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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/167

10:00 a.m., October 10, 1986

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	Mawakani Samba
	D. C. Templeman, Temporary
	H. G. Schneider
	T. Alhaimus
	M. B. Chatah, Temporary
H. Fujino	M. Sugita
	B. Goos
	Yang W., Temporary
J. E. Ismael	
A. Kafka	
	M. Foot
H. Lundstrom	H. Fugmann
	W. N. Engert, Temporary
E. I. M. Mtei	
	J. J. Dreizzen, Temporary
	J. E. Suraisry
	G. Ortiz
	S. de Forges
	G. Nguyen, Temporary
J. J. Polak	J. de Beaufort Wijnholds
C. R. Rye	A. V. Romuáldez
G. Salehkhou	O. Kabbaj
	A. S. Jayawardena
S. Zecchini	N. Kyriazidis

L. Van Houtven, Secretary
S. J. Fennell, Assistant

Also Present

Asian Department: B. J. Smith. Central Banking Department: A. A. F. Op de Beke. European Department: L. A. Whittome, Counsellor and Director; E. O. C. Brehmer, R. P. Hicks, P. C. Hole, J. T. Reitmaier. Exchange and Trade Relations Department: M. Guitián, Deputy Director; J. T. Boorman, E. Brau, C. M. Watson. Legal Department: A. O. Liuksila, J. M. Ogoola, S. A. Silard. Research Department: T. A. Wolf. Treasurer's Department: T. Leddy, Deputy Treasurer; D. Berthet, J. P. Caskey, J. C. Corr. Western Hemisphere Department: S. T. Beza, Associate Director; J. O. Bonvicini, J. P. Pujol. Advisors to Executive Directors: P. E. Archibong, J. Hospedales, A. Ouanes, P. Péterfalvy, I. Puro, R. Valladares. Assistants to Executive Directors: J. R. N. Almeida, O. S.-M. Bethel, R. Fox, G. K. Hodges, L. Hubloue, O. Isleifsson, Z. b. Ismail, K.-H. Kleine, M. Lundsager, J. A. K. Munthali, J. K. Orleans-Lindsay, J. Reddy, D. Saha, G. Schurr, S. Simonsen, H. van der Burg, E. L. Walker.

1. ROMANIA - 1986 ARTICLE IV CONSULTATION; AND OVERDUE FINANCIAL OBLIGATIONS - REPORT AND COMPLAINT UNDER RULE K-1

The Executive Directors considered the staff report for the 1986 Article IV consultation with Romania (SM/86/224, 8/28/86; Cor. 1, 9/23/86; and Sup. 1, 10/8/86). They also had before them a report on recent economic developments in Romania (SM/86/235, 9/12/86). Executive Directors also gave substantive consideration to the Acting Managing Director's complaint under Rule K-1 with respect to Romania's overdue financial obligations to the Fund (EBS/86/229, 10/9/86).

Mr. Polak made the following statement:

When attempting to interpret economic developments in Romania, one may be tempted to take as a starting point the Fund's accumulated knowledge on planned economies. The Board discussed that subject and more particularly the design of adjustment programs in planned economies, on February 28, 1986. However, the case of Romania underlines what I stated on that occasion, namely that one should be very cautious about generalizations concerning the members that the Fund classifies as having planned economies--at that time five, now six: China, Hungary, Poland, Romania, Viet Nam and Yugoslavia, because their economic systems differ widely and, in a number of countries, are in a rapid state of flux. Romania probably stands out as the country that has moved least from the old model of the centrally planned economy, where heavy emphasis on the central decision making with respect to major economic variables such as output, exports, prices, etc., has been preserved. Indeed, the movement that was visible in 1984 in the direction of a somewhat greater role for the exchange rate and interest rates as incentives toward a more rational allocation of resources has since been reversed.

This consultation report reflects accurately the current situation of the country's economy and its policymaking structure. That structure does not make it easy for Directors to address Romania's situation and problems in the traditional manner applicable to consultations with other members. This applies in particular to the main domestic variables.

On the important question of the country's growth rate, for example, it is difficult to arrive at a clear picture of recent performance, or projections for the near future, owing to conceptional problems such as the Romanian practice to forecast increases in GDP with a contingency margin which makes it exceed the sum of the forecasts for its components, and other questions raised by the staff on the consistency of the data. As regards domestic financial policies, the staff observes that neither fiscal nor monetary policies are intended to have an independent role in the design of economic policy. The purpose of these policies is to guide the execution of the physical targets of the plan and the intersectoral financial flows that derive from this objective.

Against this background it is, from a Fund point of view, probably most fruitful to concentrate attention on the international aspects of the economy, an area where there are no major data problems, although the staff would have liked to have more frequent data on trade volumes and unit values and where the various components of the picture fit clearly together in the balance of payments.

The two main features of Romania's external account in recent years have been the large surplus on current account and the use of the foreign resources so acquired to reduce the large international debt incurred in the latter part of the 1970s. In 1985, the current account surplus, although somewhat below the 1984 level, still exceeded $1.2 billion--1.8 percent of GDP--three fourths of this earned with the convertible currency area. The official forecast for 1986 is for a surplus of $1.1 billion, which would include an increase of the surplus with the convertible currency area and a small deficit with the rest of the world. Surpluses such as these have permitted Romania to reduce its convertible foreign debt from $10 billion at the end of 1981 to $6.6 billion at the end of 1985. The pressure to repay debt, especially private debt, in the face of a disappointing experience with exports and with the discharge of export credits on the part of Romania's debtors, have led to a decline of Romania's always modest reserves to a bare working minimum of about $200 million by the latter part of 1985 and to the accumulation of arrears to the Fund and the World Bank in the course of the current year. The same difficulties have also induced Romania to seek debt relief from its commercial bank creditors. In this effort, its record to reduce the debt drastically even in unfavorable external circumstances proved to be of considerable help, and a favorable agreement was reached in July 1986 with a steering committee of banks to reschedule 100 percent of the 1986 maturities and 85 percent of the much larger 1987 maturities, at 1 3/8 percent over LIBOR, as against 1 3/4 percent over LIBOR in the rescheduling exercise conducted in 1982-83.

These arrangements, which have recently been finalized, will provide some relief to the hard-pressed cash flow position, but the question for the somewhat longer run continues to hinge on the country's ability to generate a substantial current account surplus.

It is recognized that this surplus cannot be pursued through a further compression of imports; on the contrary, the expansion of exports now requires an increased supply of imports for the export industry and the same is needed for the import-competing sector. Thus imports are projected to increase by about 50 percent in value from 1986 to 1991. To maintain the current account surplus at about $1.2 billion a year, exports will, over the same period, have to increase by a similar amount as imports--about $2.5 billion. It is intended to bring about this development of exports by a full use of the instruments of economic guidance available under the Romanian system. In that system, the exchange rate is not seen as an important factor influencing foreign trade transactions, and reliance is being put on more direct stimuli, such as special allotment of scarce domestic, and especially imported, inputs; bonuses and penalties based on export performance compared to the requirements set in the plan; and various other administrative measures intended to make Romanian export industries more responsive to the needs of the country's foreign markets.

In this connection it should be recalled that some of the disappointments with respect to exports over the last year were related to factors exogeneous to Romanian policy and, at least in part, reversible in nature. These include bad weather in the early part of the year, the consequences of the Chernobyl accident, and the rise in the price of oil compared to that paid by other countries as a consequence of the practice of the Soviet Union to set the oil export price at the average world market price over the preceding five years. The recent severe earthquake that hit Romania and other Eastern European countries on August 31 also had unfavorable effects on exports, primarily because it dislocated freight traffic on the railroads.

Early this year, Romania discussed with the staff the possibility of a drawing under the compensatory financing facility in connection with a rather large export shortfall that Romania experienced in calendar year 1985. These discussions took considerable time; as a consequence, attention had to shift to the 12 months ended March 1986, a period during which there was no significant shortfall. It is possible that the period ended June 1986 would again show a considerable shortfall; moreover, the possible entitlement of Romania to an emergency drawing to meet the foreign exchange consequences of the recent earthquake could also be considered. However, the Romanian authorities made it clear during the Annual Meeting that they wanted to become current with the Fund on the basis of their own efforts. Once having re-established their creditworthiness with the Fund they reserved their right to apply for use of the Fund's resources, should this prove necessary in the future.

In the first six months of 1986 foreign exchange reserves were, to some extent restored to a level of $366 million, but this was essentially achieved by Romania incurring arrears to the Fund and the Bank. This situation led to a notice to the Board on July 28, 1986 (EBS/86/167) and a complaint under Rule K-1 by the Acting Managing Director on August 29, 1986 (EBS/86/205).

Subsequent actions taken by the new Minister of Finance--Minister Babe succeeded Minister Gigea in mid-August--and discussions held with management and staff during the Annual Meeting testify to a new resolve on the part of Romania to eliminate its

> arrears to the Fund and the Bank. Of the overdue obligations as of August 25, 1986, amounting to SDR 84.7 million, all but SDR 6.3 million had been repaid by September 21. Romania paid an additional SDR 0.9 million on September 22, but failed by an amount of SDR 5.4 million to eliminate fully the overdue repurchases on that day, which would have led to the withdrawal of the complaint. On September 23, a new obligation fell due, and a further one on September 29.
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> In a telex of October 8, 1986, the Minister has confirmed his willingness to become fully current with the Fund not later than the end of 1986, and to remain current thereafter. In view of Romania's major effort to clear its arrears with the Fund and the World Bank in recent weeks, this commitment deserves full credence and commendation. In a further effort, Romania is paying the Fund this week the amount of SDR 5.4 million referred to above. As a result it will have discharged, within six weeks of the complaint of August 29, 1986, all overdue obligations that gave rise to that complaint.

Extending his statement, Mr. Polak said that the bulk of Romania's arrears to the Fund had been repaid, and the authorities had assured the Fund that they would become current by the end of 1986 and would remain current thereafter. In discussions with the Managing Director, the authorities had asked whether, given the fact that they had paid virtually all their overdue payments, the complaint could be withdrawn. The Managing Director had explained that only full payment of arrears led to a withdrawal of a complaint. The decision with respect to Romania's overdue obligations appropriately omitted the reference to the fact that Romania was no longer eligible to make use of the general resources of the Fund, although that was, in effect, the case. However, he was concerned about paragraph 5 of the decision, which stated that the Fund would further consider the complaint under Rule K-1 not later than November 24, 1986. The authorities were making every effort to become current with the Fund, and had indicated that they would settle their obligations by end-December 1986. If the authorities were unable to become current with the Fund by November 24, he wondered what decision the Executive Board would take at that time. It would be more convenient for the Executive Board and in line with previous practice to review the complaint only after three months, in mid-January 1987.

Mr. Templeman made the following statement:

> Assessing the economic performance and outlook of Romania is a particularly difficult business. Recorded data for the past three years and the outlook for 1986 and beyond based on standard macroeconomic variables look quite favorable. Real GDP growth averaged nearly 5.75 percent in 1983-85 and growth of nearly 9.5 percent seems in prospect for this year. Inflation has been virtually zero in the past two years and a rate of inflation of about 1 percent is expected this year. The current account of the

balance of payments in convertible currencies has been in surplus by about $1-1.5 billion in the past three years and a surplus in the same range is expected for 1986. The budget has been in steady surplus and monetary growth has been moderate, in the range of 5-10 percent a year.

Yet both the final outcome of economic policies and the policies themselves may not be what they seem. The staff points out, as it did at the previous Article IV consultation with Romania, that data on real economic growth rates are full of anomalies; the inflation rate is predetermined by the authorities; and the external balance is, to a considerable extent, a function of direct controls over the volumes and prices of imports and exports. At the same time, fiscal, monetary, exchange rate, and pricing policies have little role to play, except as complements to direct controls, and little function with regard to resource allocation.

None of this is new for Romania, although the flirtation with somewhat greater use of market forces earlier in the decade suggested for a time that a modified technique for economic management might be under way. More recently, it appears that there has been a reversion to very tight planning and control methods. Given the limited role of traditional market-oriented macroeconomic policies in Romania, the Fund's surveillance role is largely limited to trying to determine if economic forecasts and assumptions are realistic and internally consistent.

Concerning economic growth, the staff report shows high recorded or expected growth rates through 1986 and a continued very high rate of growth embodied in the five-year economic plan through 1990. However, the very substantial statistical discrepancies in the macroeconomic data and some very optimistic economic assumptions in the forecasts raise doubts about the reliability and reasonableness of the outlook for growth. Discrepancies include major differences between the output side and the demand side of the national accounts, differences between exports in the national accounts and in the balance of payments data owing to the strange treatment of exportable goods in the national income accounts, and anomalies among household consumption, income, and financial balances in various data series. It appears from the demand side of the national income accounts that GDP may have grown by about 2 percentage points less in 1985 than the recorded output figure and that, this year, the demand side figure might be as much as 4 percentage points less. Also, the forecasts in the five-year plan of growth of net material product of 10 percent a year and of labor productivity in industry of 11 percent a year, do not seem very credible. These grave statistical weaknesses raise questions about the ability of the authorities, or of outside observers and creditors, to judge what is going on in the economy.

Assessment of the medium-term plan for the balance of payments also raises some questions about Romania's ability to continue to achieve current account surpluses in convertible currencies. For example, the staff warns of the danger of not assuring adequate imported inputs if export goals are to be achieved, and of the need to improve the quality of exported goods, since export demand is one area which is not amenable to direct control by the authorities. We support the staff's emphasis on the need to manage foreign debt more carefully and to rebuild international reserves.

While recognizing that the tools of economic management normally used in market-oriented economies do not perform the same functions in Romania, some questions still arise. For example, we learn that one of the reasons for the shortfall in expected total revenues last year was the implication that actual tax rates paid were not the same as announced tax rates, raising questions about the transparency of fiscal data. Monetary data seem to reveal inconsistencies among money balances, retail sales, and net renumeration of the household sector. Recently, the direct control over credit to enterprises has been made applicable to credit for individual products, instead of just for individual enterprises. This seems like fine tuning, indeed. Pricing policies, apart from the need to pass through lower world oil prices to the sector which refines and re-exports petroleum products, are no longer being employed even to the limited extent that they were a few years ago. And, the exchange rate devaluation and subsequent revaluation of the leu earlier this year suggest a stop-go approach to exchange rate policy, quite apart from its already limited allocative role in the economy.

Finally, neither wage rates nor interest rates are determined by markets or by collective bargaining nor are they employed to foster the mobility of labor and capital. It does appear that under the global contract system adopted late last year, wage rate bonuses and penalties will no longer be unlimited for overfulfillment and underfulfillment of production targets and that wages may reflect more accurately the achievement of export targets and quality improvements. This development, along with the authorities' aim of reducing the number of workers in the less efficient sectors of the economy, may help somewhat to foster the shift in labor resources to more efficient sectors. Capital mobility continues to be dependent primarily on government actions in the form of public investment planning and the achievement of public savings through budget surpluses. The recent tightening of credit to enterprises may assist somewhat in forcing greater generation of internal savings of enterprises, and deposit interest rates in the range of 2-5 percent for household deposits, when combined with the low inflation rate, would seem to provide some incentive for mobilizing household savings. But here again, the staff raise questions whether household savings growth really responds to this incentive or, rather, to consumer goods shortages, which leave no alternative but to save.

Regarding Romania's relationship with the Fund, there are two areas that give particular cause of concern: the inadequacy of data furnished to the Fund and the accumulation of arrears in the past year. The data problem is not new. The Fund has experienced chronic problems in assessing economic developments in Romania in recent years, including at the time of the 1985 Article IV consultation. This year the staff report contains the usual section on statistical issues. The list is a long one. Furthermore, the seriousness of the problem has forced the staff to point out, at numerous places throughout the report, the many inadequacies and inconsistencies in the data, which impede economic analysis by the staff and by the Board. Under the Articles of Agreement, particularly Article VIII, Section 5, member countries commit themselves to furnish the Fund with such information as it deems necessary for its activities. These activities include the important matter of assessing economic developments in member countries in the framework of Article IV consultations. The problems which have arisen in Romania are serious enough that I would ask the staff, in preparing next year's Article IV report, to include a section which explicitly addresses the question of the adequacy of information being provided to the Fund, both in terms of the ability of the staff and the Board to assess economic developments and in terms of Romania's formal compliance with its obligations under the Articles of Agreement.

This is the first occasion for substantive discussion of Romania's overdue obligations to the Fund, although there has been a regrettable pattern since May 1985 of slowness in payments which did not, initially, trigger a formal complaint. The staff suggests that there have been some factors beyond the immediate control of the authorities which have contributed to the emergence of arrears to the Fund. But, the staff also points out that, more fundamentally, Romania's arrears can be attributable to factors subject to Romania's influence or control, in particular, to the authorities' rather rigid foreign debt management policy in the last few years. If the authorities had planned their cash flows more carefully and given a higher priority to keeping current with the Fund, arrears might well have been avoided. It is worth noting that Romania made net repayments of its total debt of nearly $500 million last year and about $200 million in the first six months of 1986. This clearly indicates a pattern of discrimination against the Fund.

We do recognize and very much welcome the major effort that has recently been made to reduce these arrears and that these payments have resulted in the elimination of the arrears which originally gave rise to the formal complaint. But new arrears amounting to SDR 23 million have accumulated, and substantial new repurchase obligations, on the order of SDR 40 million, will fall due before the end of the year.

We welcome the indication by the Romanian authorities that they intend to become fully current in payments to the Fund no later than the end of 1986 and to remain current thereafter. We certainly hope that this proves to be the case. However, we would not support putting a particular date in the decision itself, which de facto would mean acceptance of rescheduling of the debt. We would be willing for this to be included in the Managing Director's telex to the Romanian authorities. We also do not believe that this justifies our failure to limit, formally, Romania's use of Fund resources, as has been done in every previous case. To fail to do so would send the wrong signal to the large majority of countries that have succeeded, despite difficulties, in staying current with the Fund. We strongly urge the Romanian authorities to become fully current with the Fund, as looks quite possible, well before any review is necessary. Certainly this will be required before Romania can contemplate access to Fund resources, as Mr. Polak indicates.

Mr. Engert made the following statement:

Commenting on the Romanian Article IV consultation is challenging, and not because of any lack of effort on the part of the staff. On the contrary, I am impressed with the effort it has made in the face of what must have been very difficult circumstances. I find this a challenging exercise for a number of other reasons.

As the staff report makes clear, the different data that are available are strikingly inconsistent. In addition, much of the data do not seem to be credible, and the authorities' forecasts for growth are excessively optimistic. Reviewing Romania's economy is also quite challenging because it appears that there are few objective efficiency standards used to guide investment and spending decisions. Like the staff, I find it difficult in the absence of more detailed information to make a thorough assessment of Romania's policy performance and prospects.

We are told that prices play no role whatsoever internally in the allocation and distribution of goods. It seems apparent that instead of a price system, allocation and distribution decisions are based simply upon political fiat. But I would be interested to know what, if any, economic standards guide these decisions. Perhaps Mr. Polak has gained some insight into this process through his experience with the Romanian authorities, and I would appreciate it if he could tell us what influenced the spending and allocation decisions made by the Romanian authorities.

Based on these considerations, I urge the Romanian authorities to undertake three things. First, as the staff suggests, I urge them to rectify their statistical problems and present data that are more credible and internally consistent. Second, I encourage the Romanian authorities to provide more information on the objective efficiency considerations that they employ in making their spending and allocation decisions. In this connection, I agree with the staff that in order to promote a more efficient allocation of resources and a more sustainable external position, the Romanian authorities ought to review in cooperation with the World Bank their investment priorities, and to conduct sectoral studies. Third, I would urge the Romanian authorities to undertake to introduce a greater degree of liberalization in their economy and increasingly base policy decisions on prices, interest rates, and exchange rates that reflect resource scarcities. I regret that the steps taken in the past to provide a somewhat greater allocative role for exchange and interest rates have been reversed.

The paper before us today contains much information which is inconsistent and even contradictory. For example, the very sharp increase in the stocks of so-called exportable goods is quite curious, as is the peculiar reporting and classification procedures associated with this term. Similarly, the divergence between the growth of the Consumption Fund and retail sales is striking. Equally curious is the Romanian authorities' explanation of this divergence as being accounted for by an increase in consumption of own-production in 1985. It strikes me as extraordinary that the marked divergence between the growth of the Consumption Fund and of retail sales could be accounted for in this way.

It is also easy to be skeptical about the Romanian forecast for a real GDP increase of 9.4 percent in 1986. The staff points out that this projected growth rate is nearly three times higher than the average forecast for Romania's chief trading partners and that achievement of this ambitious target depends significantly on the attainment of a large increase in labor productivity. I am glad to see that the Romanian representatives at least acknowledge that their productivity assumptions are ambitious. Underpinning this hopeful productivity performance seems to be the new "global contracts" system, which provides, at least in principle, incentives for increased productivity. However, it is difficult to see how the global contracts system could be effective inasmuch as production targets seem to be set so high as to virtually preclude any productivity bonuses.

Wage and employment policy in Romania is also curious. The objective of wage policy is to ensure that wage increases are less than the gains in labour productivity, which, other things being equal, would tend to afford greater employment. Another expressed policy objective is to encourage enterprises to limit labor input. So, it would appear that policy incorporates objectives that are seemingly at odds with each other.

As for financial policies, there are similar inconsistencies and contradictions. As the staff report makes clear, the revenue shortfall in 1985 of almost 17 percent is inconsistent with the announced unchanged tax rates and the substantial recorded growth of economic activity, to which the tax bases are linked. The authorities have responded to this query by noting that actual tax rates had been permitted to deviate from announced rates. A few lines later, we are told that in 1986 the authorities expect profits and production tax to rise rapidly, apparently implying that the actual tax rates have now returned to announced rates and that the authorities' commitment to enhancing the so-called self-financing capacity of firms has ended. We are also told that the authorities have decided to curtail credit to enterprises severely in order to force them to increase their productivity. This is essentially the same rationale which supports the revaluation of the Romanian leu. I agree with the staff in its assessment that this severe credit restriction may not be compatible with growth expectations. Indeed, I am quite perplexed by this policy orientation which purports that by making conditions for production and enterprises more and more difficult, there should be an associated rise in productivity and living standards. It seems that if this were true, Romania would by now be a much more prosperous and buoyant economy.

The recent revaluation of the leu has, in the context of the Romanian economic system, some internal logic, inasmuch as the authorities endeavor to ensure that enterprises derive their profits principally from lower costs of production and improvements in productivity. However, the Romanian authorities are also concerned about improving external competitiveness, which is very important to Romania's economic prospects. In this connection, I find the recent revaluation quite mysterious. A more efficient way of dealing with the Romanian authorities' concern about the so-called windfall profits that have accrued to the export sector would have been to tax them.

I agree that Romania's vulnerable external position requires a prompt change in external debt management policies. I believe that the effort to repay external debt by the Romanian authorities has been excessive and, as the staff report makes clear, that these policies have led to a rundown of foreign exchange reserves to minimal levels and the emergence of arrears, which have hampered the restoration of Romania's creditworthiness. More important, this policy approach has doubtless had an adverse effect on the living standards of the Romanian population. Consequently, I welcome the rescheduling of Romania's commercial bank obligations of 1986 and 1987, which will provide some relief to the hard-pressed cash flow position. I urge the authorities to undertake a more flexible approach to foreign debt reduction, and I agree with the staff that further resort to long-term debt relief may play a useful role.

Clearly, I am not as optimistic as the Romanian authorities regarding the prospects for their economy, and I encourage the Romanian authorities to pay close attention to the suggestions made by the staff and the Executive Board. At a minimum, I hope the Romanian authorities will in the future provide the Fund with more, and more reliable, information and insight into the workings of their economy and of their policies. I support the proposed decision on the Article XIV consultation.

Regarding the question of arrears, I regret that the Romanian authorities have placed themselves in a situation where they are in arrears to the Fund and the World Bank and, like other Directors, I would strongly encourage the Romanian authorities to clear the remaining arrears. Nevertheless, I am impressed with the recent efforts of the authorities to reduce their arrears to the Fund and with the apparently newly found seriousness with which they view the situation. In view of their recent efforts, their commitment to clear the arrears as soon as possible, and certainly before the end of this year, and to remain current thereafter, I am willing to go along with the proposed decision, as amended by Mr. Polak.

Mr. Rye made the following statement:

The central aim of Romania's economic strategy over recent years has been the rapid repayment of external debt. This strategy requires the authorities to achieve substantial growth in domestic output and slower growth in domestic expenditure to facilitate a surplus on the current account, and to adopt financial policies that generate domestic savings to replace foreign borrowing.

By following this strategy, the authorities have substantially reduced the size of Romania's external debt over the last five years. However, the staff identifies a number a areas where problems have emerged or are likely to. A major problem that continues to cause concern is the consistency and reliability of data. Accurate data are essential for meaningful analysis of economic performance and for developing the right prescriptions for correcting problems. The staff highlights a number of areas where statistical deficiencies have hampered analysis. These include the difference between projected output and demand, the divergence between export data from balance of payments and national accounts statistics, and the forecasts for productivity, the current account, and the budget. The table on page 33 of the staff report on the status of data in the International Financial Statistics confirms the lack of timeliness of some data. I urge the authorities to make greater efforts in this regard.

I have listened with interest to Mr. Polak's observations on those difficulties. I agree that it is indeed "difficult to arrive at a clear picture of recent performance, or projections for the near future, due to conceptual problems...and other questions raised by the staff on the consistency of the data." This makes it the more difficult to understand the apparent confidence with which the authorities hold to what appear to be extremely optimistic projections for the external accounts. Notwithstanding the measures the authorities have taken to improve the current account, some of which will produce returns only in the medium term, the staff's doubts whether the current account forecast for 1986, and more important, the projections for 1987-90, are likely to be met seem to be entirely justified. In particular, it is difficult not to share the staff's skepticism about the authorities forecast of a 10 percent gain in labor productivity arising from the new wage incentives and the targeted increase in total production. If an increase of that size is so readily obtainable, one wonders why the authorities did not tackle the problem well before this.

While the lower oil price is expected to help in achieving the 1986 current account target, the authorities would be well advised to examine seriously the staff's recommendations for improving the underlying convertible current account position. I also endorse the staff's comment that if the targets are not met the authorities should consider seeking longer-term debt relief rather than restricting imports and generating further domestic savings to meet any shortfall. The latter approach would probably be more harmful to the economy's growth prospects in the medium term.

Although a centrally planned economy presents special problems for economic analysis, I fail to see the logic behind using the exchange rate as a tool for reducing profitability, and thus to improve efficiency, in domestic export industries. Apart from the fact that the exchange rate has a broad-brush impact, much of which would run counter to the authorities' supposed objectives, I would have thought a more efficient way to remove excess profits and to encourage firms to pursue the authorities' goals would be via the domestic taxation system. The increased profitability of the export sector should be taken as a signal for the authorities, in the absence of a market, to shift resources into areas where productive returns, particularly in convertible currency, can be made and not to tamper unnecessarily with the exchange rate.

Domestic financial policies have been directed to generate savings to help service and repay foreign debt. The sharp fall in the budget surplus in 1985 resulted from weaker than projected profitability and lower tax revenues. Doubts about the accuracy of growth forecasts in 1986, and for the rest of the plan period, and the resultant tax revenues, place a question mark against the likely size of the budget surplus in 1986 and the projected 9.6 percent increase in household savings. These doubts are reinforced by the recent tightening of bank credit to entEprises, a move which could be seen as inconsistent with the ambitious growth projections.

In sum, it is difficult to come away from consideration of these papers without the feeling that the plans of the authorities are based on dubious figures and questionable assumptions. I support the proposed decision on the Article IV consultation.

Consideration of Romania's arrears presented one of those "on-balance" cases that make for difficult decision making. The payments of substantial amounts against arrears are encouraging, but it is not altogether clear, despite Mr. Polak's explanation, that the Romanian authorities could not have paid fully their overdue financial obligations to the Fund in recent days. We also have to take account of Romania's very poor record; most of its payments to the Fund in the last 18 months have been late. We do obviously need to watch very closely that the authorities live up to their new resolve to make stronger efforts in future, and to get away from the apparent former, quite unacceptable, policy of concentrating Romania's arrears in the Fund and the Bank. In view of the circumstances outlined by Mr. Polak and the staff report, I am prepared to support the decision drafted by the staff, with the amendments proposed by Mr. Polak to paragraph 4. As for the date of the Board's further consideration of the complaint, I would prefer to maintain the date of November 24, as proposed by the staff. If by that time, there is further evidence of the good faith of the authorities, I expect I could then support deferring any substantive decision to sometime early in the new year. But I agree with Mr. Templeman; we should not now be seen to be agreeing to some kind of unilateral rescheduling.

Mr. Schneider made the following statement:

Since I fully share the staff's concern about the recent economic developments in Romania, I can be brief. It is very regrettable to note the apparent lack of willingness of the Romanian authorities to resume the policy dialogue with the Fund that started in the early 1980s, at the time of the debt crisis in that region. It is also disappointing to learn that as the result of major statistical inconsistencies, the staff does not even have the needed information for a meaningful analysis of the underlying economic performance of the country. Under these circumstances, the task of the Board is extremely difficult because it is almost impossible to give advice to the authorities on the ways and means to achieve a viable balance of payments situation within the framework of Romania's centrally planned economic system.

Given the present liquidity problem and the existing payment arrears, which have been entirely concentrated on the Fund and the World Bank, I have no doubt that the Romanian authorities need some advice. I want to make some more specific observations.

Although the country's current account in convertible currencies is in surplus, it is more than evident that the external adjustment achieved so far is supported neither by internal adjustment nor by an appropriate debt management policy. The current account surplus to a large extent stems from cutbacks in imports. Although the supply constraints were reduced at the beginning of 1986, a possible deterioration of the trade balance should by no means lead again to a compression of imports. Insufficient imports fail to generate enough exports, and if this trend were to continue, it could easily be expected that the current account surplus might soon disappear, leading the country into even more serious liquidity problems, especially when internal adjustment is slow or does not take place at all. I also have some difficulty in understanding Romania's debt management policy. The intention of the authorities to pay off all their foreign debts within a very short period without raising new loans for even a modest increase in their reserves severely limits the country's room for maneuver. In an economy such as Romania's, if the planned export drive cannot be fully implemented, the intended current account surplus can be achieved only by cutting back imports, which would again disrupt the production targets in general as well as the export target.

I have difficulty in understanding why the Romanian authorities are so hesitant to have any meaningful dialogue with the Fund on the country's internal adjustment needs and on policies conducive to a viable balance of payments situation. Experience has shown that the Fund can give very useful advice to its members regardless of the existing economic system. The Fund is now certainly aware that in centrally planned economies, internal adjustment requires a different approach. Systemic measures have to be implemented in a comprehensive way in order to reach all sectors of the economy. The Fund is also aware that the usual demand management measures do not necessarily have the same effects in those economies as they do in market economies.

I urge the Romanian authorities to re-engage in a dialogue with the Fund on internal adjustment, because the present policies followed by the authorities put an unduly heavy burden on the Romanian population and cannot be sustained in the longer run. I have taken note of the substantial payments made by Romania to the Fund last September in order to reduce its overdue obligations and I hope that Romania will soon become fully current with the Fund. At the same time, I take this as a hopeful sign of a change in attitude of the authorities vis-à-vis the Fund. As to the proposed decision, I have listened to Mr. Polak's explanation of the situation and find his argument convincing. I would therefore be prepared to support the proposed decision as amended by Mr. Polak.

Mr. Goos made the following statement:

Recent relations between Romania and the Fund have been less than satisfactory for three reasons. First, there is the accumulation of arrears to the Fund. Although these arrears have been substantially reduced, it is worrying to note that the authorities are apparently discriminating against the Fund and the World Bank in settling their external debt service obligations, as evidenced by the staff's finding that Romania's overdue obligations are concentrated entirely in these two institutions. This discrimination is a matter for serious concern: it is a far cry from the preferred creditor status the Fund enjoyed only a few years ago with all its members and makes one wonder what could have caused such a change in attitude. It is worth emphasizing that arrears to the Fund continue to have a negative impact on a country's creditworthiness. As the staff rightly points out, such arrears run counter to the authorities' intention of improving Romania's credit standing by rapidly reducing its external debt. Second, recent relations with Romania are unsatisfactory owing to the continued provision to the staff of generally poor and inconsistent statistical data. Moreover, there are disquieting indications in the paper that the authorities are unwilling to provide information that has been specifically requested by the staff. I am referring in particular to the request to discuss the structure and operations of the economic system, and the request for several technical notes and the release of certain data series. In both cases the authorities apparently failed to provide the staff with the information they had requested. Third, there seems to be considerable reluctance on the part of the authorities to follow the Fund's policy advice, as evidenced most notably by the reversal in the policy stance that had been adopted under the Fund arrangement in 1981/82.

These aspects of the relationship with the Fund are quite difficult to reconcile with Romania's obligations under the Fund's Articles of Agreement, and they also raise questions with regard to the authorities' willingness to cooperate with the Fund. Against this background, I am pleased to note from Mr. Polak's helpful statement the apparently encouraging discussions that took place between the new Minister of Finance and management and staff. I would hope that the authorities will take the necessary steps to settle promptly the remaining arrears and avoid the re-emergence of overdue obligations to the Fund. At the same time, I would urge them to provide the staff with comprehensive and reliable information that allows a meaningful analysis of economic policy and performance. In this regard, the Fund should continue to offer technical assistance. Such assistance would, of course, be appropriate only if it would meet with a stronger inclination on the part of the authorities to adopt the staff's recommendations. I might add that a restoration of normal relations with the Fund along those lines would, certainly, greatly facilitate a favorable response to a possible request for the use of Fund resources.

Regarding recent economic developments and policy issues, I will be rather brief since I am in broad agreement with the staff appraisal and, perhaps more important, since I find it difficult to draw firm conclusions on the basis of the information provided by the authorities. In fact, there is considerable evidence that Romania's economic performance is much less favorable than the official national accounts data and the external projections imply. According to certain observers, economic developments have further deteriorated, even to the stage of crisis, as a result of persistent and widespread bottlenecks especially in the domestic supply of energy, industrial inputs, and agricultural produce. And there are also reports referring to continued low labor productivity, excess industrial capacity, and innovative weakness. Available information clearly suggests that the policy stance pursued by the authorities has failed to tackle the serious problems in Romania's economy.

Closer analysis of this policy stance reveals that the recommendations expressed by the Board and the staff on the occasion of last year's consultation discussions remain broadly valid. It appears that the central planning system and its extremely rigid application in the case of Romania lie at the heart of the problem and that the deficiencies of that system are being greatly exacerbated by the fundamental objectives of a rapid reduction in external debt and the maintenance of strict price stability. Since the detrimental effects of these factors on overall efficiency, growth, and external viability are adequately discussed in the paper, I will restrict myself to supporting the staff's recommendation that the authorities should reconsider pricing policy and external debt management policies. While the recent rescheduling arrangement with commercial banks constitutes a welcome step in the right direction, I hope that the authorities will adopt a similar more pragmatic and flexible stance in other areas of economic management. In this context, they would be well advised to study closely the recent economic reforms implemented in other centrally planned economies, including in particular the transfer of decision-making power to the enterprise level and greater reliance on the price mechanism, which in general have produced very encouraging results in such economies. Finally, I would like to lend our support to the proposed decision.

Extending his statement, Mr. Goos stated that he was somewhat uncertain about the appropriate course of action regarding Romania's overdue obligations to the Fund. He noted that Romania had made payments sufficient to settle fully the obligations outstanding at the time the Acting Managing Director's complaint had been issued but that further obligations had become due during the period. He agreed with Mr. Polak that the Executive Board might be faced with an awkward situation on November 24, 1986, as it was expected that Romania would be unable to clear its arrears by that time. Therefore, he agreed that paragraph 5 should be amended as suggested by Mr. Polak, but in order to ensure equal treatment of members, paragraph 4 should refer to the fact that Romania was ineligible to make use of the general resources of the Fund until such time as it became current in its obligations.

Mr. Yang made the following statement:

> Romania has maintained sustained economic growth over the past several years, and enormous efforts have been made by the authorities to enhance labor productivity, improve the quality of production, and strengthen the management of the enterprises. We also note the firm determination of the Romanian authorities to reduce the external debt and become current in their financial obligations to all creditors.
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> Currently, Romania's economy has been beset by many difficulties, some of which have obviously been due to factors beyond the control of the authorities, such as the declining commodity prices, the growing protectionism in the industrial countries, and the adverse weather conditions in the past year. Faced with this background, the Romanian authorities have taken several steps to try to eliminate the impact of these adverse factors. However, further efforts may be needed. As Romania's external position is still vulnerable and foreign exchange reserves remain very tight, an improvement in debt management would be conducive to alleviating the overriding debt burden. In addition, policies may well need to be centered on export promotion rather than import compression in order to generate the necessary current account surplus. This chair supports the proposed decision concerning the 1986 Article IV consultation.
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> With regard to Romania's overdue obligations to the Fund, this chair notes that Romania recently made several payments to the Fund. Consequently, Romania's arrears to the Fund have been reduced substantially. Also, the Romanian authorities have reaffirmed their commitment to settle fully their overdue obligations to the Fund not later than the end of this year. In view of these circumstances, I can go along with the draft decision as amended by Mr. Polak.

Mr. Foot stated that he agreed with the staff appraisal. He recalled that after continued prodding, the problems experienced with regard to Yugoslavia's statistics had been overcome, and he hoped the same would be true in the Romanian case. It was difficult to understand how a centrally planned economy could function if the data were inadequate. He hoped that progress could be made between the staff and the authorities in that area.

The authorities' external debt management policy had been inappropriate in recent years and had left Romania in a difficult liquidity position, with an impaired credit standing with the commercial banks, Mr. Foot noted. Romania was in the seemingly unique position of having worsened its credit rating, while reducing its external debt. He urged the authorities to give urgent priority to clearing their arrears with the Fund and the World Bank. As of October 1, the payments that were overdue to the World Bank by more than one month had exceeded $19 million. Romania ran the risk of being publicly identified as being an overdue debtor to the Bank.

The focus for growth in 1986 depended on high productivity growth, of which there had been little evidence, Mr. Foot remarked. Furthermore, the growth estimate was also based on an increase in grain production of 37 percent, far above the levels achieved in recent years, and a rapid growth in output of other agricultural products. In addition, exports of refined oil products were projected to increase rapidly. While the performance of those products might be better in 1986 than 1985, it was unlikely that output would be as encouraging as assumed. The projected growth in non-oil exports would be difficult to achieve given the overvalued exchange rate and the difficulties facing the developing countries that account for two thirds of Romania's exports to nonsocialist countries. Several of those considerations also cast some doubt on the realism of the authorities' forecast for a current account surplus in 1986. The data for the first eight months of that year showed that the authorities were on track with respect to their objectives, unless the earthquake noted by Mr. Polak had imposed major dislocations. As the liquidity difficulties had been manifest long before the earthquake, it could only be presumed that either the surplus was being achieved by the provision of export credit to developing countries, which did not actually produce immediate foreign exchange, or that the forecast surplus was not consistent with the objective of avoiding liquidity difficulties. It would seem from the available data that even if the net surplus was on track, it was being achieved only as a result of lower than projected imports and exports. It was vital for Romania to avoid further harmful import compression if it was to achieve its export objectives. He could accept the proposed decision concluding the Article XIV consultation.

On the question of Romania's arrears to the Fund, while he agreed with Mr. Polak that the next review should be held in three months rather than in six weeks, he regretted that there was no reference in the decision to the fact that Romania was ineligible to use the general resources of the Fund, Mr. Foot indicated. In any event, the cable from management transmitting the Board's decision on Romania's arrears to the Fund should record the fact that Romania was ineligible to use the Fund's resources. He was unhappy with the staff's suggestion that it was important that the arrears that gave rise to the original complaint had been cleared. That sentiment appeared to be a de facto acceptance of a "credit card" mentality. In sum, the authorities had clearly made considerable efforts to repay their arrears. He would welcome any recognition of that fact in management's cable to the authorities but agreed with Mr. Templeman that the standard reference in decisions on overdue obligations to the fact that a country was ineligible to use the Fund resources should be included.

Mr. Nguyen made the following statement:

It is not without some concern that we examine the case before us. Romania is now at a turning point characterized by an unfavorable cash flow position, a low level of reserves, and the emergence of payments arrears to the Fund and the World Bank. Indeed, according to official statements, the Romanian economy continued to expand strongly in 1985. The current account registered a sizable surplus despite the harsh winter conditions in early 1985. This surplus is expected to remain high in 1986. These are favorable and welcome developments which, however, must be taken with caution. To say the least, a correct assessment of the situation is rather challenging for the two reasons put forward by the staff, namely, the statistical discrepancies in the macroeconomic data, which have been mentioned by other Directors, and the absence of dialogue between the staff and the authorities on the structure and operations of the economic system. Therefore, unless proper solutions are designed to deal with these two problems, any comment or consideration we may have on the economy will lack solid foundation, as recognized by Mr. Polak in his very interesting opening statement.

Nevertheless, we will not follow Mr. Polak's advice to concentrate only on the international aspects of the economy. We have to appraise the domestic economy in order to follow his argument that the expansion of exports requires an increased supply of imports for the export industry and for the import competing sector in order to be able to re-establish the linkages between external and domestic issues. How are the Romanian authorities going to achieve their external objectives without correct policy instruments? Indeed, I am rather perplexed by the answers given. Mr. Polak rightly stressed that, of the planned economies, Romania has moved the least from the old model of the centrally planned economy. A question however arises whether the same results could not have been obtained at a lower cost through the use of different policy instruments. In this respect, I regret that the discussion we had on the design on adjustment programs in planned economies was not fully conclusive. It is clear that the Fund has to pursue further its studies on these economies so as to improve its understanding and to assist the members concerned.

The views expressed by this chair last year and shared by many around the table are still valid. The situation in Romania has not changed much in the past year. The problems confronting the economy are the same: the absence of clear market signals, delays in implementing structural measures, insufficient response on the supply side. These problems are further exacerbated by the lack of reliable statistical data, and we have not been alone in suggesting increased recourse to the Fund's technical assistance. Mr. Templeman has rightly stressed Romania's obligations under the Articles of Agreement with respect to the surveillance exercise.

I found the issues raised in Section III of the staff report--economic issues and policies--particularly relevant. The staff has correctly pointed out the main issues on which the authorities should focus their attention. I would like to mention only two of them. First, on the debt management policy, I share the staff's suggestion that a more flexible course should be followed. The favorable rescheduling agreement with the commercial banks will bring some relief, allowing a limited recourse to foreign borrowing to address the vulnerable external position. Second, the reorientation of trade toward the convertible zone, particularly toward market-oriented countries, would certainly imply initially a deterioration in the trade balance. Like the staff, I would urge the authorities to resist the temptation to compress imports again. In this connection, it would appear more realistic to adopt adequate signals, for instance in the areas of prices and exchange rates. I note with regret from Mr. Polak's opening statement that the authorities are taking a different course in relying heavily on administrative measures. On a different ground, the expertise of the World Bank in reviewing investment priorities and conducting sectoral studies could be called upon.

As for the crucial question of the need to restore Romania's creditworthiness, I urge the authorities to attach the highest priority to settling all their overdue obligations with the Fund and the World Bank. Like Mr. Goos, I regret that Romania has discriminated against the Fund and the Bank, which have been supporting Romania's efforts to overcome its debt problem by providing technical and financial assistance. Mr. Polak's statement on the Romanian authorities' recent policy approach and Romania's recent payment to the Fund of SDR 5.4 million are thus welcome. I hope Romania will soon settle all its obligations vis-à-vis the Fund, at the latest by the end of the year, as committed and will remain current thereafter. I can reluctantly go along with the compromise that will emerge from the discussion.

Finally, I would like to reiterate the hope that the active and confident collaboration between Romania and the Fund, which has proved to be useful, could be resumed soon. In my authorities' view, a quick settlement of all the overdue obligations is a clear prerequisite.

Mr. Kyriazidis made the following statement:

I am deeply puzzled by the picture that has been given to us regarding economic developments in Romania in 1985 and estimated for 1986. The two elements that come out clearly are the negative developments, in terms of growth of the domestic economy and in terms of the balance of payments. If I interpret the staff's remarks correctly, the rate of growth in 1985 should be less than 4 percent, about two percentage points lower than the official estimate, which indicates a very significant deceleration of growth. Severe skepticism is also justified with respect to the official forecasts for 1986. There may indeed be external factors that have substantially contributed to this result but this is certainly not the entire explanation. More information would be necessary in order for us to see more clearly what is actually happening.

The other negative element which comes out clearly is the significant reduction in the balance of payments surplus on current account, which reflects a reduction of exports, particularly to the convertible currency areas. In this case also external factors have adversely affected developments in 1985 and the first half of 1986, but one suspects that there are also domestic factors which are not fully explained. Price stability on the other hand has been maintained.

I understand the frustration of the staff in its attempt to interpret developments and I admit that I am strongly tempted by Mr. Polak's advice not to try to comment on developments in the domestic economy. The inconsistencies in the figures are too numerous and glaring to be ignored, and a deeper understanding of the economy which is an essential condition for any rational comment or advice is lacking. The Executive Board should urge the Romanian authorities to eliminate the statistical inconsistencies and to engage in a more searching and sincere dialogue with the Fund. This is all the more necessary if Romania intends to make further use of Fund resources as intimated in Mr. Polak's statement. We are faced with a system in which the central authorities determine almost totally the allocation of resources. Under these conditions price stability does not indicate equilibrium in supply and demand or the absence of inflationary pressures. In fact, domestic disequilibria and inflationary pressures manifest themselves in different ways through scarcities, long lines, and empty shelves. In fact, an interesting indication that this is the case is provided by the staff in its analysis of the monetary aggregates where the otherwise inexplicably large increase in liquid savings of households is ascribed to the inability to spend. It is therefore clear that price stability does not have the meaning that we usually ascribe to it and, from the point of view of the criteria of macroeconomic policy, is irrelevant.

Given the importance that the Romanian authorities seem to attach to price stability, some erratic movements in their exchange rate policy are difficult to understand. Perhaps the staff could comment on the reasons for the devaluation of the leu in March of this year, which was rapidly reversed in a move that appears more in keeping with the overall concepts of the Romanian authorities' policy approach.

It is also very difficult to comment on the balance of payments position. I fully share the reservations and doubts of the staff on the medium-term projections, which would appear to reflect objectives rather than forecasts. It is indeed very doubtful whether they are attainable and it is unclear by what means the Romanian authorities proposed to achieve them. The policy measures described in the staff report cannot be quantified and the attainment of the objectives seems to be intimately linked with the growth and productivity forecasts of the Romanian authorities, which the staff rightly judges as being too ambitious. In view of these uncertainties, which affect not only medium-term prospects but also short-term prospects as evidenced by the severe cash flow problems that have arisen this year, one cannot but agree with the staff's recommendation that the Romanian authorities should adjust their debt management policy. The rescheduling agreement reached with the leading banks in July 1986 is a significant step in the right direction but is very probably insufficient. Therefore, I strongly support the recommendations of the Fund staff that additional rescheduling arrangements or other alternative new medium-term financing should be sought so as to relieve the extremely tight conditions under which the Romanian authorities are operating. This is all the more important since improved growth and export performance will depend crucially in the medium term on an increased volume of imports, in which case the current account surplus objective may well not be achieved.

Although the arrears in Romania's obligations to the Fund that caused the complaint under Rule K-1 of August 29 have been substantially reduced, it is particularly disturbing, and in this I fully agree with the remarks of Mr. Goos, that the Romanian authorities have discriminated against the Fund and the World Bank in the servicing of their external debt obligations. This is an attitude that is deeply regrettable. In this connection, the assurance given by the Romanian authorities and reiterated by Mr. Polak that all the arrears, including those that have arisen since August 29, will be settled at the latest by the end of the year is certainly welcome. It is to be hoped that the Romanian authorities will see to it that such a situation does not recur.

We support the proposed decision, with Mr. Polak's comments.

Mr. Jayawardena made the following statement:

> I note from Mr. Polak's opening statement, that Romania suffered a rather large export shortfall in calendar 1985 and initiated discussions for a drawing under the compensatory financing facility early this year. This was presumably well before Romania became overdue to the Fund on June 17, 1986. Hence, it is possible that Romania may not have had to scrape the bottom of the barrel as Mr. Polak described, or perhaps may not have fallen into arrears in the first instance, if prompt assistance had been available under the compensatory financing facility. These factors are rather disconcerting to those members who consider the compensatory financing facility and its quick disbursing character as a critically important and an essential part of the Fund's armory. I wonder whether the staff could tell us what factors in this instance made compensatory financing unavailable to Romania.
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> Regarding Romania's overdue obligations, we are convinced of the validity of Mr. Polak's observations. Hence, we support the proposed decision, with the amendments proposed by Mr. Polak.

Mr. Lundstrom stated that he was in broad agreement with the staff appraisal and shared the concerns expressed by previous speakers. Romania's poor performance with regard to the provision of statistical data was particularly disappointing, and he supported Mr. Templeman's suggestion for dealing with that issue in the next Article IV consultation discussions. With respect to the decision on Romania's arrears, he agreed with the staff that the recent payments made by Romania should be recognized. He could go along with Mr. Polak's amendment of paragraph 5 of the decision.

Mr. Fujino remarked that the problem of Romania's arrears was serious and should be addressed in a determined and coherent manner. While he welcomed the recent substantial payment by the authorities, there had been a series of delays in payments since May 1985. He was not fully convinced that the authorities would need until the end of 1986 to become current with the Fund and, therefore, favored the decision as originally drafted by the staff. However, if the feeling of the Executive Board was in support of Mr. Polak's proposal, he could go along with it.

Mr. Suraisry made the following statement:

> I agree that Romania has made substantial efforts to remain current with the Fund. These efforts need to be reflected somehow in the decision. However, our decision should not have adverse effects on the Fund's efforts to contain the problem of overdue payments. Any notion that could give the impression that the Fund is relaxing its procedures on overdue obligations should be avoided. In this context, the proposed decision lacks, for the first time, explicit mention of the fact that the country, in this case, Romania,

shall not make use of the general resources of the Fund until it becomes current with the Fund. Omitting this reference is likely to give the wrong signal and could create problems for the Fund in the future.

The decision also proposes further consideration of the complaint under Rule K-1, the first proposal of its kind and an explicit recognition of rescheduling. I am concerned that this could be the first step toward a formal recognition of the rescheduling of the Fund's arrears. Therefore, while recognizing the efforts made by the authorities to remain current with the Fund, I find it difficult to support the proposed decision as it stands. This is particularly so in view of Romania's discrimination against the Fund and the Bank, even though I was encouraged by Mr. Polak's comment on the favorable discussions between Fund management and Romania's new Finance Minister that took place during the Annual Meetings. I find Mr. Templeman's suggestion quite appropriate. I could also support the proposed decision if it is revised in a way that would reduce the potential adverse effects associated with the departure from our current procedures.

Mr. Templeman stated that he would welcome the staff's clarification on a number of issues. If the Executive Board approved the decision as drafted, would it be the first occasion on which the Executive Board had taken a decision of that kind, in which the reference to the fact that the country should not make use of the general resources of the Fund was omitted? Had the Executive Board ever approved a decision on a report and complaint under Rule K-1 that included a date by which the authorities were expected to become current to the Fund, which would imply that the Executive Board was accepting a fixed date for payment that was different from the originally scheduled payment date? Regarding Romania's ability to pay, he noted that Romania's gold reserves amounted to about SDR 150 million, valued at SDR 35 an ounce. At the market rate, Romania's gold was worth about SDR 1.5 billion. Could the staff indicate whether the authorities could have used some of the gold reserves to make their payments to the Fund? What were the prospects for payments by Romania in the next few weeks?

The staff representative from the European Department recalled that Directors had raised a number of questions regarding the economic system in Romania. Some speakers had suggested that there should be more intense dialogue between the authorities and the staff so that the staff could achieve a better understanding of the Romanian economic system. However, it was difficult to determine at what level of Government such a dialogue should take place. It was not clear whether the staff should hold discussions at the level of technicians or at the decision-making level of the Government. It should also not be overlooked that although Romania was a centrally planned economy, many decisions were taken at different levels, for example, the level of "controls," the specialized ministries, and the central planning authority.

The authorities had made erratic use of the exchange rate as an instrument to improve efficiency in the economy, as a number of Directors had noted, the staff representative commented. For example, there had been a devaluation of the leu in March 1986 and a revaluation of the leu in July 1986. The staff had indications that the revaluation had been undertaken after the devaluation had met with disapproval by the political leadership. The authorities had indicated in their five-year plan that there would be an occasional revaluation of the currency, presumably in order to maintain the pressure on enterprises to improve their efficiency. He agreed with Directors that efficiency could have been improved through the greater use of taxation and other fiscal policy measures.

The authorities estimated that net agricultural output would rise by 7 percent in real terms in 1986, a projection the staff considered optimistic, the staff representative observed. The authorities' forecasts for exports in 1986 were also optimistic, particularly with respect to the projected increase in oil exports. Preliminary figures indicated that oil exports were no higher in the first quarter of 1986 than in the first quarter of 1985. The export side of the balance of payments was therefore likely to be off track. In the second quarter of 1986, the current account surplus had been $150 million below target for that quarter. The staff did not expect that the authorities would be able to reach a current account surplus of $1.2 billion projected for 1986.

The possibility that Romania might want to make use of resources under the compensatory financing facility had first been discussed between the staff and the authorities in February 1986, the staff representative indicated. At that time, Romania had not been in arrears to the Fund, but the staff had been concerned about the policy approach in Romania and about the question of cooperation with the Fund. Furthermore, the balance of payments projections presented by the Romanian authorities had been too optimistic. At the time of the Interim Committee meeting in April 1986, discussions with the Romanian authorities had been more fruitful. However, it was not until May 1986 that they had requested a rescheduling arrangement with the commercial banks, a course of action that the staff had been recommending in order to solve Romania's immediate liquidity problem. By the time of the consultation discussions in Romania, foreign trade data for the year ended March 1986 had become available, and, contrary to the data for calendar year 1985, they did not support a request for compensatory financing. In the year ended March 1986 the calculated shortfall had fallen to only about SDR 5 million, as the main reason for the relatively large shortfall in 1985--namely, the severe winter in early 1985--had disappeared.

Given the weakness of exports so far in 1986 and the likelihood of a smaller than expected current account surplus, the prospects for Romania becoming current with the Fund were not good, the staff representative stated. However, the authorities had indicated their intention to eliminate their arrears to the Fund by end-1986.

The staff had questioned the authorities on the reason behind the large stocks of exportable goods in 1984 and 1985, the staff representative commented. The Romanian authorities had stated that they would address that question as well as the problem of the statistical discrepancies in a written memorandum to the Fund. The staff had stressed the importance of overcoming the statistical problems in an effort to improve cooperation with the Fund.

The Deputy Treasurer stated that if the Executive Board approved the decision as drafted, it would be the first occasion on which the Board did not impose a formal limitation on the member's right to use the Fund's general resources at the time of the consideration of the report and complaint under Rule K-1. The staff had suggested that course of action because of the large repayments that had been made by the Romanian authorities in recent weeks and the substantial reduction in the amount of outstanding arrears. The staff had also proposed in the decision that the Board should further consider the complaint in two months, rather than in three months, as was the usual practice. The shorter period had been recommended in view of the fact that the decision did not include a formal limitation on Romania's right to use the Fund's resources and because Romania had experienced considerable difficulties in remaining current with the Fund in the past.

Board decisions on complaints under Rule K-1 had not included a specific date by which a member intended to become current with the Fund, as reference to a specific date might imply acceptance of the notion of rescheduling, the Deputy Treasurer remarked. The normal practice had been for those matters to be handled in communications with the authorities following the Board meeting. In only one case had a specific date been noted in the decision. The decision had indicated that the member would automatically become ineligible to use the Fund's resources if it did not make a payment by the specific date. In the draft decision currently before the Board, the staff had referred to a further consideration of the complaint rather than a review of the decision because there was no reference in the decision to a formal limitation on Romania's right to use the Fund's resources.

Mr. Suraisry remarked that he still had some concerns about the decision as drafted in the staff report. He suggested that the usual reference to the formal limitation of a country's right to use the Fund's general resources should be included. In addition, the period of the review should be extended to three months.

Mr. Templeman noted that there were three issues to be resolved; the inclusion of the usual reference limiting a member's right to make use of the Fund's general resources, the timing of the review, and the inclusion of a specific date by which Romania should become current with the Fund. The Executive Board could indicate its views to the authorities in two ways; through the formal decision, or through a communication from the

Managing Director. He was in favor of Mr. Suraisry's proposal. The authorities' determined efforts to eliminate their arrears should be acknowledged in the communication from the Managing Director.

Mr. Foot indicated his agreement with Mr. Templeman.

The staff representative from the European Department, responding to a question from Mr. Templeman, stated that most of Romania's gold had been pledged and was therefore not available for making repayments to the Fund.

Mr. Polak recalled that in the case of Peru, a specific date had been included in the decision, perhaps because it explained the timing of the next review. However, he agreed with Mr. Templeman that the repayment date proposed by the authorities could be recognized in the Managing Director's communication. It seemed appropriate to review the decision taken at the present meeting in three months, first, because it was the standard period of time and, second, because it was soon after the date on which the authorities had indicated they would become current with the Fund. Finally, he thought that it was important that the clause relating to the formal limitation of Romania's right to use the Fund's general resources be omitted.

Mr. Suraisry remarked that as Romania would in fact be unable to make use of the general resources of the Fund while it was in arrears to the Fund, it was important to include the limitation clause in the decision.

The Counsellor remarked that Mr. Suraisry was right in saying that Romania was not able to make use of the general resources of the Fund while it was in arrears to the Fund. The question before the Board was whether to make that limitation explicit in the decision or not. In the past, the authorities had made considerable efforts to repay the Fund when they had the resources available. The authorities were particularly sensitive to the limitation on their use of Fund resources. They feared that if it became known in the international financial community that Romania was unable to draw on the Fund's resources, the experience of the early 1980s, when imports could only be secured against prior payment of foreign exchange, would recur.

Mr. Templeman recalled that the Executive Board had agreed on some standard procedures with regard to the actions that should be taken at certain stages when a member was in arrears to the Fund. It had also been agreed that each member's situation would be considered on a case-by-case basis. He wondered whether, if the limitation clause were omitted from the decision, a precedent would be set that would have to be followed in all other cases.

The Deputy Treasurer stated that the Executive Board had established guidelines with respect to the timing of the issuance of a complaint under Rule K-1 and the timing of the reviews of that complaint. However, the Board had not taken a decision of a general nature with respect to the substance of the actions it would take at the different stages. It had been the desire of Directors, bearing in mind the precedents, to consider the particular circumstances of each case.

Mr. Polak considered that the Executive Board should maintain its policy on arrears and should not change its established procedures if that change would set a precedent to be followed in the future. Romania had repayed a large proportion of its overdue payments and had indicated its commitment to become current in the next few months. If there were another case that was similar to Romania's, he would be willing to support a decision along the lines of the draft decision in the staff report, which omitted the limitation clause.

Mr. Chatah expressed his agreement with Mr. Polak. As Romania had made substantial payments and as the arrears had been outstanding for relatively short periods, he was in favor of holding the review in three months and omitting the limitation clause in the decision on the complaint under Rule K-1. The fact that the decision did not include a limitation clause would not delay any subsequent actions should Romania fail to become current with the Fund.

Mr. Rye noted that Romania's case was unique in the sense that its arrears had been outstanding for only a short period. He would therefore not be concerned if the limitation clause were omitted, and he could go along with the proposal to hold the review in three months. However, it should be pointed out in the Managing Director's communication to the authorities that the Board was following its normal procedure of holding a review after three months and was not acquiescing to Romania's own timetable of repayments.

Mr. Polak commented that it followed from the interventions of the two previous speakers that the fact that Romania could not make use of the Fund's general resources should be mentioned in the communication from the Managing Director to the authorities.

Mr. Goos suggested that the decision could perhaps be approved as drafted, and at the time of the review on November 24, 1986, the Executive Board could reconsider the complaint and include the formal limitation clause at that time. That course of action might encourage the authorities to repay the Fund by that date.

Mr. Templeman reiterated that he could not support the decision if the limitation clause were omitted.

Mr. Foot remarked that developments in the Romanian case had become more encouraging in the past six weeks. He wondered whether the authorities would take less offense if the limitation clause were included in a rather obscure way, perhaps by referring to the relevant Article of the Articles of Agreement.

The staff representative from the Legal Department stated that the limitation clause could not refer to the Articles of Agreement, as the legal basis for the limitation on the use of Fund resources was laid down in Rule K-2.

The Acting Chairman noted that there was a small majority of voting power in favor of the decision amended to refer to a review of the decision to be held in three months. In an effort to reach a consensus, he proposed that the decision be reworded to allow for a review of the decision within the three-month period if no progress were made by the Romanian authorities in clearing their arrears to the Fund. That decision would send a clear message to the authorities that the Board expected prompt repayment to the Fund and expected continuing evidence of the authorities' efforts in that regard. Furthermore, the letter from management to the authorities would emphasize the concerns that the Board had expressed regarding Romania's previous record of arrears to the Fund. The communication could also stress the importance of clearing the arrears before the end of 1986.

The Deputy Treasurer stated that paragraph 5 could be worded to say "the Fund shall review this decision within a period of three months from the date of the decision." The communication from management to the authorities could emphasize that the Executive Board could accelerate the review if it so desired.

Mr. Templeman suggested that the limitation clause be included, together with an explanation that such a limitation was standard in all cases of overdue obligations. On another point, he wondered what would trigger an acceleration of the review of the decision. Perhaps the staff could prepare a short paper on a fixed date providing details of recent developments regarding Romania's overdue payments to the Fund.

Mr. Foot stated that he could go along with the Acting Chairman's proposal. The staff could prepare a short note to the Executive Board on about November 24 indicating Romania's progress in eliminating its arrears to the Fund. Directors could decide on the basis of that note whether to review the decision regarding Romania's overdue obligations before the scheduled date.

After a brief discussion, Directors generally agreed with the Acting Chairman's proposal regarding the decision on Romania's overdue obligations.

Mr. Polak, commenting on the Article IV consultation, noted that all Directors who spoke referred to the difficulty for the Fund of holding an active Article IV consultation with Romania given the inadequacy of the country's statistics. He agreed that the next Article IV consultation discussions should address the problem of Romania's statistical base.

The working of the Romanian economy was determined by a rigid planning mechanism, the reliance on which had intensified over the past year, Mr. Polak commented. Prices in the world markets and the costs of production in Romania played a role in that planning process. From an optimistic viewpoint, it could be said that the economy was planned on the basis of the theory of comparative costs. Hoewever, it was difficult to understand how the economy really operated. For that reason, it was easier to look at developments on the external side, for example, the balance of payments position, the level of international reserves, and external debt. Information on those issues was readily available.

On the internal operations of the economy, many Directors had made a number of recommendations; that the authorities should allow prices, and especially the exchange rate, to play a larger role; that they should look at and learn from the experience of other socialist economies; and that they should have a more active dialogue with the staff, Mr. Polak noted. Although those recommendations were entirely appropriate, he was uncertain whether they would be taken up by the authorities. With the recent changes at the ministerial level in the Romanian Government, the authorities' policy approach had been adapted, particularly with respect to foreign debt and Romania's relations with the Fund and the Bank. However, it would take some time before it could be determined whether there had been a change in policy with respect to the running of the Romanian economy.

Mr. Yang remarked that the history of the planned economic system was short compared to that of the market system. In addition, individual planned economies were evolving, resulting in a wide diversity of forms. It was therefore understandable that the staff had some difficulties in comprehending the planned economy of Romania. He welcomed the efforts of the staff and the Executive Board to try and gain a better understanding of planned economies, but given the staff's difficulty in undertaking intensive dialogue with the Romanian authorities, further efforts were called for on the part of the Fund to study the operations, evolution, and prospective improvement of the planned economy.

The Acting Chairman made the following summing up:

Directors generally agreed with the staff appraisal. I will open with some general observations that came out of the discussion. First, Directors emphasized that a lack of transparency in Romania's policymaking procedures and the large statistical discrepancies made it particularly difficult to analyze economic developments in Romania. In this context, some Directors questioned whether the lack of adequate data was compatible with Romania's obligations to the Fund. Second, they regretted that earlier moves to assign a greater role to the price system and to ensure a more efficient allocation of resources had been reversed. Third, the strong, and even overriding, emphasis placed by the authorities in recent years on achieving large current account surpluses and repaying foreign debt would have severe negative implications for economic growth and the standard of living, Directors noted. Finally, several Directors, in urging the Romanian authorities to reconsider the thrust of their economic policies, referred to the considerable benefits that other centrally planned economies had derived from more flexible pricing policies and from resource allocation that more closely reflected relative scarcities.

On more specific points, Directors noted that Romania had achieved a sizable current account surplus in convertible currencies in 1985, although it was considerably below the target. The smaller than expected surplus had placed strains on the capital account, and reserves had dropped to a very low level. The position had been aggravated by debt management policies aimed at repaying medium- and long-term foreign loans on maturity and avoiding recourse to new loans from abroad.

Directors were particularly concerned to note that Romania's weak external position had led to substantial arrears vis-à-vis the Fund and the World Bank. Many Directors regretted the apparent discrimination against repayments to the Fund and the World Bank. Directors observed that Romania had recently reduced its arrears to the Fund considerably but stated that it was essential that Romania settle its remaining arrears to the Fund promptly. They noted the assurance given by the Romanian authorities to pay all remaining arrears by the end of 1986 and to remain current in its obligations to the Fund thereafter. The Executive Board took a separate decision on a complaint under Rule K-1. It was also essential that arrears to the Bank should be cleared promptly to help restore Romania's creditworthiness.

In the view of Directors, a more flexible approach to Romania's external debt management policies was urgently needed. They welcomed, as a first step, the Romanian Government's approach to foreign commercial banks with a view to obtaining a rescheduling of medium- and long-term debt due in 1986 and 1987, until after 1988 when the debt burden would have fallen substantially. However, with the current account position apparently turning out to be less favorable in 1986 than expected, Directors advised Romania to seek additional debt relief, particularly also in view of the need to strengthen its external liquidity position. Longer-term considerations of growth and efficiency underlined the need to review external debt management policies, many Directors observed.

Directors welcomed the intended relaxation of the policy of import compression and considered that Romania's continued ability to sustain a current account surplus could come under strain without some easing of the supply constraints. They noted various other measures aimed at strengthening the current account--priority allotment of resources to the traded goods sector, remuneration benefits related to export performance, and improvements in productivity--but found that the adequacy of those measures and their impact on the external position were difficult to assess. In addition, for several reasons, Directors wondered whether Romania's high growth expectations could be achieved. They noted that official expectations of broadly based improvements in efficiency and export performance stemming from those steps seemed to be optimistic. Directors also observed that the severe credit restrictions that had been applied might also have a negative impact on economic growth. Directors supported the proposal that the Romanian authorities review, in cooperation with the World Bank, their investment priorities and conduct sectoral studies to help determine Romania's comparative advantage.

Directors noted that revaluation of the leu on July 1, 1986 largely reversed the devaluation in March 1986. They questioned the official view that the earlier devaluation had weakened the pressure on enterprises to improve efficiency and product quality. Several Directors expressed the view that an appropriate use of taxation would have been a more efficient way of dealing with excess profits of export enterprises. Directors generally regretted the limited allocative role of the pricing system, including the exchange rate, in Romania's system of quantitative planning.

Directors noted that, according to the official national accounts statistics, the Romanian economy had continued to expand strongly. However, actual economic performance might well have been much less favorable than indicated by the official data, which included a substantial discrepancy between recorded output and identified final demand, they considered. The accelerated economic growth projected for 1986 assumed major gains in productivity, and Directors doubted whether the measures taken--particularly the new wage incentives and penalties--would indeed be effective in achieving those objectives. Furthermore, the projections again incorporated wide discrepancies between production and final demand, and between the national accounts and balance of payments forecasts. Directors noted a range of other statistical problems and encouraged the Romanian authorities to give priority to resolving those difficulties. They felt that a clarification of the statistical problems was essential for a meaningful analysis of economic performance in the Romanian economy. In addition, Directors regretted that the staff had found it difficult, in the absence of a more intense dialogue with the authorities on the structure and operations of the economic system, to assess the official medium-term projections and to judge the adequacy of measures designed to ensure the required current account surpluses.

It is expected that the next Article IV consultation with Romania will take place on the standard 12-month cycle.

The Executive Board then took the following decisions:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision relating to Romania's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1986 Article XIV consultation with Romania, in the light of the 1986 Article IV consultation with Romania conducted under Decision No. 5392-(77/63), adopted April 29, 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.

Decision No. 8417-(86/167), adopted
October 10, 1986

Overdue Financial Obligations - Report and Complaint Under Rule K-1

1. The Acting Managing Director has reported to the Executive Board, under Rule K-1 of the Fund's Rules and Regulations, the facts on the basis of which it appeared to him at the date of this report that Romania was not fulfilling its obligations under the Articles of Agreement, and submitted a complaint on August 29, 1986 (EBS/86/205) in accordance with that Rule. The complaint under Rule K-1 was that Romania was not fulfilling its obligations relating to repurchases and the payment of charges in the General Resources Account. As of August 25, 1986, the total amount was SDR 83,535,910. These facts and the complaint of the Acting Managing Director were communicated to the authorities of Romania on September 6, 1986.

2. Taking into account that further obligations of Romania have become overdue since August 25, 1986, and that Romania has since made several payments to the Fund totaling SDR 84,750,981, Romania's overdue obligations to the Fund now total SDR 22,848,160 in the General Resources Account.

3. Having considered the report of the Acting Managing Director, the complaint under Rule K-1, and the views of Romania, the Fund finds that Romania has failed to fulfill its obligations under the Articles of Agreement as stated in paragraphs 1 and 2 above.

4. The Fund welcomes the payments that have been made recently by Romania and the resulting settlement of the overdue obligations outstanding at the time of issuance of the complaint under Rule K-1. However, the Fund regrets the continued nonobservance by Romania of its obligations and urges Romania to resume their observance forthwith.

5. The Fund shall review this decision within a period of three months from the date of the decision.

Decision No. 8418-(86/167), adopted
October 10, 1986

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/86/166 (10/8/86) and EBM/86/167 (10/10/86).

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/86/240 (10/8/86) is approved.

APPROVED: June 15, 1987

LEO VAN HOUTVEN
Secretary