance made a negative contribution to growth of about 1 percentage point. The statistical discrepancy in the national accounts between the production and demand sides accounted for around 2 percentage points--or around one--third--of the growth in output in 1985. The statistical discrepancy may have been even larger given a possible overstatement of domestic demand due to an unexplained divergence between growth of the Consumption Fund ^{2/} (7.4 percent) and of retail sales (1.8 percent).

At the time of the 1985 consultation, the authorities still expected to achieve a convertible current account surplus in 1985 in

^{1/} Gross output either sold or maintained as inventories. For a breakdown see 1985 RED (SM/85/275), Table 11, p. 36.

^{2/} The Consumption Fund is the allocation of net material product for domestic consumption. It is comprised to a major degree of consumption by the population and to a minor degree of government consumption but excludes consumption of nonmaterial services (see SM/85/275, 10/2/85, Table 6).

excess of US\$1.5 billion, as in 1984, despite a serious setback suffered in the first quarter of the year. A strong rebound of exports in the second quarter led to an expectation that the earlier export losses could be recovered later in the year. In the event, the current account weakened in the third and fourth quarters so that the current account surplus for 1985 as a whole fell to US\$0.9 billion (Tables 3 and 4).

The decline in Romania's current account surplus in 1985 is explained by a decline in the volume of non-oil exports by 8 percent and in the unit value in U.S. dollar terms by 3 percent as well as an increase in the oil deficit. A regional breakdown of Romania's exports to nonsocialist countries shows that there was a roughly similar proportionate decline in exports to developed and developing countries. In explaining the disappointing export performance, the authorities pointed to the severe winter which had caused a fall in industrial production and a consequent loss of industrial exports early in the year, followed by the drought which had adversely affected agricultural exports in the fourth quarter. As for external factors, the authorities pointed to growing difficulties in gaining access to industrial country markets and to a softening of commodity prices. The U.S. dollar value of merchandise imports grew at a rate of nearly 3 percent and the deficit on services account was broadly as projected.

The shortfall from target in the current account surplus put unexpected strains on the capital account and the reserve position. Debt management policies proved too inflexible to deal with these strains. Despite the approach to commercial banks in May 1985 for a partial refinancing of two installments falling due in that year under the 1982 bank rescheduling and some short-term rollovers of other obligations falling due, there was a rapid deterioration in Romania's liquidity position in the second half of 1985. Romania's own extension of trade credit absorbed a net amount of US\$200 million as receipts from such credit remained broadly unchanged and payments declined. All told, Romania's foreign exchange reserves declined from US\$709 million at end-1984 to US\$199 million at end-1985, equivalent to only two weeks of convertible currency imports, which is considered by the authorities to represent minimum working balances (Table 6). Over the same period, Romania's nonreserve foreign assets--comprising mainly trade credits extended to developing countries--increased from US\$2.3 billion to US\$2.7 billion. The authorities stated that the latter figure included claims which were overdue of some US\$0.4 billion, an amount unchanged from 1984. The convertible currency debt service ratio amounted to almost 32 percent in 1985, up from 26 percent in 1984.

As regards the current account in nonconvertible currencies, exports increased in 1985 by 2 percent (expressed in U.S. dollars), while imports stagnated instead of increasing by over 8 percent as planned. As a result, following years of trade surpluses, Romania was again not able to achieve the projected net absorption of goods traded in non-convertible currencies. In the event, the nonconvertible trade surplus increased to about US\$0.3 billion (Table 2). In response to queries by

the staff team, the Romanian authorities explained that it had not been possible to obtain certain imports under countertrade arrangements from the nonsocialist, nonconvertible area. The Government had made several interventions to obtain fulfillment of the agreements.

3. Official forecast for 1986

Plan targets call for a real GDP increase of 9.4 percent in 1986 (Table 1). The projected growth rate is nearly three times higher than the average forecast by the Fund for Romania's chief trading partners. Achievement of this ambitious target depends importantly on the attainment of a large increase in labor productivity permitting a comparable rise in net industrial output with virtually no change in the level of material input. The Romanian representatives acknowledged that the productivity assumptions were indeed ambitious, but felt that new wage incentives for workers introduced in the latter part of 1985 would quickly achieve positive results, especially as they would be reinforced by new technologies and an improved training of workers. The authorities considered their projections realistic in view of the expansion of marketable industrial output by 11 1/2 percent in the first five months of 1986 as against the same period a year earlier; however, activity in the opening months of 1985 was depressed because of the severe winter weather. Official projections provide for an increase in net agricultural output of 7 percent in 1986, reflecting recovery from the drought as well as major improvements in agricultural technology.

Growth in final domestic demand in 1986 is again forecast to be substantially lower than the projected expansion in output. Fixed investment is forecast to increase by 7 1/2 percent and the traditional policy of ensuring a very large share (nearly 30 percent) of investment in total output would be continued. Investment policy would concentrate more than previously on improving existing capacity rather than on its further expansion (with the main exceptions being investment in the mining and energy sectors). This policy--aimed principally at improving the quality of output--would focus on modernization and a more efficient use of raw materials. The mission noted the continued emphasis of the investment program on producer--rather than on consumer--goods. With final consumption forecast to grow by a little below 3 percent, expansion in domestic demand is expected to account for about 4 percentage points of the growth in output. The net foreign surplus--projected in the national accounts to reach lei 73.4 billion (equivalent to about US\$4.5 billion) 1/--is to contribute a further 3 1/2-4 percentage points to growth, while plan reserves 2/ would provide the remaining 2 percentage points.

1/ This is much higher than the projected surplus on goods and non-factor services in the overall balance of payments of US\$1.6 billion. This suggests that the figure for exports in the national accounts is projected to again exceed substantially that in the balance of payments.

2/ Plan reserves are that part of production for which no allocation of domestic expenditure has yet been made.

The authorities expect the current account surplus in convertible currencies in 1986 to rise to US\$1.2 billion. This improvement will be based entirely on a decline in the oil trade deficit. The oil trade balance is determined by: (i) the volume of imported oil needed to supplement domestic production; and (ii) the value added resulting from Romania's sizable refining of imported crude oil for subsequent export. Romania as a net importer of oil stands to benefit from the sharp reduction in crude oil prices. The Romanian authorities said that they expected lower oil prices to raise world demand for oil products, thus permitting an increased utilization of Romania's refining capacity at a profit. The authorities expected that prices for oil products would decline less rapidly than crude oil prices, thus ensuring a profit margin on refining. Finally, the oil trade balance would benefit from a lower volume of oil imports for domestic use than in 1985, when weather conditions were unfavorable.

The projected small reduction in the non-oil trade surplus to US\$2.1 billion in 1986 results from large expected increases in the U.S. dollar value of exports (10 percent) and imports (27 percent). The increase in imports (over 20 percent in volume terms) would signal a turnaround in the past policy of import compression which would help alleviate supply constraints and permit the needed modernization of the capital stock. Non-oil exports are expected to benefit from export promotion policies and from the envisaged greater availability of imported inputs, but will be unfavorably influenced by trade restrictions abroad, the impact of sharply reduced oil prices on the purchasing power of important partner countries in the Middle East, and the nuclear accident in Chernobyl. The adverse effect of Chernobyl on agricultural exports to nonsocialist countries has been mitigated by purchases of such products by the U.S.S.R. on a convertible basis in exchange for oil.

The capital account in 1986 is again dominated by heavy medium- and long-term debt repayment obligations, estimated at US\$1.2 billion. About half of this amount is expected to be financed with new loans from the World Bank (US\$70 million) ^{1/}, government export credits (US\$200 million), and a rescheduling of US\$350 million due to commercial banks. In addition, the authorities have arranged for short-term roll-overs of several other financial obligations. Despite a considerable expansion of exports, the projected net extension of export credit is to fall below US\$200 million in 1986, a projection which, according to the authorities, contains a very conservative estimate for the collection of overdue credits owed to Romania. Overall, the balance of payments in convertible currencies is to show a surplus in 1986 of US\$510 million, to be split between repurchases to the Fund (US\$218 million) and an increase in reserves (US\$292 million).

Official projections for the current account in nonconvertible currencies reflect again the authorities' wish to bring about a deficit

^{1/} This figure appears to be too optimistic in view of the suspension of disbursements by the World Bank.

in these transactions (equivalent to some US\$150 million) through sharply increased imports.

III. Economic Issues and Policies

Amidst growing concern over Romania's tight external liquidity position, the central issues of the consultation discussions were debt management policies and the sustainability of a large current account surplus in convertible currencies. The authorities' approach to these issues is circumscribed by continued adherence to the fundamental policy objectives of a rapid reduction in external debt and the maintenance of strict price stability.

1. External debt management policies

Romania's unfavorable cash flow position, its low level of reserves, and its payments arrears to the Fund and to the Bank make a prompt change in its external debt management policies imperative. In the last few years such policies have been characterized by repayment of medium- and long-term foreign loans on maturity combined with a reluctance to raise new financial loans abroad. These policies have led to a run down of foreign exchange reserves to minimal levels and the emergence of arrears which have hampered restoration of Romania's creditworthiness.

In the early summer of 1985, Romania had the opportunity of raising a financial loan abroad. However, because of long delays in coming to an agreement on the conditions for such a loan, hopes of a possible oversubscription were thwarted as the current account and reserve positions deteriorated in the second half of 1985; as a result, only US\$150 million was finally raised. Romania also obtained assistance from some foreign creditors, in 1985 and again in January 1986, in the form of rollovers, but these were mostly short-term in nature. Accordingly, debt management policy in 1985 remained largely unchanged.

After considerable hesitation, the Government in May 1986 asked the creditor banks of the 1982-83 reschedulings to postpone the installments falling due in 1986-87, until after 1988 when the debt burden will have fallen rapidly. Romania was able to point to the sharp reduction of its debt to foreign commercial banks from end-1981 to end-1985 as well as the prospect of further net reductions in debt to foreign commercial banks despite the planned reschedulings. There was an urgent need for a rapid conclusion of a rescheduling agreement given the fact that Romania had fallen back into arrears vis-à-vis the Fund in June 1986, that the arrears position to the Fund and the World Bank had subsequently worsened, and that resort had to be made in July 1986 to new short-term rollovers of maturing debt to banks. Romania reached agreement in July 1986 with a steering committee of banks on a rescheduling of the maturities due in 1986 and 1987 stemming from the 1982-83 reschedulings. The debt relief is to be 100 percent of the US\$350 million due

in 1986, to be repaid in 1989-90, and 85 percent of the US\$530 million due in 1987 (US\$450 million), to be repaid in 1991-92. The interest margin is to be reduced to $1 \frac{3}{8}$ percentage points over LIBOR from the $1 \frac{3}{4}$ percentage points paid on debt rescheduled in 1982-83. It is thought likely that the 250 creditor banks will agree to the proposed rescheduling but no decision is expected before September 1986. If this agreement were signed, Romania's outstanding convertible foreign debt would amount to US\$5.1 billion by the end of 1987, compared with US\$10.1 billion at the end of 1981.

The heavy debt repayment obligations throughout the period 1986-88 and the clear need to rebuild reserves require a continued strengthening of the balance of payments in the period ahead. The convertible current account surplus is officially projected to remain at around US\$1.2 billion per annum based on a rapid expansion of non-oil exports, supported by a substantial increase in non-oil imports, and favorable terms of trade in the oil sector. The inflow of medium- and long-term capital is forecast to increase considerably due to the expected reschedulings. The staff believes that the projected increase in foreign exchange reserves of about US\$500 million over 1986-87 to a level of some US\$700 million (equivalent to some 7 weeks of imports) is the minimum needed to avoid arrears. The mission urged the Romanian authorities to seek additional debt relief should the current account surplus and capital inflows fall below targets.

2. Sustainability of convertible current account surplus

Romania's ability to achieve a viable balance of payments position in 1986 and ensuing years rests not only on a flexible debt management policy but also on policies directed toward sustaining a considerable current account surplus in convertible currencies. Such policies are particularly important since rapid reduction of external debt continues to be a major economic objective of the Government. This is to be achieved by preferential allocation of material inputs to the export and import competing sectors, special wage incentives for export production, improved product quality and marketing arrangements, a speedier adaptation to changing market conditions abroad, and concentration on export products with a high value added.

The reversal of the policy of import compression, while in the short term affecting negatively the current account position, will in the longer run have a positive effect on the balance of payments, if the additional imports would ease supply constraints in the export sector.

The mission found it difficult to ascertain whether or not the policies put in place are adequate to sustain the current account surplus necessary to finance the prospective large capital outflows in 1986-88, particularly as most of the measures taken do not lend themselves to quantification. Furthermore, some of the measures will have a positive effect on the current account only in the longer run. It is also not clear whether investment policy gives sufficient priority to

the external sector as the criteria for investment appraisal, including the prices used, appear inadequate to ensure an optimal allocation of resources based on a determination of the areas where Romania has a longer-term comparative advantage. In addition, the authorities' desire to expand in particular exports to developing countries would not be compatible with the overriding objective of a large current account surplus on a cash basis, if it involved an increase in concessional trade credit. A number of Romania's traditional partners among developing countries are experiencing lower growth rates and balance of payments constraints.

For 1986, the staff doubts whether the projected trade surplus of US\$1.8 billion (consistent with the projected current account surplus of US\$1.2 billion) can be attained. The trade surplus, after a relatively satisfactory outcome in the first quarter (US\$475 million), declined to US\$286 million in the second quarter; there was a sharp fall of both exports and imports from the same period in 1985. This, together with Romania's request for further short-term rollovers of commercial bank debt in July and an increase in arrears to the Fund and the World Bank, seems to suggest that by midyear the cash flow from the current account had fallen below target. If continued, the deterioration in the trade accounts could reduce the willingness of the Romanian authorities to relax import compression.

In order to promote a more efficient allocation of resources and a more sustainable external position, the mission suggested to the Romanian authorities that they review, in cooperation with the World Bank, their investment priorities and conduct sectoral studies.

3. Arrears to the Fund

In the period since May 1985, most payments to the Fund were significantly delayed, but until recently settlements were made in sufficient time to avoid notification to the Executive Board under the Fund's procedures on overdue financial obligations. The Romanian representatives attributed the arrears partly to factors outside Romania's control (including the drought in 1985, and nonrepayment of export credits previously extended by Romania) as well as to factors subject to Romania's influence (viz. the lack of reserves that was an outgrowth of an overly rapid reduction in foreign debt). On August 25, 1986, Romania's arrears to the Fund amounted to SDR 84.7 million (US\$102.9 million) which relate to obligations due in the period since June 23, 1986. At this level, arrears to the Fund represented 16 percent of Romania's quota, a little over 1 percent of its convertible exports of goods and services (estimated for 1986), and almost one half of its estimated total overdue obligations which are concentrated on the Fund and the World Bank. As of August 25, 1986, Romania has had overdue obligations to the Fund for a total of eight of the past twelve months. The average delay in settlements in 1986 has exceeded three weeks. In response to representations from the mission, the Romanian

authorities stated that they had every intention of settling the arrears to the Fund as soon as possible; it was hoped by the authorities that after September 1986 new arrears could be avoided.

4. Exchange system and commercial policies

Under the last stand-by arrangement, the Romanian authorities repeatedly expressed the intention to unify their two exchange rates. Instead, the authorities have continued to maintain a dual exchange rate system for convertible currencies that distinguishes between the commercial and noncommercial exchange rates, with the latter applying to only a small share of external transactions, notably individual tourism. Both rates remain pegged to a basket of currencies with adjustments to bilateral rates being made on a weekly basis. As indicated in EBS/86/77 (4/4/86), on March 1, 1986, the commercial and noncommercial exchange rates were each devalued by 13.7 percent to lei 17.50 = US\$1 and lei 12.50 = US\$1, respectively, in order to bring exchange rates in line with assumptions incorporated in the foreign trade and financial plans of enterprises for 1986. This devaluation offset the appreciation of the leu/U.S. dollar rate due to the weakening of the U.S. dollar relative to other major currencies and returned the leu/U.S. dollar rate to that prevailing on November 1, 1984. On July 1, 1986, the authorities partly reversed the March measure by revaluing the commercial exchange rate of the leu by 8.8 percent to lei 16.00 = US\$1 and the noncommercial exchange rate by 13.0 percent to lei 11.00 = US\$1 (EBS/86/153, 7/14/86). The authorities explained that this new step would help ensure that enterprises derived their profits principally from lower costs of material production, and improvements in labor productivity and the technical quality of production. The earlier devaluation, it was now felt, had permitted enterprises to benefit without pursuing these fundamental goals. The authorities considered that the July 1986 revaluation of the leu would have no significant impact on either export or import volumes which were determined essentially by the plan. In the absence of an allocative role of prices, exchange rate policy has little significance in the adjustment process.

The authorities reaffirmed that unification of exchange rates remained a policy objective and would be achieved through appreciation of the commercial exchange rate rather than depreciation of the noncommercial rate. However, no timetable for unification had been decided. The present dual exchange rate system continues to constitute a multiple currency practice subject to approval by the Fund under Article VIII.

The authorities stated that no changes in foreign trade regulations had been implemented since the beginning of 1985. The bilateral payments arrangement with Viet Nam was discontinued on December 31, 1985; payments with Viet Nam are now effected on a multilateral clearing basis through the International Bank for Economic Cooperation (IBEC).

5. Statistical issues

The mission discussed the factors accounting for the large statistical discrepancy in the national accounts statistics which was itself reflected in a major discrepancy between exports recorded in the national accounts and in the balance of payments. The authorities stated that exportable goods totaling US\$900 million in 1984 and US\$800 million in 1985--held in stock pending shipment--were registered in producers' books as exports (rather than as stocks) and were therefore similarly classified in the national accounts. These goods would be exported when external conditions became more favorable and only then would be registered in the balance of payments statistics. The mission pressed for details about this massive build up in stocks of exportable goods, which first emerged as a major item in the national accounts in 1984. The mission expressed its concern about the reporting and classification procedures that permitted such wide discrepancies between the national accounts and the balance of payments data.

The marked divergence between growth of the Consumption Fund and of retail sales was attributed by the Romanian representatives to a sharp increase in consumption from own production in 1985, due to the record agricultural output and to the incorporation in the 1985 data of the results of a statistical review of this item; this review meant that the estimate for final consumption in 1985 was not fully comparable with data for the previous year and exaggerated the growth of final demand. The mission asked for an urgent review of these reporting arrangements to help reduce the statistical discrepancy and improve the realism of the national accounts statistics. The Romanian representatives said that every effort would be made to reduce the discrepancy.

There are also other statistical anomalies including the inconsistencies between the strong growth in money balances of households and the modest growth both in retail sales and net remuneration ^{1/} in the recent past.

As is shown in Appendix II, problems persist in most areas of Romania's statistics. The Romanian representatives said that organizational changes in the data collection process should bring about a significant improvement in the transmission of data to the Fund by end-1986.

6. Price policy

Price policy continues to emphasize overall price stability, although some changes in relative prices are undertaken to avoid undesirable shifts in profitability between various sectors and economic branches. Producer prices fell slightly in 1985 reflecting a cut in prices of certain goods--mainly components of machinery equipment--aimed

^{1/} Net remuneration equals wages, salaries, and bonuses minus tax on the remuneration fund and social security contributions.

at helping reduce domestic prices of final products and improve external competitiveness. These price adjustments are expected to have little effect on supplies which are determined essentially by the plan. The drop in oil prices abroad did not lead to cuts in domestic prices of oil and oil products, partly because a curtailing of energy consumption remains an important policy objective. However, prices of imports of crude oil for refining for exports were lowered to ensure the competitiveness of the refining industry. Consumer prices in socialist retail trade registered a marginal increase in 1985 almost exactly offset by a small decline in consumer prices in peasant markets. Since 1984, consumer prices in the peasant markets have been depressed by price controls, so that prices in peasant and socialist markets now differ by only a small margin. In 1986, consumer prices are projected to rise by 1.3 percent, equal to the projected increase in average net remuneration.

7. Wages, productivity, and employment

The objective of wage policy continues to be an increase in wages by less than recorded gains in labor productivity. Accordingly, average net remuneration rose by only 1.9 percent in 1985--the slowest rate of increase for some years--while labor productivity in industry was recorded to have increased by 5 percent.

To improve labor productivity, a new system of wage determination, based on so-called "global contracts," was introduced at the end of 1985 designed to increase efficiency and encourage a qualitative improvement in output. The previous system, introduced in 1983-84, related wage increases to productivity advances attributable to labor-related factors. The authorities noted that this system had frequently not been implemented at the enterprise level and had not produced the hoped for incentives to improve the quality of output. The new global contract system stipulates that bonuses and penalties for over- and under-fulfillment of production targets are no longer limited. Furthermore, additional wage incentives have been applied to help achieve fulfillment of export targets and new indicators established to determine whether qualitative improvements have occurred that could justify increased remuneration. In addition, the new system encourages enterprises to limit their labor input to the minimum needed for efficient production. The plan targets for 1986 rest critically on the effectiveness of this global contract system in boosting labor productivity in industry (assumed to increase by 10 percent).

Employment in 1985 rose on average by less than 1 percent with a modest shift from agricultural to industrial employment over the year. An important objective of labor market policy--embodied in the new "global contract" system--is a reduction in the number of workers in the less efficient sectors in order to boost profitability and productivity. This policy is to be effected in part by allowing employees to benefit from the reduced costs of the enterprise due to cuts in the work

force. The continuing shortages of labor in certain sectors--particularly mining--emphasize the need for improved incentives and flexibility in absorbing labor released from inefficient sectors.

8. Financial policies

In the Romanian system of central planning, fiscal and monetary policies do not independently shape economic policy but are conducted so as to ensure consistency between physical plan targets and intersectoral financial flows. Specifically, the present policy of giving high priority to repaying maturing foreign debt is reflected in financial policies which substitute internal for external financial resources, mainly by producing a budget surplus, generating household savings, and in 1986 by restricting credit to enterprises.

The budget outturn in 1985 showed a decline in government revenues of 3.5 percent, and a shortfall of 16.6 percent from the 1985 budget estimate. The decline in revenue was concentrated in "payments from profits" due to a much weaker profitability than projected. Revenues from the tax on net production also declined in 1985, while revenues from the turnover tax did not change. The mission pointed out that the development of revenues from these taxes was not consistent with the announced unchanged tax rates and a substantial recorded growth of economic activity to which the tax bases are closely linked. The authorities explained this outcome by their commitment to enhancing the self-financing capacity of firms, implying that actual tax rates had been permitted to deviate from announced rates. A question remains, however, as to the reliability of revenue projections that omit reference to this commitment in 1985 and also in the 1986 estimates. Despite the fall in revenue, total expenditure in 1985 rose by 8.5 percent, leading to a sharp drop in the budget surplus to 2 percent of GDP from 6 percent in 1984.

In 1986, total revenue is projected to rise by 13.6 percent, with "payments from profits" and net revenues from the production tax rising rapidly. On the expenditure side, a reserve fund equal to 12.9 percent of total estimated revenue is included, some of which will be reflected in another budget surplus.

The financial resources necessary to make foreign debt repayments in 1985 were provided not only by the budget surplus but also by an increase in household savings deposits at an average rate of 10.3 percent, well in excess of economic growth. At the same time, currency outside banks increased by 11.8 percent, a development the authorities found difficult to interpret and would attempt to curb. The increase in household savings deposits was attributed to a combination of high interest rates (2-5 percent) and price stability. However, in view of the primacy of the central plan, it would seem that savings are foremost a function of the quantity of consumer goods available rather than of interest rates; since November 1984 interest rates have not been changed.

In 1986, household savings deposits are projected to grow by 9.5 percent. The authorities decided in July 1986 to curtail credit to enterprises severely in order to force them to economize on the use of material inputs and to reduce stocks. Credit will no longer be allotted by enterprise but by individual product to put a stop to the enterprises' practice of shifting credit between products.

9. Medium-term projections

The new five-year plan, covering the period 1986-90, calls for annual average growth of around 10 percent for overall net material product. Net industrial production is to rise by 13-14 percent per annum, supported by a growth of labor productivity in industry by over 11 percent a year. At the same time, the principal demand components are to rise much less rapidly. Consumer sales through the socialist retail trade, accounting for about three quarters of total household expenditure, are projected to grow by only 1.8 percent a year. Also, total investment is to rise by only 3 1/2 percent. Thus, the five-year plan again includes a substantial discrepancy between output targets and projected final domestic expenditure. Balance of payments projections in convertible currencies suggest that the net foreign balance is unlikely to contribute to growth on a significant scale.

The official medium-term projections for the balance of payments and external debt in convertible currencies over the period 1986-91 (Table 9) show (i) steady current account surpluses of around US\$1.2 billion through 1990, composed of declining oil deficits as well as declining non-oil surpluses; (ii) average annual growth of convertible exports and imports of 7 percent and 8 1/2 percent, respectively, in U.S. dollar terms; (iii) a continuous flow of World Bank disbursements in excess of the level achieved in 1985 (US\$44 million) and despite the suspension of disbursements presently in effect; (iv) medium- and long-term inflows from commercial banks to take the form of debt relief during 1986-87 and the form of fresh loans during 1989-90; and (v) amortization obligations on medium- and long-term debt of around US\$1.2 billion each year during 1986-88 followed by a decline to US\$1.0 billion in 1989 and US\$0.8 billion each year in 1990-91. On these projections, gross convertible foreign debt would be reduced to less than US\$3 billion by the end of the projection period and Romania's convertible currency debt service ratio would fall from a peak of 32 percent in 1985 to just over 10 percent in 1991. Reflecting the decline in debt service obligations, foreign exchange reserves are to rise steadily over the projection period.

IV. Staff Appraisal

According to official statistics, the Romanian economy continued to expand strongly in 1985. Growth of total output at almost 6 percent, while lower than in 1984, was more than twice the average of Romania's chief trading partners. However, the staff considers that the underlying economic performance in 1984-85 was probably much less favorable than indicated by the national accounts statistics. Apart from a likely overstatement of agricultural output in 1985, a major concern centers on the substantial excess of recorded output over identified final demand. This statistical discrepancy was explained as due primarily to a substantial build up since 1984 of exportable goods awaiting shipment and was reflected in a marked divergence between export data as reported in the national accounts and balance of payments statistics. The staff feels that a clarification of this major statistical inconsistency is essential for a meaningful analysis of underlying economic performance. The discrepancy between final demand and recorded output in 1985 would be even larger but for an implausibly large difference between a strong increase in consumer spending and a significantly slower rise in retail sales, its major component. Altogether, a significant part of the recorded economic growth in 1984-85 is attributable to these statistical anomalies.

The plan calls for an acceleration in the rate of growth of real GDP to around 9 1/2 percent in 1986 and an annual average rate of about 10 percent for the remainder of the decade. These targets assume that new wage incentives will translate into substantial gains in labor productivity even though these reforms have not changed fundamentally the incentive system for improvements in productivity. The optimistic growth forecasts for 1986 and beyond are based on projections that include wide discrepancies between total production and final demand, and major inconsistencies between the national accounts and balance of payments forecasts. The staff feels the authorities should endeavor to improve the realism and consistency of their projections.

In 1985, another large current account surplus was achieved, corresponding to 1.8 percent of GDP, although it was below both the 1985 target and the 1984 level. Non-oil exports declined significantly due to the harsh winter followed by drought and to a weakening of export prices. In the capital account, the usual pattern of modest inflows of medium- and long-term capital and continued large debt repayments prevailed. Despite some short-term rollovers and a longer term loan, foreign exchange reserves were run down. With reserves at a minimum level and external debt management policies slow to adjust, arrears have since accumulated.

The convertible current account surplus in 1986 is officially expected to rise to US\$1.2 billion. The trade forecast assumes an increase of 5 percent in the volume of non-oil exports, not much out of line with projected market growth. Romania's exports, while unfavorably influenced by trade restrictions abroad, stand to benefit in the longer

run from a reduction in supply constraints through the envisaged sharp increase in the volume of non-oil imports (20 percent). The staff hopes that a further deterioration in the trade account beyond the second quarter of 1986 would not prompt the Romanian authorities to revert to their earlier policy of compressing imports, as this would be in conflict with the desire to sustain the current account surplus in the medium term. With respect to oil trade, the official 1985 forecast assumes a sharp increase in the volume of exports which, together with an expected smaller decline in oil product prices than in crude oil prices, will permit a higher utilization of Romania's refining capacity at a profit.

Foreign exchange reserves are expected to rise to the equivalent of only four weeks of imports by the end of 1986. At this level, the reserve position would certainly remain tight. In the first six months of 1986, foreign exchange reserves rose by US\$167 million to US\$366 million, but this increase was roughly matched by an increase in arrears to the Fund and World Bank.

Apart from the low level of reserves, the present weakness of Romania's external position is reflected in: (1) the existence of large arrears vis-à-vis the Fund and the World Bank; (2) short-term rollovers of some obligations in January and July 1986; and (3) the request by Romania in May 1986 to certain creditor banks to reschedule a large part of the debt owed to them.

Romania's vulnerable external position requires a prompt change in external debt management policies. The policy of avoiding new financial loans caused a drop in reserves to a very low level in 1985 when there was an unforeseen deterioration of the convertible current account. As a result, arrears emerged and the restoration of Romania's creditworthiness, which was to be accomplished with the debt reduction, was greatly hampered. The staff therefore welcomes the approach of the Romanian Government in May 1986 to foreign commercial banks with the view to obtaining a rescheduling of medium- and long-term debt due in 1986 and 1987, until after 1988, when the debt burden will have fallen rapidly. Since the rescheduling package has been agreed rather quickly with the lead banks, approval by all the creditor banks may be obtained by September 1986. The staff welcomes the inclusion in the package of maturities due in 1987. With this debt rescheduling, the official balance of payments projections for 1986 and 1987 provide for an increase in reserves in this period to a minimum required to avoid arrears.

The Government's adherence to the objective of reducing foreign debt will require considerable current account surpluses in the foreseeable future. The trade account, after a satisfactory outcome in the first quarter of 1986, recorded a sharply reduced surplus in the second quarter. Together with the worsening of arrears and the resort to new short-term rollovers of some maturing debt in recent months, this has placed the forecast for the full year 1986 in doubt.

To sustain a current account surplus in the medium term at around US\$1.2 billion, the Romanian authorities are relying on a variety of measures. These include a relaxation of the policy of import compression as evidenced by the rapid growth of non-oil imports projected for 1986 and beyond. Without this, the sustainability of the current account surplus would be very much in question. In addition, economic plans foresee priority allotment of domestic and imported resources to the export and import competing sectors, an improvement in product quality, extra bonuses/penalties for over/underfulfillment of export targets, and better adaptation to changing market conditions abroad. In the context of the Romanian system of detailed economic planning, the staff finds it difficult, in the absence of a more intense dialogue with the authorities on the structure and operations of the economic system, including the decision-making apparatus, to assess the official medium-term projections and to judge the adequacy of measures designed to ensure the required current account surpluses.

Realization of the current account surplus in the medium term may be difficult on several grounds. The staff doubts whether the new wage system will provide adequate incentives for increasing productivity. In combination with highly ambitious targets for total production and exports, the new system may reduce wages because of penalties in the case of plan underfulfillment, and thereby result in disincentives. Concerning investment in the export and import competing sectors, the authorities may not be able to determine the areas where Romania has a comparative advantage, as long as investment appraisals are based on criteria that do not reflect resource scarcities. In this context, the staff would advocate that the Romanian authorities review, in cooperation with the World Bank, their investment priorities and conduct sectoral studies. For Romania to find new markets for manufactured exports in developed countries, product quality will have to be improved. In addition, the authorities need to make special efforts to eliminate the current account surplus vis-à-vis the nonconvertible area to help alleviate domestic imbalances.

Should the current account surplus in 1986-88 fall below the target, the staff urges the Romanian authorities to seek additional debt relief promptly. The staff regrets the Government's decision not to seek additional longer-term debt relief beyond the amounts foreseen in 1986 and 1987 and to adhere instead to their goal of rapid foreign debt reduction.

The staff regrets that the arrears have been concentrated entirely on the Fund and World Bank and considers speedy settlement of Romania's arrears to the Fund as absolutely essential. In order to restore Romania's creditworthiness, it will also be essential that the arrears to the World Bank be cleared promptly.

The devaluation of the leu in March 1986 was largely reversed through a revaluation on July 1, 1986 on the grounds that extra profits of export enterprises coming from the devaluation had weakened the

pressure on them to increase efficiency and improve product quality. A significant role for exchange rate policy in the adjustment process is precluded as long as price stability remains a major goal of economic policy and prices continue to play no allocative role. The staff can find no justification for the maintenance of a separate exchange rate for commercial and noncommercial transactions, and approval of this multiple currency practice is therefore not recommended.

Financial policies in 1985 continued to be directed toward substituting domestic for external sources of finance as the foreign debt was being reduced. This was achieved in 1985 by a surplus in the state budget, as in previous years, and a sizeable increase in household savings deposits. The budget surplus in 1985 was sharply lower than in 1984 as budget revenue declined. This decline is in apparent conflict with the reported large expansion of economic activity and the assumed constancy of tax rates. A greater transparency of the structure of actual tax rates would be desirable.

In July 1986, the monetary authorities decided to curtail severely bank credit to enterprises in order to force them to reduce stocks and to use their own resources more efficiently. In the staff's view, this credit restriction may not be compatible with the projected rate of economic growth. The simultaneous decision to allot bank credit no longer by enterprises but by individual product entails an intensification of control over enterprises.

The staff notes the termination of the bilateral payments arrangement with Viet Nam and regrets that no further reduction in bilateral payments arrangements is in prospect.

The Romanian authorities agreed that the next Article IV consultation with Romania be held on the standard 12-month cycle.

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision relating to exchange measures of Romania subject to Article VIII, Sections 2 and 3, in concluding the 1986 Article XIV consultation with Romania and in light of the 1986 Article IV consultation with Romania conducted under Decision No. 5392-(77/63), adopted April 9, 1977 (Surveillance over Exchange Rate Policies).

2. Comprehensive restrictions on the making of payments and transfers for current international transactions are maintained by Romania in accordance with Article XIV, Section 3. The multiple currency practice of Romania resulting from differential exchange rates for its currency with respect to commercial and noncommercial transactions is subject to approval under Article VIII, and the Fund urges Romania to eliminate this practice as soon as possible. Moreover, the Fund encourages Romania not to abandon its efforts to reduce reliance on bilateral payments arrangements with other Fund members.

Table 1. Romania: National Accounts: Main Aggregates, 1982-86

	In Billions of Lei at Current Prices					Projection
	1985	1982	1983	1984	1985	1986
(Percentage change; at constant prices)						
Net material product (national income)	727.1	2.7	3.7	7.7	5.9	10.0
By sector of origin						
Industry	455.4	1.8	6.1	7.2	7.8	10.2
Agriculture	109.1	7.4	-3.6	12.3	1.2	7.1
Construction	57.0	0.7	9.3	6.3	5.0	2.5
Transportation	33.8	0.9	-2.5	2.8	—	3.6
Other sectors	71.8	3.1	2.0	6.8	4.5	22.4
By demand components						
Consumption Fund	492.6	-1.3	0.7	5.9	7.4	2.8
Accumulation Fund	177.8	-2.0	6.0	-4.7	-0.5	5.7
Net fixed investment	157.3	-9.1	-0.3	4.4	-1.8	6.9
Increase in stocks 1/	20.5	1.9	1.7	-2.4	0.3	0.1
Residual 1/ 2/	56.7	4.2	1.7	5.0 3/	1.2 3/	6.7 4/
Value added from nonmaterial services	52.5	-3.1	6.1	-0.6	0.4	1.5
Depreciation	89.1	7.3	6.8	8.8	8.8	9.0
Gross domestic product	868.7	2.8	4.2	7.2	5.8	9.4
Of which:						
Final consumption	543.6	-1.5	0.9	5.2	6.7	2.7
Gross fixed investment	246.4	-3.8	2.5	6.0	1.7	7.5
(Percentage change; at current prices)						
Net material product (national income)	727.1	18.5	4.6	7.8	2.6	10.0
By type of income:						
Primary incomes of economic units	312.4	19.2	12.5	12.3	-6.3	...
Of which:						
State units	304.7	19.4	14.1	11.4	-6.2	...
Primary incomes of population	414.7	18.0	-1.2	4.1	10.4	...
From state and cooperative units	286.9	9.7	2.9	4.5	2.5	...
From personal plots	127.8	45.5	-11.2	3.0	33.5	...
(Percentage change)						
Implicit deflators						
Net material product	...	15.4	0.9	0.1	-3.1	—
Gross domestic product	...	13.1	1.1	—	-2.6	—
Final consumption	...	16.7	-0.5	-1.0	—	—
Gross fixed investment	...	7.4	4.1	0.1	-1.0	—

Source: Data provided by the Romanian authorities.

1/ Changes expressed as percent of net material product of the preceding year (contribution to growth).

2/ Net foreign balance and statistical discrepancy.

3/ Including the contributions to growth of lei 15.8 billion of commodities ready for export at end-1984 and lei 13.7 billion at end-1985 recorded in the statistical discrepancy.

4/ Including a plan reserve and a projected net foreign surplus of lei 73.4 billion (equivalent to around US\$4.5 billion).

Table 2. Romania: Balance of Payments Summary, 1982-86

(In millions of U.S. dollars)

	1982	1983	1984	1985	Official Forecast 1986	First Quarter 1985 1986	
Convertible currencies							
Exports, f.o.b.	6,235	6,246	6,892	6,280	7,080	1,170	1,449
Imports, f.o.b.	<u>-4,710</u>	<u>-4,558</u>	<u>-4,706</u>	<u>-4,835</u>	<u>-5,290</u>	<u>-909</u>	<u>-974</u>
Trade balance	1,525	1,688	2,186	1,445	1,790	261	475
Services balance	<u>-870</u>	<u>-766</u>	<u>-650</u>	<u>-530</u>	<u>-566</u>	<u>-219</u>	<u>-144</u>
Current balance	655	922	1,536	915	1,224	42	331
Capital balance	117	-881	-1,442	-1,230	-714	-298	-216
Errors and omissions	<u>35</u>	<u>-29</u>	<u>34</u>	<u>6</u>	<u>—</u>	<u>11</u>	<u>-3</u>
Overall balance	807	12	128	-309	510	-245	112
Nonconvertible currencies <u>1/</u>							
Exports, f.o.b.	5,324	5,266	5,754	5,887	6,810	1,356	1,580
Imports, f.o.b.	<u>-5,035</u>	<u>-5,085</u>	<u>-5,628</u>	<u>-5,597</u>	<u>-7,050</u>	<u>-1,228</u>	<u>-1,475</u>
Trade balance	289	181	126	290	-240	128	105
Services balance	<u>96</u>	<u>57</u>	<u>57</u>	<u>34</u>	<u>87</u>	<u>-10</u>	<u>-7</u>
Current balance	385	238	183	324	-153	118	98
Capital balance	-343	-157	-131	-83	-39	-62	-82
Errors and omissions	<u>2</u>	<u>-3</u>	<u>-4</u>	<u>-15</u>	<u>—</u>	<u>-18</u>	<u>-2</u>
Overall balance	44	78	48	226	-192	38	14

Source: Data supplied by the Romanian authorities.

^{1/} Ruble transactions have been converted into U.S. dollars at the annual average US\$/transferable ruble rate established by the International Bank for Economic Cooperation (IBEC).

Table 3. Romania: Balance of Payments in Convertible Currencies, 1984-87

(In millions of U.S. dollars)

	1984	1985	Official Forecast 1/ 1986	Official Forecast 1/ 1987	Outcome First Quarter	Official Forecast 1/ Second Quarter	Official Forecast 1/ Third Quarter	Official Forecast 1/ Fourth Quarter
						1986	2/	
Current account, net (for details, see Table 4)	<u>1,536</u>	<u>915</u>	<u>1,224</u>	<u>1,235</u>	<u>331</u>	<u>345</u>	<u>235</u>	<u>313</u>
Capital account, net	<u>-1,442</u>	<u>-1,230</u>	<u>-714</u>	<u>-801</u>	<u>-216</u>	<u>-163</u>	<u>-96</u>	<u>-239</u>
Medium- and long-term capital, net	<u>-1,039</u>	<u>-1,118</u>	<u>-734</u>	<u>-755</u>	<u>-191</u>	<u>-143</u>	<u>-146</u>	<u>-254</u>
Credits received	-771	-977	-554	-532	-127	-73	-132	-222
Receipts	274	292	620	750	35	233	87	265
World Bank	(131)	(44)	(70)	(100)	(3)	(5)	(15)	(47)
Commercial banks	(--)	(150)	(350)	(450)	(--)	(177)	(--)	(173)
Of which: under rescheduling	(--)	(--)	(350)	(450)	(--)	(177)	(--)	(173)
Governments	(46)	(98)	(200)	(200)	(32)	(51)	(72)	(45)
Other	(97)	(--)	(--)	(--)	(--)	(--)	(--)	(--)
Payments	-1,045	-1,269	-1,174	-1,282	-162	-306	-219	-487
World Bank	(-121)	(-149)	(-174)	(-231)	(-19)	(-12)	(-71)	(-72)
Commercial banks	(-546)	(-809)	(-620)	(-766)	(-110)	(-240)	(-35)	(-235)
Governments	(-201)	(-209)	(-229)	(-231)	(-33)	(-35)	(-55)	(-106)
Other	(-177)	(-102)	(-151)	(-54)	(--)	(-19)	(-58)	(-74)
Credits extended	-268	-141	-180	-223	-64	-70	-14	-32
Receipts	120	145	185	...	14	...	...	...
Payments	-388	-286	-365	...	-78	...	...	...
Short-term capital, net	<u>-403</u>	<u>-112</u>	<u>20</u>	<u>-46</u>	<u>-25</u>	<u>-20</u>	<u>50</u>	<u>15</u>
Credits received	-261	-29	29	-17	9	-5	77	-52
Receipts	272	361	462	...	125	131	121	85
Payments	-533	-390	-433	...	-116	-136	-44	-137
Credits extended	-142	-83	-9	-29	-34	-15	-27	67
Receipts	319	328	412	...	31	...	...	...
Payments	-459	-411	-421	...	-65	...	...	...
Errors and omissions, net	<u>34</u>	<u>6</u>	<u>--</u>	<u>--</u>	<u>-3</u>	<u>3</u>	<u>--</u>	<u>--</u>
Overall balance	<u>128</u>	<u>-309</u>	<u>510</u>	<u>434</u>	<u>112</u>	<u>185</u>	<u>139</u>	<u>74</u>
Change in reserves (increase -)	-184	484	-292	-185	-101	-127	-33	-31
Use of Fund credit	56	-175	-218	-249	-11	-58	-106	-43
Purchases	(190)	(--)	(--)	(--)	(--)	(--)	(--)	(--)
Repurchases	(-134)	(-175)	(-218)	(-249)	(-11)	(-58)	(-106)	(-43)

Source: Data provided by the Romanian authorities.

1/ Repayment obligations valued at exchange rates in effect at end-1985.

2/ Actual and projected quarterly data are shown on a payments basis. At the end of the first and second quarters of 1986, Romania had arrears to the Fund (SDR 47 million at each time) and to the World Bank.

Table 4. Romania: Current Account in Convertible Currencies, 1984-86

(In millions of U.S. dollars)

	1984	1985	Official Forecast 1986	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr. 1986
				1985				
Exports, f.o.b.	6,892	6,280	7,080	1,170	2,115	1,600	1,395	1,449
Oil	2,164	2,066	2,425	380	605	412	669	394
Non-oil	4,728	4,214	4,655	790	1,510	1,188	726	1,055
Imports, f.o.b.	-4,706	-4,835	-5,290	-909	-1,584	-1,163	-1,179	-974
Oil	-2,610	-2,813	-2,720	-573	-755	-706	-779	-628
Non-oil	-2,096	-2,022	-2,570	-336	-829	-457	-400	-346
Trade balance	2,186	1,445	1,790	261	531	437	216	475
Oil	-446	-747	-295	-193	-150	-294	-110	-234
Non-oil	2,632	2,192	2,085	454	681	731	326	709
Interest on debt	-706	-649	-565	-251	-79	-209	-110	-169
Receipts	62	52	55	12	20	14	6	11
Payments	-768	-701	-620	-263	-99	-223	-116	-180
Transportation and tele- communications	-68	-48	-105	-4	-18	-35	9	-6
Receipts	299	281	320	57	77	48	99	68
Payments	-367	-329	-425	-61	-95	-83	-90	-74
Tourism	110	87	70	11	12	27	37	16
Receipts	121	96	80	12	17	29	38	17
Payments	-11	-9	-10	-1	-5	-2	-1	-1
Other services	14	80	34	25	2	26	27	15
Receipts	126	93	140	32	4	28	29	19
Payments	-112	-13	-106	-7	-2	-2	-2	-4
Services balance	-650	-530	-566	-219	-83	-191	-37	-144
Current balance	1,536	915	1,224	42	448	246	179	331

Source: Data provided by the Romanian authorities.

Table 5. Romania: Foreign Trade in Convertible Currencies, Quarterly 1981-86

(In current prices)

	In Millions of U.S. Dollars			Percentage Change from Previous Year	
	Exports f.o.b.	Imports f.o.b.	Trade Balance	Exports	Imports
1981	7,281	7,065	216	10.8	-12.7
1982	6,235	4,710	1,525	-14.4	-33.3
1983	6,246	4,558	1,688	0.2	-3.2
1984	6,892	4,706	2,186	10.3	3.2
1985	6,280	4,835	1,445	-8.9	2.7
1986 official forecast	7,080	5,290	1,790	12.7	9.4
1981					
1st quarter	1,784	2,095	-311	4.1	-0.8
2nd quarter	1,968	2,105	-137	35.5	-17.9
3rd quarter	1,686	1,583	103	8.4	-5.5
4th quarter	1,843	1,282	561	-0.5	-26.4
1982					
1st quarter	1,675	1,266	409	-6.1	-39.6
2nd quarter	1,550	1,357	193	-21.2	-35.5
3rd quarter	1,450	1,151	299	-14.0	-27.3
4th quarter	1,560	936	624	-15.4	-27.0
1983					
1st quarter	1,419	963	456	-15.3	-23.9
2nd quarter	1,533	1,278	255	-1.1	-5.8
3rd quarter	1,449	998	451	-0.1	-13.3
4th quarter	1,845	1,319	526	18.3	40.9
1984					
1st quarter	1,562	1,033	529	10.1	7.3
2nd quarter	1,872	1,502	370	22.2	17.5
3rd quarter	1,634	1,020	614	12.8	2.2
4th quarter	1,824	1,151	673	-1.1	-12.7
1985					
1st quarter	1,170	909	261	-25.1	-12.0
2nd quarter	2,115	1,584	531	13.0	5.5
3rd quarter	1,600	1,163	437	-2.1	14.0
4th quarter	1,395	1,179	216	-23.5	2.4
1986					
1st quarter	1,449	974	475	23.8	7.2
2nd quarter	1,604	1,318	286	-24.2	-16.8

Source: Data supplied by the Romanian authorities.

Table 6. Romania: International Reserves, 1981-86

(In millions of U.S. dollars at end of period)

	SDRs	Reserve Position in the Fund	Foreign Exchange	Gold <u>1/</u>	Total Reserves
1981 March	--	--	223	161	384
June	8	17	427	150	604
September	2	--	482	148	632
December	1	--	403	146	550
1982 March	--	--	396	141	539
June	4	--	467	140	611
September	--	5	796	132	933
December	13	--	437	137	587
1983 March	--	--	489	133	622
June	--	--	543	133	675
September	--	--	575	133	708
December	--	--	525	133	658
1984 March	2	--	700	136	838
June	--	--	793	133	926
September	1	--	726	129	856
December	--	--	709	128	837
1985 January	1	--	580	128	708
February	1	--	505	126	631
March	1	--	412	130	542
April	1	--	375	131	506
May	--	--	326	132	458
June	--	--	396	130	526
July	--	--	461	137	598
August	--	--	533	137	670
September	--	--	567	141	708
October	--	--	309	142	451
November	--	--	186	146	332
December	--	--	199	146	345
1986 January	--	--	176	149	325
February	--	--	182	155	337
March	--	--	300	153	453
April	1	--	299	158	458
May	--	--	311	153	464
June	--	--	366	159	525

Sources: IMF, International Financial Statistics; and data supplied by the Romanian authorities.

1/ Valued at SDR 35 per ounce.

Table 7. Romania: External Debt in
Convertible Currencies, 1981-85

(In millions of U.S. dollars at end of period)

	1981	1982	1983	1984	1985
Medium- and long-term	8,248	8,354	8,267	6,763	6,413
Official creditors	3,058	3,809	3,846	3,470	3,452
International institutions	1,756	2,448	2,620	2,402	2,349
Of which:					
IMF	(590)	(863)	(947)	(937)	(864)
Government and government guaranteed credits	1,302	1,361	1,226	1,068	1,103
Private creditors	4,814	4,168	4,080	3,100	2,683
Commercial banks	4,189	3,993	3,639	2,991	2,613
Nonguaranteed suppliers' credits	625	175	441	109	70
Socialist banks	412	377	341	193	278
Short-term	643	956	490	327	221
Arrears	<u>1,143</u>	<u>388</u>	—	—	—
Total	10,070	9,698	8,757	7,090	6,634
Of which:					
In U.S. dollars	(...)	(6,160)	(5,080)	(4,100)	(3,680)
Memorandum items:					
Change in stock of debt	611	-372	-941	-1,667	-456
Debt-creating balance of payments flow	952	165	-661	-976	-1,181
Difference (mainly valuation changes)	-341	-537	-280	-691	725

Source: Data provided by the Romanian authorities.

Table 8. Romania: Commercial Exchange Rate, 1981-86

(Period averages)

	Nominal U.S. Dollar Rate	Nominal Effective Rate	Real Effective Rate ^{1/}
	(lei/U.S. dollar)	(1981 first quarter = 100)	
1981			
1st qtr.	15.00	100.0	100.0
2nd qtr.	15.00	107.8	104.7
3rd qtr.	15.00	114.6	108.1
4th qtr.	15.00	110.8	101.8
1982			
1st qtr.	15.00	115.5	121.4
2nd qtr.	15.00	119.2	122.1
3rd qtr.	15.00	125.4	125.0
4th qtr.	15.00	129.2	126.1
1983			
1st qtr.	16.50	117.9	118.8
2nd qtr.	16.50	123.0	121.1
3rd qtr.	17.77	120.7	115.8
4th qtr.	17.95	123.3	114.8
1984			
1st qtr.	21.55	105.0	96.3
2nd qtr.	21.61	106.5	95.5
3rd qtr.	22.58	109.4	95.6
4th qtr.	19.39	136.7	116.5
1985			
1st qtr.	18.21	152.2	126.4
2nd qtr.	17.61	154.2	124.7
3rd qtr.	16.82	155.2	122.9
4th qtr.	15.93	156.2	120.9
1986			
January	15.48	156.9	119.8
February	15.34	153.9	117.0
March	16.89	137.5	104.2
April	17.79	131.3	99.1
May	17.39	132.9	99.9
June	17.54	132.6	99.4
July	15.87	...	...

Source: Staff calculations based on data provided by the Romanian authorities.

^{1/} Nominal effective exchange rate deflated by relative consumer prices.

Table 9. Romania: Official Medium-Term Balance of Payments and Debt Outlook, 1985-91

(In convertible currencies)

	1985	1986	1987	1988	1989	1990	1991
(In millions of U.S. dollars)							
Payments flows							
Current account balance	915	1,224	1,235	1,145	1,236	1,258	1,440
Exports	6,280	7,080	7,870	8,250	8,750	9,150	9,500
Imports	-4,835	-5,290	-6,210	-6,780	-7,250	-7,700	-7,900
Trade balance	1,445	1,790	1,660	1,470	1,500	1,450	1,600
Oil trade balance	(-747)	(-295)	(-400)	(-400)	(-250)	(-150)	(-100)
Non-oil trade balance	(2,192)	(2,085)	(2,060)	(1,870)	(1,750)	(1,600)	(1,700)
Services, net	-530	-566	-425	-325	-264	-192	-160
Of which: gross interest payments	(-701)	(-620)	(-540)	(-455)	(-375)	(-315)	(-275)
Capital inflows	263	649	733	925	515	517	200
World Bank	44	70	100	150	100	100	100
Governments, medium- and long-term	98	200	200	200	200	200	200
Commercial banks, total	150	322	500	550	200	167	25
Medium- and long-term	150	350	450	530	150	150	--
Short-term, net	--	-28	50	20	50	17	25
Other, total	-29	57	-67	25	15	50	-125
Medium- and long-term	--	--	--	--	--	--	--
Short-term, net	-29	57	-67	25	15	50	-125
Capital outflows	-1,494	-1,363	-1,534	-1,537	-1,343	-1,243	-1,171
Amortization of medium- and long-term debt 1/	-1,270	-1,174	-1,282	-1,282	-1,003	-809	-824
On debt incurred by end-1985	-1,270	-1,174	-1,242	-1,202	-702	-427	-309
Of which:							
To commercial banks	(-825)	(-620)	(-766)	(-721)	(-316)	(-124)	(-27)
On inflows after 1985	--	--	-40	-80	-301	-382	-515
Of which:							
To commercial banks	(--)	(--)	(--)	(--)	(-175)	(-205)	(-285)
Credit extended, net	-224	-189	-252	-255	-340	-434	-347
IMF, repurchases 1/	-175	-218	-249	-175	-141	-59	-19
Change in gross reserves (increase -)	484	-292	-185	-358	-267	-473	-450
Stocks (end of year)							
Convertible external debt	6,634	5,890	5,093	4,562	3,933	3,582	2,939
Of which:							
To international institutions	(2,379)	(2,026)	(1,542)	(1,287)	(1,002)	(783)	(619)
To governments	(1,103)	(1,074)	(1,043)	(961)	(925)	(905)	(857)
To commercial banks	(2,654)	(2,356)	(2,090)	(1,919)	(1,628)	(1,466)	(1,179)
Gross reserves	345	637	822	1,180	1,447	1,920	2,370
Of which: foreign exchange	(199)	(491)	(676)	(1,034)	(1,301)	(1,774)	(2,224)
(In percent of current receipts)							
Debt service ratio							
Including IMF repurchases	31.6	26.2	24.2	21.3	15.9	11.9	10.8
Excluding IMF repurchases	29.0	23.4	21.3	19.3	14.5	11.3	10.6

Source: Staff calculations based on projections provided by the Romanian authorities.

1/ Repayment obligations for 1986-91 valued at exchange rates in effect at end-1985.

Romania--Fund Relations

(As of July 31, 1986)

I. Membership Status

(a) Date of membership:	December 15, 1972
(b) Status:	Article XIV

(A) Financial Relations

II. General Department (General Resources Account)

	(Millions of SDRs)	(Percent of Quota)
(a) Quota	523.4	100.0
(b) Total Fund holdings of currency	1,225.4	234.1
(c) Fund credit	702.0	134.1
Of which:		
Credit tranches	261.5	50.0
Enlarged access	440.5	84.2
Compensatory financing exports	--	--
(d) Reserve tranche position	--	--

III. Stand-By Arrangements and Special Facilities

(a) Stand-by arrangements during the last ten years:

	(1)	(2)
Date of Board approval	Sept. 9, 1977	June 15, 1981
Duration	1 year	Originally 3 years canceled as of January 31, 1984
Amount (in millions of SDRs)	64.1	1,102.5
(In percent of quota)	(33.7)	(300.0)
Utilization (in millions of SDRs)	64.1	817.5

On January 23, 1984, the Executive Board reviewed the then existing stand-by arrangement, approved a further purchase under the arrangement, and accepted its cancellation effective January 31, 1984.

(b) During the past two years, Romania has not drawn under the Fund's special facilities.

IV. SDR Department

	(Millions of SDRs)	(Percent of net cumulative allocation)
(a) Net cumulative allocation	75.95	100.0
(b) Holdings	--	--

V. Overdue Obligations

Romania's overdue financial obligations to the Fund were recently described in EBS/86/167 (7/28/86), and are discussed in Section III. 3 of this paper.

(B) Nonfinancial Relations

VI. (a) Exchange Rate Arrangement: The currency of Romania is the Romanian leu. The exchange rate used for all trade transactions in convertible currencies is the commercial exchange rate, which is defined in terms of a basket of six currencies reflecting the geographical pattern of Romania's trade and payments. Weekly adjustments are made in the leu/U.S. dollar rate (and correspondingly in the rates for all other quoted currencies) in such a way as to maintain the central point on the basket peg. On July 31, 1986 the commercial exchange rate was lei 15.78 = US\$1. The National Bank of Romania quotes rates for 16 other currencies defined as "fully convertible." For currencies of other countries, exchange rates are based on rates quoted in Romania for third currencies; for members of the Council for Mutual Economic Assistance (CMEA), Albania, and the Democratic People's Republic of Korea, the third currency used for this purpose is the transferable ruble.

Certain nontrade exchange transactions with the convertible area are carried out at the noncommercial exchange rate, which is pegged to the same basket of currencies as the commercial rate and is also adjusted on a weekly basis. On July 31, 1986 the noncommercial rate was lei 10.85 = US\$1.

Capital transactions with the convertible area are settled at the commercial rate.

For nontrade transactions with the CMEA countries, Albania, and the Democratic People's Republic of Korea, special exchange rates are established by multilateral or bilateral agreements.

(b) Unapproved exchange restrictions subject to Article VIII, Section 3: See text of decision below.

VII. The last Article IV consultation was concluded on October 28, 1985. Romania is on a 12-month consultation cycle. The following decision was taken by the Board on October 28, 1985.

1. The Fund takes this decision relating to exchange measures of Romania subject to Article VIII, Sections 2 and 3, in concluding the 1985 Article XIV consultation with Romania and in the light of the 1985 Article IV consultation with Romania conducted under Decision No. 5392-(77/63), adopted April 9, 1977 (Surveillance over Exchange Rate Policies).

2. Comprehensive restrictions on the making of payments and transfers for current international transactions are maintained by Romania in accordance with Article XIV. The multiple currency practice of Romania resulting from differential exchange rates for its currency with respect to commercial and noncommercial transactions is subject to approval under Article VIII, Section 3, and the Fund urges Romania to eliminate this practice as soon as possible. Moreover, the Fund encourages Romania to continue its efforts to reduce reliance on bilateral payments arrangements with other Fund members.

VIII. Technical Assistance

(a) Central Banking Department

In May 1983, Romania received technical assistance concerning the introduction of a currency basket system.

(b) Bureau of Statistics

In February 1985, a technical assistance mission visited Bucharest to review Romanian statistics in key areas (national accounts, production, prices, labor, and foreign trade). The mission made a number of specific recommendations and requested several technical notes and the release of certain data series.

Romania - Statistical Issues1. Outstanding Statistical Issues

Problems persist in most areas of Romania's statistics. The reporting of data for inclusion in Fund statistical publications has been infrequent (with some categories of statistics unreported) and, as indicated in the table below, with many key aggregates uncurrent. The authorities informed the mission that organizational changes were being implemented in order to help the data collection process. It was hoped that by the end of 1986 a significant improvement in the provision of data to the Fund would become apparent.

a. Monetary accounts

A number of changes have been introduced to the monetary accounts since the Bureau of Statistics' technical assistance mission in 1981. However, it has not been possible for the staff to determine the nature of these changes. The currentness of monetary data continues to lag and the coverage of the statistics needs to be extended.

b. Government finance

Annual data on government finance published in IFS are those reported for the GFS Yearbook. Quarterly data reported for IFS are not consistent with annual aggregates.

The 1985 Government Finance Statistics Yearbook contains data on revenue and expenditure of the consolidated central and general governments only through 1983. Data on financing are not reported. The government has no outstanding direct external debt.

c. Real sector(i) National accounts

National accounts data provided to the Fund following a Bureau of Statistics' technical assistance mission in February 1985 contained a number of inconsistencies. Among them are estimates of growth in gross industrial production which are not consistent with data on branch output or with output of individual commodities. Large statistical discrepancies also arise from problems in the estimation of changes in stocks.

(ii) Prices and production

Romania reports data on the Consumer Price Index (CPI) and industrial production on an annual and quarterly basis, respectively. The technical assistance mission of February 1985 proposed to the authorities a change in the frequency of compilation of these data and suggested that quarterly data on producer prices be provided for inclusion in IFS. The authorities have advised that they are now planning to compile

- 33 -

quarterly data on producer prices and would provide them to the Fund on a regular basis.

(iii) Employment

Quarterly and annual data series on employment are inconsistent. The Bureau of Statistics has asked the authorities for an explanation of these differences.

2. Coverage, Currentness, and Reporting of Data in IFS

The table below shows the currentness and coverage of data published in the country page for Romania in the August 1986 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Ministry of Finance.

Status of IFS Data

		<u>Latest Data in August 1986 IFS</u>
Real Sector	- National Accounts	1984
	- Prices: CPI	AA 1984
	- Production: Industrial	Q2 1985
	- Employment: Industrial	Q2 1985
	- Earnings: Average	Q2 1985
Government Finance	- Deficit/Surplus	Q1 1985
	- Financing	...
	- Debt	...
Monetary Accounts	- Monetary Authorities	Q1 1985
	- Deposit Money Banks	Q1 1985
	- Other Financial Institutions	...
Interest Rates	- Discount Rate	...
	- Bank Lending/Deposit Rates	...
	- Bond Yields	...
External Sector	- Merchandise Trade: Values	AA 1984
	Prices	...
	- Balance of Payments	AA 1985
	- International Reserves	April 1986
	- Exchange Rates	May 1986

Romania: Selected Economic Indicators

	1982	1983	1984	1985	Official Forecast 1986
(Percentage changes)					
1. National income and expenditure					
In constant prices:					
Gross domestic product (GDP)	2.8	4.2	7.2	5.8	9.4
Net material product (NMP)	2.7	3.7	7.7	5.9	10.0
Net industrial production	1.8	6.1	7.2	7.8	10.2
Net agricultural production	7.4	-3.6	12.3	1.2	7.1
Final consumption	-1.5	0.9	5.2	6.7	2.7
Gross fixed investment	-3.8	2.5	6.0	1.7	7.5
In current prices:					
Net material product (NMP)	18.5	4.6	7.8	2.6	10.0
Retail sales	12.5	3.3	5.0	1.8	1.2
2. Prices, wages, productivity, and employment					
Implicit NMP deflator	15.4	0.9	0.1	-3.1	--
Industrial producer prices	10.7	5.6	-0.1	-1.1	...
Consumer prices	14.1	4.7	-0.3	0.1	1.3
Average nominal earnings	7.8	3.0	6.6	1.9	1.3
Average real earnings	-5.4	-1.7	6.9	2.0	--
Labor productivity in industry ^{1/}	1.2	2.9	9.2	5.0	10.0
Employment in industry	1.7	0.6	0.8	1.6	6.1
(In billions of lei)					
3. General government budget					
Revenue	277.4	259.4	310.9	300.1	340.9
Expenditure	257.5	236.8	260.2	282.0	297.0
Reserve fund allocation	--	--	--	--	43.9 ^{2/}
Surplus	19.9	22.6	50.7	18.1	...
(In percent of GDP)	(2.7)	(2.9)	(6.0)	(2.1)	(...)
(Percentage changes)					
4. Foreign trade (in U.S. dollar terms)					
All currencies:					
Exports	-7.9	-0.4	9.9	-3.8	14.2
Imports	-21.4	-1.0	7.2	0.9	18.3
Convertible currencies:					
Total exports	-13.6	0.2	10.3	-8.9	12.7
Non-oil exports	-11.0	-8.9	10.4	-10.9	10.5
(In volume terms)	(-9.4)	(-4.6)	(14.3)	(-8.5)	(5.2)
Total imports	-32.8	-3.2	3.2	2.7	9.4
Non-oil imports	-38.5	-6.5	-0.2	-3.5	27.1
(In volume terms)	(-38.9)	(1.0)	(2.6)	(-1.3)	(22.8)
(In millions of U.S. dollars)					
5. Balance of payments in convertible currencies					
Trade balance	1,525	1,688	2,186	1,445	1,790
Services balance	-870	-766	-650	-530	-566
Current account balance	655	922	1,535	915	1,224
(In percent of GDP)	(1.3)	(2.0)	(3.9)	(1.8)	(2.1)
Capital account balance ^{3/}	152	-910	-1,408	-1,224	-714
Overall balance	807	12	128	-309	510
6. External assets in convertible currencies (at end of year)					
International reserves	587	658	837	345	637
(In months of convertible imports)	(1.5)	(1.7)	(2.1)	(0.9)	(1.4)
Nonreserve assets	...	...	2,312	2,655	...
7. External liabilities in convertible currencies (at end of year)					
Total debt	9,698	8,757	7,090	6,634	5,890
(In percent of GDP)	(19.5)	(19.4)	(18.3)	(12.0)	(10.0)
Of which:					
Short-term debt	956	490	327	221	250
Arrears	388	--	--	--	--
(In percent of convertible exports of goods and services)					
8. Debt service in convertible currencies					
Interest payments	14.1	11.8	10.2	10.3	8.1
Total debt service payments	22.6	24.3	26.0	31.6	26.2
(In lei per U.S. dollar)					
9. Exchange rates (annual average)					
Commercial rate	15.0	17.2	21.3	17.1	...
Noncommercial rate	11.0	13.1	14.0	12.2	...

Sources: Direcția Centrală de Statistică, Anuarul Statistic; Ministry of Finance, Economic Memorandum; IMF Data Fund; and data provided by the Romanian authorities.

^{1/} Based on marketable (gross) industrial production.

^{2/} Budget projections. In earlier years, a varying part of the reserve fund allocation remained unspent, yielding an overall budget surplus.

^{3/} Including errors and omissions.