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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/157

10:00 a.m., October 28, 1985

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	J. K. Orleans-Lindsay, Temporary
	M. K. Bush
	M. Lundsager, Temporary
	H. G. Schneider
B. de Maulde	S. de Forges
	T. Alhaimus
	M. Sugita
	B. Goos
J. E. Ismael	
	L. Leonard
	J. Hospedales, Temporary
T. P. Lankester	S. King, Temporary
	H. Fugmann
E. I. M. Mtei	A. Abdallah
F. L. Nebbia	
	S. Geadah, Temporary
	J. E. Rodríguez, Temporary
	J. de Beaufort Wijnholds
	A. V. Romuáldez, Temporary
	R. Msadek, Temporary
	A. S. Jayawardena
S. Zecchini	N. Coumbis
Zhang Z.	Jiang H.

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

Also Present

African Department: J. Artus. Asian Department: W. G. L. Evers, S. Kohsaka. European Department: L. A. Whittome, Counsellor and Director; E. O. C. Brehmer, P. C. Hole, H. B. Junz, J. T. Reitmaier. Exchange and Trade Relations Department: J. T. Boorman, S. Kanesa-Thasan. Legal Department: A. O. Liuksila, J. K. Oh. Research Department: L. A. Wolfe. Treasurer's Department: M. A. Lumsden. Western Hemisphere Department: S. T. Beza, Associate Director; J.-P. Amselle, M. Caiola, H. E. Khor, E. L. Rojas-Suarez, S. J. Stephens, M. A. Tareen, G. Yadav. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: S. M. Hassan, G. Nguyen, J.-C. Obame, P. Péterfalvy, G. W. K. Pickering, A. Vasudevan. Assistants to Executive Directors: J. R. N. Almeida, W.-R. Bengs, Bo T., J. J. Dreizzen, G. Ercel, V. Govindarajan, G. D. Hodgson, K. Murakami, M. Rasyid, V. Rousset, C. A. Salinas, M. Sarenac, S. Simonsen.

1. ROMANIA - 1985 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1985 Article IV consultation with Romania (SM/85/243, 8/23/85; and Sup. 1, 10/23/85). They also had before them a report on recent economic developments in Romania (SM/85/275, 10/7/85).

Mr. Wijnholds, speaking on behalf of Mr. Polak, made the following statement:

> Economic developments in Romania showed a considerable improvement in 1984, with an upsurge in production, particularly in agriculture, and a strong export performance as well as a recovery of import levels. The increased surplus in the convertible current account of the balance of payments to almost 4 percent of CDP made possible a further substantial reduction of Romania's external debt. At the same time, international reserves rose substantially to a level exceeding two months of imports in convertible currencies. Prices were kept stable in 1984.
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> The Romanian economy suffered a setback early this year on account of the unusually severe winter, the coldest for many decades. The adverse weather conditions caused difficulties particularly in the supply of energy and for the transportation system. Domestic production, including that of energy, was importantly curtailed, and the level of exports was depressed. Exports in convertible currencies fell by 25 percent in the first quarter of 1985. Although imports also declined, this was much less pronounced. Oil imports actually increased in the first quarter in view of the disruption of domestic energy supplies, although unusually strong conservation measures helped contain such imports. As a result of the weather-related economic developments, the external current account fell to a surplus of no more than \$40 million, compared with \$280 million in the first quarter of 1984. Together with the heavy amortization obligations on the external debt, the reduction in the current account surplus led to some tightness in Romania's foreign exchange position.
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> In the second quarter a substantial rebound occurred both in production and exports. The latter almost doubled in comparison with its level in the first quarter. Although imports also recovered, the net result was a marked improvement in the convertible current account. As this satisfactory performance was sustained in the third quarter, the chances are good that the official forecast for a current account surplus of \$1.5 billion for 1985 as a whole will be achieved. The fall in Romania's international reserves in the first half of this year was to a considerable degree reversed during the third quarter. A further substantial increase in reserves is envisaged for the

final quarter. As regards production, the expectation is that strong growth will be recorded, although a prolonged drought may affect agricultural output adversely. As stated in the staff report, the Romanian authorities expected the GDP growth rate for 1985 to be at least as high as that of last year. The staff points out that the official forecast of an increase in real GDP of 9 1/2 percent for 1985 is not fully matched by the projections for domestic demand, and that such a discrepancy also exists between output targets and projected demand in the draft of the new five-year plan for the period 1986-90. This discrepancy is due mainly to a large "plan reserve," which should be seen in the light of the normative character of the national accounts projections to which the staff alludes. As regards statistics, important data requests made at the previous consultation discussion on Romania by the Executive Board and subsequently by the staff have been met recently.

In evaluating Romania's economic policies it is essential to keep firmly in mind the centrally planned nature of its economy and the authorities' strong commitment to maintaining overall price stability. Indeed, the staff appraisal notes the absence of an allocative role for the exchange rate, domestic prices and interest rates, which the staff feels makes it very difficult to judge the appropriateness of Romania's economic policies in these areas. While this candid admission of the difficulties encountered by the staff in fully understanding the functioning of a highly centrally planned economy is understandable, it does point to the need for further study on the subject. The paper on "The Design of Adjustment Programs in Planned Economies," originally scheduled for a seminar discussion earlier this year but, according to the latest tentative schedule now to be issued in December, should be useful in helping to focus on these problems.

As to the exchange rate, I believe that the staff has fairly represented the views of the Romanian authorities on this revaluation of the leu in November 1984. I would merely add that since the Romanian price performance is now considerably better than that of the weighted average of its trading partners, the real effective exchange rate shows a clear tendency to decline. Interest rates, which had been raised in early 1984, were lowered again in November 1984. This measure was intended to lower costs and reflected the international trend toward lower interest rates. Moreover, the strong deceleration of price increases to about zero implies that the real rate of interest has remained positive. It should also be mentioned that in the Romanian context interest rates do not serve as a means of influencing the demand for credit.

Considerable attention has been focused in the staff report on Romania's external debt and foreign borrowing policy. Indeed, this policy plays an important role in the country's economic strategy. Romania remains committed to further reducing and indeed eliminating its net external debt in coming years. It has succeeded in reducing its gross external debt from a peak of $10 billion in 1981 to $7 billion at the end of 1984. This year the external debt is being further reduced to less than $6 billion. As mentioned before, Romania suffered temporary external cash flow problems earlier this year, exacerbated by nonpayment on export credits extended by Romania. The staff appraisal points to the need for rebuilding reserves and urges the authorities to take up medium-term bank credit. Romania tested the international financial market in the spring with a short-term credit and recently followed this up by negotiating a sizable medium-term credit with a syndicate of international banks. Considerable interest has been shown by the banks, testifying to Romania's strongly improved credit standing in the markets. This is also borne out, for instance, by the considerably higher ranking accorded to Romania in the most recent country credit rating survey conducted by the Institutional Investor. It should also be mentioned that Romania intends to resume its borrowing from the World Bank and expects to obtain considerable amounts from that source in coming years. All in all, the present approach of the authorities points to a pragmatic implementation of Romania's foreign borrowing strategy.

The resumption of medium-term borrowing also implies that, at least for 1985, a larger amount of capital inflows on account of bank credit can now be inserted in the medium-term projections (Table 9), as has already been done by the staff in the table of Supplement 1 of its report. In general, however, the medium-term projections remain valid. Imports are projected to show a considerable increase and could be allowed to rise even more if the strengthening of the international reserves that is foreseen, particularly toward the end of the decade, materializes. Another feature of the projections worth noting is the rapid decline in interest payments, which is made possible by the progressive reduction of external debt.

Mr. Zhang remarked that the staff report contained considerable information, particularly on foreign trade, the balance of payments, and the servicing of the foreign debt. However, the scarcity of data on the domestic economy made it difficult to assess the domestic situation and policies in the period under review.

Noting the discrepancies between the long-term planned targets for output, investment, and consumption, the staff had said that it doubted whether the authorities could achieve all the 1985 targets, partly because of the effects of the severe winter on both domestic production and foreign trade, Mr. Zhang continued. However, according to the latest available information, which was provided in Mr. Wijnholds's statement, there had been a substantial rebound of production and exports in the second quarter of 1985. In addition, in the third quarter of 1985 there had been a marked improvement in the convertible current account, which had reversed the declining trend in reserves. Despite the effects of the prolonged drought, GDP growth in 1985 was expected at least to equal GDP growth in 1984.

The staff report contained impressive analysis of external relations, including the weak demand for Romanian exports, the difficulties in collecting payments of maturing export credits, the attempt to accelerate the reduction of the foreign debt, and the authorities' reluctance to seek additional foreign credit, Mr. Zhang commented. The analysis supported the staff's conclusion that Romania should immediately seek medium-term credit from foreign banks in order to eliminate the need to restrict imports that were essential for domestic uses and for the production of exports.

He had some reservations about the staff's approach to the analysis of internal policy problems in Romania, Mr. Zhang commented. For example, the staff seemed to believe that planning decisions should be based on a structure of relative prices and on an exchange rate that reflected resource scarcities. In reaching that conclusion the staff apparently had overlooked certain difficulties. For example, even in market economies, where prices reflected to some extent relative scarcities, relative prices were determined partly by the deliberate decisions of oligopolistic concerns. In addition, exchange rates in market economies reflected relative costs to only a small extent; the exchange rate was significantly influenced by the short-term effects of interest rate differentials, divergent government policies, political considerations, and other factors. Even if existing price relationships reflected scarcities, they probably could not serve as indicators of the country's future needs.

There were even more fundamental problems in analyzing any centrally planned economy, irrespective of the degree of centralization and the relative importance attached by the Government to the role played by market mechanisms, Mr. Zhang continued. In all those economies the purpose of planning was to achieve significant structural changes and certain social objectives. Such long-term goals obviously could not be pursued in the context of relative scarcities and prices. Existing scarcities were certainly taken into account in the formulation of annual plans, which was greatly facilitated by the existence of a price system that reflected--with certain modifications--relative costs as well as supply and demand conditions. However, such plans, which dealt with current problems, were subordinated to the achievement of longer-term goals. The applicability of relative scarcities and prices was less evident in Romania, where the scope of central administrative decisions was considerably greater than in some other centrally planned economies.

He doubted whether it was useful for the Fund to advocate certain measures that might be effective in market economies but which--as the staff itself recognized--were likely to be ineffective in Romania's highly centralized system, Mr. Zhang said. The staff had noted that Romania's financial policies were designed to play the subordinate role of ensuring that the financial flows among different sectors were consistent with the development plans. Interest rates were not used to regulate financial flows; the guiding criterion was that credit should be distributed in a way that would induce enterprises to meet the plan targets. Modifications in the exchange rate were not designed to affect exports or imports but rather to influence the prices of intermediate goods and to increase the efficiency of enterprises. The revaluation of the leu in 1984 had not resulted in any change in the volume of imports, which was determined by the plan. The lower cost of imports following the devaluation had been partially reflected in producer prices but had not affected the cost of living index. Nor would the revaluation discourage import substitution, as subsidies were given to finance new import substitution projects. Apparently the main purpose of the revaluation in Romania was different from the purpose of revaluations in market economies. The Romanian authorities had concluded that previous devaluations had made export targets, expressed in terms of the leu, excessively easy for enterprises to achieve; the revaluation of 1984 was intended to make export targets more difficult to meet, thereby forcing enterprises to increase the efficiency of their production.

The staff had noted that consumer prices had increased by 14 percent in 1982 and by 4.6 percent in 1983, but the staff report did not clearly show the extent to which those increases had been the result of the devaluations in 1982, Mr. Zhang said. However, it was significant that those devaluations--which at first glance seemed to indicate a certain willingness to rely on market forces--had soon been reversed because according to the Romanian authorities, subsequent rapid price increases had complicated the process of central planning and had become politically unacceptable. In 1983 the authorities' emphasis on price stability was reflected in their unwillingness to pass through to domestic prices the effect of the devaluations and of increases in the cost of capital. In November 1984 the previous devaluations were effectively reversed by a revaluation and a reduction in the cost of capital. The developments that he had mentioned clearly showed that under the Romanian system changes in interest rates, exchange rates, and prices were designed mainly to facilitate the implementation of the central plan.

The distinctive features of centrally planned economies had been explicitly recognized in various Fund documents, Mr. Zhang commented. However, the staff had advocated policy measures that were neither compatible with nor at all effective in an economic system like Romania's. For example, during the 1984 Article IV consultation with Romania the staff had suggested that constraints on the effectiveness of the devaluation in Romania should be reduced by passing on the devaluation effects to final prices; by increasing the flexibility of enterprises to expand exports in response to a devaluation; by ceasing to "tax away" extra profits accruing to exports; and by giving enterprises more autonomy in investment decisions. Those measures might well be useful in some centrally planned economies, but many of the recommendations reflected an insufficient appreciation by the staff of the institutional characteristics of the Romanian economy. That failing was also reflected in the conclusion on page 14 of the staff report that "the absence of an allocative role for the exchange rate, domestic prices and interest rates makes it extremely difficult for the staff to evaluate the appropriatenesss of Romanian economic policies and to suggest meaningful adjustment measures that are effective in the Romanian centrally planned economic system. Experience suggests that the impact of policy changes in these areas may be limited or offset in one way or another by central directives." To increase the usefulness and effectiveness of its policy advice the staff must go beyond general statements of recognition of the distinctive features of centrally planned economies. In formulating policy proposals for those economies the staff should pay more attention to the fact that the proposals were not addressed to free market economies and that even in other centrally planned economies, where the allocative role of prices, interest rates, and exchange rates was much greater than that of Romania, their functioning of those variables was still subordinated to the effort to achieve the objectives under the general plan.

Mr. Goos said that the decision by the Romanian authorities to abandon the adjustment course envisaged under the recently approved arrangement with the Fund was disappointing. The reversal of the devaluation effected under that arrangement and the authorities' efforts to prevent the price signals given by the devaluation from working their way through the economy were particularly regrettable. The authorities had missed a major opportunity to strengthen the economy's international competitiveness and to increase the efficiency of resource allocation.

The external accounts had admittedly performed fairly strongly through 1984 and were estimated to have performed satisfactorily in 1985, given the considerable adverse effect of the severe winter weather in 1984/85 on overall production and trade, Mr. Goos continued. However, it was clear that the recent favorable external developments had been achieved at a considerable overall economic cost that was reflected in the increasingly serious domestic supply bottlenecks, especially in the areas of food supplies, energy, raw materials, and spare parts. Recent press reports had referred to the prospects of "another dark winter of austerity, with years of inappropriate government policies and mismanagement to blame for the worsening economic crisis." Moreover, the staff had noted that the external financial position continued to be tight. Those developments were a reflection of the serious deficiencies in the present allocative system, which had unfavorable effects on productivity, competitiveness, innovation, and product quality--all of which were crucial to the achievement of a viable overall economic position.

In the circumstances, he agreed with the staff that it was difficult to understand why the authorities were still reluctant to liberalize Romania's economic structure and to provide some scope for decentralized and market-oriented decision making, moves that had been successfully made by a number of other centrally planned economies, Mr. Goos remarked.

The new price regulations introduced in the peasant market in 1984 suggested that the authorities were even moving in the opposite direction, despite the obvious negative effect on food production. The authorities' reluctance to accept the staff's recommendations to assign an allocative role--or at least a greater role--to the exchange rate, domestic prices, and interest rates underscored the basic difficulty in holding meaningful discussions between the Fund and the authorities of centrally planned economies. He hoped that those difficulties would be discussed in the coming staff paper on the design of adjustment programs in planned economies.

Acceptance by the authorities of the policy advice summarized in the staff appraisal would be in the best interest of Romania, Mr. Goos concluded. The authorities also should implement the recommendations of the Bureau of Statistics in order to improve their data. In this context, he welcomed the statement by Mr. Wijnholds that "important data requests made at the previous consultation discussion on Romania by the Executive Board and subsequently by the staff have been met recently." The proposed decision was acceptable.

Mr. Zecchini commented that it was difficult for outsiders to assess precisely the extent to which various policy instruments and public sector intervention were responsible for the correction of economic imbalances in centrally planned economies, especially more developed ones. It was especially difficult to judge the strength and durability of economic adjustments in such countries. Still, the picture drawn by the staff in its report of Romania's economy contained many positive features. In 1984, given the need to contain the expansion of external debt, Romania had managed to achieve a healthy convertible current account surplus of $1.5 billion, and a similar outcome was expected in 1985. Furthermore, real GDP growth had accelerated to 7.2 percent in 1984 and inflationary measures had been brought under control. Financial policies had been cautious: there had been a large surplus in the public sector budget, and the rate of expansion of the money supply had been moderate.

However, the significant bottlenecks in the energy sector continued to constrain economic growth, Mr. Zecchini went on. That problem had been particularly evident in early 1985. In addition, there was some question about the ability of the present policy instruments to encourage efficient resource allocation. In that connection, the role played by the exchange rate and interest rates should be reconsidered.

The authorities' main objectives--price stability and the progressive reduction of the foreign debt--must continue to be given the highest priority, Mr. Zecchini considered. The authorities' use thus far of exchange rate policy and interest rate adjustments in their efforts to achieve those objectives did not seem appropriate. The staff had noted on page 6 that the exchange rate seemed to have been used--through a large appreciation, which exerted a downward pressure on production costs--mainly to help to achieve price stability. Exchange rate policy should be used instead to achieve the objective of improving the external position. The recent appreciation of the commercial exchange rate by 32.5 percent was inconsistent with the objective of achieving the sizable current account surpluses needed to reduce the external debt. Moreover, the authorities' argument that the appreciation had been introduced to increase the efficiency of export industries was not fully convincing, and the staff had suggested that that objective could be reached through alternative and more appropriate means which would favor increases in the cost effectiveness of exporting firms.

Another significant measure in the November 1984 policy package was the general reduction in interest rates, Mr. Zecchini continued. A reduction in nominal interest rates seemed justified, as the rate of increase in consumer prices had been reduced by 4.6 percentage points in 1984 compared with 1983. His doubts about the appropriateness of interest rate policy were not based on either the new level of real interest rates or their structure; rather, he was worried about the role that apparently had been assigned to interest rate policy. Apparently the management of interest rates was not designed either to make credit demand compatible with the supply of credit, or to improve the allocation of credit. The decision to cut interest rates seemed to have been part of the overall effort to reduce costs and to achieve price stability. In contrast, a reduction in interest rates--particularly real interest rates--in market economies was generally expected to intensify inflationary pressures.

He agreed with the authorities that a progressive reduction in the outstanding external debt should be sought, but he also agreed with the staff that some borrowing would be appropriate to finance certain priority projects and to avoid delays in debt service payments which could negatively affect the country's credit rating and its future access to financial markets, Mr. Zecchini commented. The good export performance and strong GDP growth in 1984 had been due in part to the easing of supply constraints through the increase in imports. In the circumstances of Romania, it might be preferable to borrow abroad in order to increase the availability of certain imports which would in turn enhance the country's export performance. Excessively cautious debt management could therefore be counterproductive in the medium run, and the authorities' recent pragmatic approach--which included the decision to make limited recourse to foreign borrowing--was therefore welcome. A more careful allocation of trade credit would also be desirable, even at the cost of somewhat reducing exports to some developing countries.

The continued existence of the noncommercial exchange rate and the absence of definite plans to reunify the exchange rates were disappointing, Mr. Zecchini said. Given the external payments position, there was no reason for the Fund to approve that multiple current practice; therefore, the proposed decision was acceptable.

Mr. Schneider remarked that lacking information in addition to that provided in the staff report, Executive Directors had difficulty in commenting on recent developments in Romania and their likely short-term and long-term effects. However, it was helpful to consider the relationship that seemed to be emerging between Romania and the international financial community. The debt crisis had regrettably disrupted the process of Romania's integration into the world economy and the dialogue between the Fund and the authorities on their adjustment measures. The dialogue had given the Fund an opportunity to gain a better understanding of Romania's centrally planned economy, and the disruption in the dialogue was clearly reflected in the staff reports: the devaluation, which had been undertaken at the recommendation of the Fund, had been reversed; the unification of the exchange rates--another staff recommendation--had been postponed; interest rates had been further reduced; and while some of the rigidities in the areas of investment, prices, and salaries had been left intact, others had increased. Moreover, Romania had canceled its stand-by arrangement with the Fund, and the authorities had declared that they intended to eliminate the entire foreign debt by the end of the 1980s.

Given those developments, the positive developments in the economy over the previous two or three years were not particularly impressive, especially as the methods used to achieve them had been purely administrative in character, Mr. Schneider said. Moreover, given the source of those accomplishments he doubted whether they could be repeated in the future, particularly in view of the enormous social costs involved. The measures introduced by the authorities had weakened, rather than strengthened, Romania's ability to integrate its economy into the world economy, as they had tended to increase the rigidity in Romania's system of economic management.

The immediate goal of the Fund's involvement in Romania was to help the authorities to solve the balance of payments problems facing the country, but the Fund's overall task was much broader, Mr. Schneider remarked. There were signs that the methods used by the authorities would not enable the Government to achieve its medium-term goals. Despite the considerable social costs of the measures that the authorities had introduced thus far, the level of reserves had been lower in the first half of 1985 than in some quarters in 1981, when payments arrears had accumulated. The nominal increase in export credit had failed to achieve the desired results, and the intensification of the countertrade practices--which did not necessarily promote efficiency--had made only a small contribution to Romania's convertible foreign exchange holdings. He fully agreed with the staff that the quality of the current account surplus mattered as much as its quantity.

The ominous nature of all the signs that he had mentioned seemed to be prompting the authorities to recognize that a dialogue with the outside world should be re-established, Mr. Schneider went on. The authorities' decision to seek new borrowing from the World Bank was perhaps evidence that that reassessment was occurring. In addition, Romania had recently signed agreements in principle for loans from the official export credit agencies of a number of industrial countries, and normal banking relationships had somehow been re-established. If those developments were to continue, the Fund should, in its usual cautious manner, resume its dialogue with the authorities. It was incorrect to assume that the Fund was incapable of contributing substantially to the solution of the economic problems facing centrally planned economies. There were already good examples of such positive contributions. Nevertheless, it was essential for the Fund and centrally planned economies to maintain a dialogue so that they could learn from each other. He hoped that in the future the staff would not have to report that it was extremely difficult for the staff to evaluate the appropriateness of Romania's economic policies and to suggest meaningful adjustment measures that were effective in the Romanian centrally planned economic system. The Fund should be able to suggest the adjustment measures that were called for on the basis of what the Fund had learned thus far from its involvement in Romania, and the authorities should be willing to consider seriously whether suggestions made by the Fund might not fit into and improve their particular economic system.

Mr. de Maulde remarked that the policy course taken by the authorities since the previous Article IV consultation (EBM/84/142, 9/12/84) had been unusual and had led to unexpected developments in various areas. The improvements that had been achieved were impressive and commendable, but he wondered whether the same results could not have been achieved at a lower cost through the use of different policy tools.

There had been a number of improvements in the economy over the previous year, Mr. de Maulde continued. Despite the statistical problems, the staff had concluded that the GDP growth performance in 1984 apparently had been good. Moreover, the improvement in the convertible current account position recorded in 1984 had been continued in 1985. The most recent data showed that the disappointing trends evident in the first quarter of 1985--owing to conditions beyond the control of the authorities--had been reversed in the second quarter. Moreover, while the projections for 1985 as a whole had initially been thought to be optimistic, they had proved to be accurate. The external debt had continued to decline at the scheduled rate, thereby allowing Romania to re-enter the international capital markets, albeit timidly, in the spring of 1985 and more boldly in the fall. New borrowing on improved terms and conditions was helping significantly in the authorities' efforts to reduce the external debt.

However, no significant progress had been made in reorienting Romania's trade toward the convertible zone in general, and toward market-oriented countries in particular, Mr. de Maulde went on. That development might well be evidence of the continued structural weakness in the export-oriented sector of Romania's economy.

The policies responsible for the overall economic performance over the previous year were puzzling, Mr. de Maulde said; they were the opposite of those recommended by the Executive Board. The authorities' policy course--including in the exchange rate and price policy areas--was surprising in the context of traditional economic analysis: prices, interest rates, and exchange rates played no role in the allocation of resources in Romania, where markets had in effect been replaced by the administrative regulations, constraints, and rationing which were mentioned but not described in detail in the staff reports.

He hoped that the discussion of the staff paper on the design of adjustment programs in planned economies would help the Board to improve its understanding of the Romanian economy, Mr. de Maulde commented. The discussion should help Executive Directors to determine whether or not the elimination of market signals and of the allocative function of markets was not causing considerable waste, inefficiency, and productivity losses in Romania. It would also be useful to consider whether a fully administered economy could achieve as rapid a rate of economic growth as an economy that permitted markets to play an adequate allocative role. Such issues were practical ones, not theoretical ones; other socialist countries, such as Hungary and China, had reaped positive benefits from the introduction of market-oriented mechanisms.

Mr. Leonard said that it was difficult to assess Romania's economic performance and the effectiveness of the authorities' policies. He fully agreed with Mr. Polak that the Executive Board should further study the functioning of centrally planned economies. He had assessed recent developments in Romania, first, in the context of the usual factors taken into account by the Executive Board--namely, demand management and the impact of prices, including the exchange rate and interest rates, on resource allocation and economic efficiency--and, second, in the context of the authorities' planning objectives and priorities.

Economic policy in Romania was guided by two planning objectives--namely, elimination of the net foreign debt by early in the next plan period and the achievement of overall price stability, Mr. Leonard continued. The goal of reducing the external debt had in effect been met through the increasing convertible currency current account surpluses since the early 1980s. There had been a further large increase in the surplus in 1984, owing mainly to the continuing compression of non-oil imports and some recovery of non-oil exports. From Romania's perspective the desire to avoid large-scale recourse to external capital markets was understandable. The authorities seemed to feel that they had become highly vulnerable as a result of the banks' decision late in 1981 and 1982 to curtail loans to Eastern European countries, and the authorities believed that increases in current account surpluses were needed to avoid the adverse effects of a withdrawal of bank financing. In that context, the recent and present surpluses constituted a policy success.

Similarly, the authorities' decision in November 1984 to reduce many domestic prices, appreciate the leu, and reduce interest rates also had a certain internal logic in the context of the authorities' main objective of achieving price stability, Mr. Leonard went on. Indeed, in a centrally planned economy--where resource allocation decisions were based on physical units, rather than on relative prices, and where prices essentially performed merely an accounting function--a reduction in all prices contributed to the stability of the functioning of the overall economic system.

However, that line of reasoning did not take into account the adverse effects of such efforts on the dynamism of the economy and on the real standard of living of the Romanian people. The net repayments of foreign debt had reduced the level of foreign borrowing but only at the cost of a considerable sacrifice of living standards in Romania. The authorities had deliberately decided that real wages should fall again in 1985 in order to enable the Government to make net debt repayments. Moreover, the present level of non-oil convertible currency imports was less than half the level of 1980 and had undoubtedly limited consumption and the quality of investments. Even if the authorities' claim that economic growth had reached 7 percent in 1984 was accepted, press reports of lengthening lines and empty shelves did not suggest that the benefits of growth had trickled down to the population at large. He agreed with the staff that Romania should be prepared to borrow further abroad in order to improve the supply situation. That approach made sound economic sense in a country that was plagued by shortages.

It seemed odd for the authorities to stabilize the price level at the expense of the prices paid to peasant farmers in the relatively open markets for their goods, Mr. Leonard said. Peasant farmers were still by far the poorest group in Romania, and a shift of prices in their favor might well have been expected. In any event, the lower prices appeared to have curtailed supply and to have contributed to the food shortages. The staff could usefully comment on how the recent price changes had affected food production and the distribution of income between the urban and rural areas.

There seemed to be little room for innovation and dynamism in the planning system, Mr. Leonard commented. The authorities' explanation of how the appreciation of the leu might increase efficiency within exporting enterprises was striking; it failed to take into account the fact that efficiency in an enterprise and in an economy needed to be encouraged through innovation and technological change, which were likely to occur only if there was some material reward for taking risks. In Romania, price changes through a revaluation might increase engineering efficiency but were unlikely to improve the quality of goods or to make them more marketable abroad. That perhaps explained why so much emphasis had had to be placed in Romania on trading techniques, such as countertrade, and on subsidized export credits. Those techniques enabled Romania to export goods but were unlikely to help the country to develop strong, dynamic trading relations in growing markets.

He generally agreed with the staff's assessment of Romania's performance in the context of more orthodox economic analysis, Mr. Leonard said. In the absence of appropriate price signals it had been difficult for the authorities to increase production efficiency. In addition, inappropriate interest rates could not encourage efficient investment, and a misaligned exchange rate could not encourage a shift in resources to the traded goods sector. He, like the staff, found it difficult to understand how the growth in investment projected for 1985 could be achieved, particularly in view of the adverse effects of the severe weather conditions in the winter of 1985 on production during the first quarter of the year. He also agreed with the staff that a less rigid approach toward external borrowing could contribute to economic development without jeopardizing the achievement of the goal of reducing total external debt. The information on the new syndicated loan was therefore welcome, and the authorities should seek other loans as conditions warranted.

Tourism receipts had fallen significantly since 1980, and he wondered to what extent they would be bolstered by a unification of the exchange rate, Mr. Leonard commented. In addition, he had been struck by the mention on page 8 of the staff report that, according to the official plans, nuclear power would meet 20 percent of total electricity requirements by 1990. At present Romania had no nuclear electrical production capacity and the projected achievement in just five years seemed optimistic. Finally, he wondered whether the World Bank was actively considering providing support for any projects in Romania. The proposed decision was acceptable.

Mr. Lankester remarked that the numerous apparent inconsistencies in the official statistics made it difficult to analyze recent economic developments in Romania. As the staff had pointed out, the large discrepancy between the reported growth in output and the identified final demand suggested that growth in output might have been overstated. That conclusion was confirmed by reports from Bucharest which emphasized the squeeze on living standards in Romania. He wondered whether the staff might not have made a fuller reference to living standards in its report, and he would welcome any estimates on the effects that the poor harvest could be expected to have in 1985. There also appeared to be signifiant discrepancies between the trade statistics contained in the staff reports and those submitted by the authorities to the GATT in May 1985. He hoped that the authorities would be able to act quickly to deal with the statistical problems.

He sympathized with the staff, who clearly had difficulty in analyzing the Romanian economy, especially as the price structure played only a small role in the allocation of resources, Mr. Lankester continued. That problem was typical of centrally planned economies, and he looked forward to discussing the staff paper on the design of programs for those economies. In future Article IV consultation discussions with Romania the staff should concentrate somewhat more on institutional reforms and other supply-side measures that were required to promote faster growth.

In recent months there had apparently been a substantial reversal of the policies that the Romanian authorities had introduced in the early 1980s, Mr. Lankester remarked. The staff had been unable to assess fully the significance of that reversal for the economy. The authorities were confident that the economic recovery in Romania would continue, but it remained to be seen whether they would be able to achieve their ambitious growth target for 1985. More effective use of investment resources was essential to the effort to promote faster growth. In that connection, he agreed with the staff that it was difficult to conclude that the present arrangements for allocating resources were the optimal ones, and he wondered whether shadow prices might not have a role to play in improving investment decisions. The staff could usefully comment on the extent to which import restraint had already caused some deterioration of the capital stock.

The authorities' medium-term balance of payments projections seemed somewhat optimistic, Mr. Lankester commented. The impact of the severe winter in 1985 underscored the fragility of the Romanian economy, and the achievement of the objective of promoting convertible exports would be hampered by the weak oil market and by Romania's heavy reliance upon exports to developing countries. If the authorities' projections were to be realized, strenuous efforts would have to be made to improve product quality and to identify the production areas in which Romania enjoyed a comparative advantage. Should the external position turn out to be weaker than the authorities had projected, they should accept the staff's suggestion to undertake modest external borrowing to ease the external constraint and to leave room for crucial imports. However, the banking community apparently was not yet fully confident in Romania's policies and external position; the banks' wariness of Romania's prospects was reflected in the fairly stiff terms on borrowing by Romania. Finally, the staff should comment on the schedule of World Bank lending to Romania. The proposed decision was acceptable.

Mr. Romuáldez remarked that Romania, like all centrally planned economies, presented special problems in the context of Article IV consultations. He basically agreed with the staff appraisal, but he was not certain whether the Fund's recommendations for a centrally planned economy could be made as confidently as its recommendations for market-oriented economies. It wsa important to give all members evenhanded treatment, but evenhandedness should be defined in terms of the goals sought by individual members; it should not be defined on the assumption that there must be parallelism in the policy tools used by centrally planned and market-oriented economies. Neither the Articles of Agreement nor the Fund's decisions required any member to use specific economic management tools. In becoming members of the Fund, countries merely agreed to subscribe to the achievement of certain collective goals and to forgo the use of certain methods of achieving those goals. Article IV was designed to encourage orderly underlying economic and financial conditions, including orderly economic growth. Accordingly, the main goal of surveillance of members' economic and financial policies was to avoid economic disturbances in one or more members which could be transmitted to other countries. Similarly, Article VIII was designed to assure that members did not adopt practices that would materially impede balance of payments adjustment or otherwise harm the interest of other members; in addition, a member's exchange arrangements must be nondiscriminatory.

The staff was understandably concerned about developments in Romania's external accounts in early 1985, Mr. Romuâldez commented. The level of reserves at that time had been lower than at any time in 1981, when the accumulation of payments arrears by Romania had accelerated. The authorities' performance in 1984 was commendable, especially the further large increase in the external current account surplus and the reduction in the foreign debt. However, there was no room for slippage in hard currency receipts if Romania were to remain current in its debt payments. Hence, he agreed with the staff that rather than restrict imports in response to unforeseen revenue shortfalls, the authorities should immediately seek medium-term credit from foreign banks in order to rebuild reserves. Of course, it was up to the authorities to choose which course to take, and in making their choice, they would determine the relative weights to attach to their various policy objectives.

He had been particularly pleased to learn from Mr. Wijnholds's opening statement that there had been a substantial rebound in production and exports in the second quarter of 1985 and that the fall in Romania's international reserves in the first half of 1985 had to a considerable extent been reversed during the third quarter of 1985, Mr. Romuâldez remarked. The expected further increase in reserves in the final quarter of 1985 was heartening.

He agreed with the staff that the authorities should eliminate as soon as possible the difference between the commercial and noncommercial exchange rates which constituted a multiple currency practice that was subject to the Fund's approval under Article VIII, Mr. Romuâldez said. The staff had correctly concluded that approval of that practice could not be recommended at the present stage, as there was no justification for maintaining separate commercial and noncommercial exchange rates. However, that practice admittedly had not given Romania any particular advantage and was not impeding Romania's balance of payments adjustment.

Beyond those obvious recommendations, it was difficult to make further suggestions to the authorities with any great confidence, Mr. Romuâldez commented. For example, in the circumstances, he doubted whether it was appropriate to question the authorities' revaluation of the exchange rate, which was aimed at reinforcing the general effort to reduce costs and increase efficiency. Until more was known about the functioning of centrally planned economies he preferred to interpret even more broadly than the staff its admission on page 14 that "the absence of an allocative role for the exchange rate, domestic prices, and interest rates makes it extremely difficult...to evaluate the appropriateness of Romanian economic policies and to suggest meaningful adjustment measures that are effective in the Romanian centrally planned economic system." The present lack of knowledge about centrally planned economies in general, and about Romania's economy in particular, probably need not be a cause for great concern, especially as Romania was not using the Fund's resources. However, given the prospective demand for those resources by other members and by potential members with centrally planned economies, he looked forward to examining the coming staff paper on the design of adjustment programs in those economies. He hoped that the paper would be issued soon; it had been in preparation for some time. Finally, the proposed decision was acceptable.

Ms. Bush remarked that there had been a number of favorable developments in 1984, including rapid economic growth, the recovery of gross fixed investment, the large increase in the convertible current account surplus, and the 18 percent cut in the foreign debt. In addition, price stability had been achieved, although because of administrative controls; prices still had not been assigned a role in the allocation of resources in Romania.

Policy revisions in a number of areas could further improve the economic performance, Ms. Bush considered. Many of the recommendations in those policy areas had been made during the 1984 Article IV consultation with Romania. For example, enterprises should have more flexibility to respond to export opportunities resulting from the devaluation, the authorities should not tax away profits accrued as a result of growing exports, and greater autonomy should be given to enterprises in their investment decision making. Apparently there had been no movement in those policy directions. Indeed, the partial reversal of some economic policy measures adopted under stand-by arrangements--such as the revaluations of the leu and the reductions in interest rates, capital charges, and profit rates for certain enterprises--suggested that the authorities were not greatly interested in opening the economy and in increasing the scope for market forces. The staff had stressed that even in a highly planned economy relative domestic prices and an exchange rate which accurately reflected resource scarcities had a significant role to play. Given the reliance on administrative price setting, it was difficult to know for certain whether relative scarcities were correctly reflected in prices in Romania. In any event, as an economy grew in size and complexity, the authorities' ability to make effective price decisions undoubtedly became increasingly difficult. Given the lack of any substantial degree of freedom for the operation of market forces in Romania, she, like the staff, hesitated to make firm judgments on Romania's economic policies. Accordingly, she looked forward to the Executive Board's consideration of the staff paper on the design of adjustment programs in planned economies.

She was worried that the authorities were moving backward to an even more closed economy and even less involvement in world financial markets, Ms. Bush continued. At the same time, Romania apparently was becoming increasingly dependent upon organized trade relationships that did not reflect the country's ability to compete freely in markets on the basis of quality, price, dependability and other factors that had traditionally been important in world trade relations. In the circumstances, she strongly doubted whether Romania would be able either to develop its domestic economy in an efficient manner or to take full advantage of trade and other opportunities that might originate outside Romania.

The staff should comment on the likelihood that the authorities could achieve the desired 15 percent increase in industrial productivity in 1984, Ms. Bush said. The authorities had decided that, given their objective of creating conditions for a transfer of real resources abroad to permit them to reduce the foreign debt, nominal wage increases should be held below overall productivity increases. The amount of production in most sectors of the economy was determined by the central plan. She wondered whether in periods in which the plan called for relatively slow growth of production, adjustments were made in the employed labor force which would affect productivity. In other words, was the growth of the employed labor force reduced when the rate of increase in production accelerated, thereby increasing potential productivity, or did the employed labor force remain at the same level during planned levels of low production, which would imply relatively lower wages for workers in such periods?

She shared the staff's concern about the reduction in prices in peasant markets, Ms. Bush continued. The potential adverse effect on production was particularly worrying. At the same time, the authorities' policies designed to restore balance to the budget and to contain monetary expansion were commendable.

The staff should comment on the extent to which the medium-term forecast for export growth in convertible currency markets was likely to prove to be accurate, Ms. Bush remarked. Export growth would play a significant role in the effort to achieve a sustainable balance of payments position and to reduce the foreign debt as planned--including repayment of substantial amounts owed to the Fund in the coming several years.

The prudent financial management reflected in the authorities' approach to foreign debt and in their success in reducing that debt was welcome, Ms. Bush said. Their debt management had perhaps played a role in the authorities' ability recently to arrange for short-term and medium-term credit in the credit markets. The authorities should maintain their conservative stance on debt, but it should be balanced by action to ensure an ample cushion of reserves to meet unexpected or potential cash flow problems, such as those that had already occurred in 1985. It had been suggested that the reserve shortage might be aggravated by the authorities' conservative borrowing practices. Such shortages could best be dealt with through a more open, market-oriented economy, rather than by borrowing abroad. Movement toward a more market-oriented economy--including structural changes that would contribute to that objective--was the best means of achieving optimal growth and overall economic performance.

Mr. Nebbia remarked that the present consultation reports, like the previous ones, suggested that there had been sustainable, impressive improvement in most of the key variables of the economy. The most remarkable achievement over the previous several years was the reduction in the outstanding external debt from more than $10 billion in 1981 to $7 billion by the end of 1984. A further significant reduction was expected in 1985: the debt could drop to less than $6 billion by the end of that year. That impressive progress was explained partly by the favorable performance of the external current account balance; the 1985 target of $1.5 billion was expected to be met despite the adverse effects felt early in 1985 of the unusually severe winter weather.

The developments in the external current account, particularly during 1984 and early 1985, contrasted sharply with the number of economic distortions in the economy which still existed and which were probably limiting the full utilization of Romania's economic potential and had adversely affected living standards in Romania, Mr. Nebbia commented. Although that outcome was common to most members with adjustment programs, the implications of recent policy developments in Romania for the standard of living in that country should be examined during the next Article IV consultation with Romania. Indeed, the subject should be a part of consultation discussions with all members and should be highlighted in staff reports in countries with Fund-supported programs.

Despite the distortions in the economy, convertible exports had continued to grow in 1984 at the impressive rate of 10 percent while imports had begun to recover modestly following their negative growth in earlier years, Mr. Nebbia went on. Overall external developments had made a decisive contribution to the rapid rate of economic growth--7.2 percent in 1984 and an estimated 9.5 percent in 1985--and had substantially improved Romania's credit standing. As a result, an increased interest had recently been shown by commercial banks in providing Romania with sizable medium-term credit. The authorities should carefully evaluate that opportunity in the light of their need to build up reserves.

The authorities were strongly committed to maintaining price stability and to that end attached increasing importance to productivity increases and wage restraint, Mr. Nebbia remarked. The effectiveness and appropriateness of price controls in a centrally planned economy need not be debated during the present discussion. The beneficial effects on resource allocation of freely determined prices were evident in the context of market-oriented economies that gave considerable freedom to interest rate and exchange rate movements. It was difficult to say whether market-oriented prices would effectively contribute to improving resource allocation in a system where interest rates did not serve as a means of influencing the demand for credit. He fully agreed with Mr. Wijnholds that there was a need for further study of the functioning of centrally planned economies, and he looked forward to the early distribution of the staff paper on the design of adjustment programs for those economies.

Meanwhile, while he recognized the distinctive features of centrally planned economies, he agreed with the conclusions in the staff appraisal regarding the potential role of the key prices in the economy, including interest rates and the exchange rate, Mr. Nebbia said. The adoption of comprehensive measures in those areas would undoubtedly help to increase productivity, improve product quality, restrain inflationary pressures, and ensure more lasting price stability and export growth. Finally, the proposed decision was acceptable.

The staff representative from the European Department recalled that the question had been raised whether the large price increases in 1982 had been connected with exchange rate changes in that year. The question had arisen because the staff had concluded that the devaluations in 1984 had not resulted in increases in domestic prices. It was important to remember that price increases before 1983 had been due partly to the introduction of structural price reform measures. The exchange rate adjustments in 1982 probably had had no net effect on prices. In that year, the authorities had maintained a multiple exchange rate system, and downward exchange rate adjustments had been essentially offset by upward adjustments, so that the net effect on domestic prices had been negligible. The price increases in 1983 had occurred early in the year; for the year as a whole, the authorities had maintained a policy of restoring price stability.

The poor quality of the domestic data provided by the Romanian authorities was reflected in a large errors and omission item in the internal accounts which revealed the overstatement of output growth in comparison with identified final demand growth, the staff representative remarked. On the output side, there were discrepancies between the reported output growth in important branches of industrial activity such as engineering in the period 1982-83, and the change in the output of products constituting the main part of the output of branches like engineering. Similarly, there were also discrepancies in sectoral labor productivity changes. Moreover, trade data provided by the Romanian authorities to the GATT differed from the comparable data reported by Romania to the Fund. While export and import data provided to the GATT were based on reports by enterprises, the comparable data provided to the Fund were based on payments documents processed by the Romanian Bank for Foreign Trade.

The reduction in capital goods imports had been particularly severe, owing partly to import substitution that had perhaps exceeded the point of maximum efficiency, the staff representative continued. The decline in capital goods' imports from Western countries had been particularly large. Since those imports were of a relatively high quality, it could be assumed that the cut in such imports had had a noticeable effect on the quality of Romania's capital stock. In addition, there was a clear need to adjust the geographical orientation of Romania's exports. Much of Romania's machinery production was sold to developing countries and socialist countries where Romania had less difficulty in marketing its products; only a minor portion of Romania's machinery production was directed to Western countries.

The authorities' estimate of economic growth in 1985 was probably overoptimistic, the staff representative commented. That estimate had been made before information on the latest harvest--by some accounts the poorest in 15 years--had become available. Economic growth in 1985 was likely to be about the same as in 1984, rather than the more than 9 percent initially projected by the authorities.

The authorities' goal of having nuclear power account for 20 percent of total electricity production by 1990 obviously was very ambitious, the staff representative said.

The question had been raised whether unification of the commercial and noncommercial exchange rates would have a noticeable effect on the balance of payments in general and on tourist receipts in particular, the staff representative recalled. The authorities had not yet indicated whether unification of the exchange rate would be achieved through a revaluation of the commercial rate or a devaluation of the noncommercial rate. A revaluation of the commercial rate would probably not have the same effect on external receipts as a devaluation of the noncommercial rate to the level of the commercial rate. Other factors also should be taken into account in assessing tourism. For instance, services in the tourist sector seemed to have been deteriorating, and the food supply situation probably had not helped the sector.

The authorities' expectations with respect to World Bank financing of projects in Romania over the coming four or five years seemed overoptimistic, the staff representative remarked. While the authorities expected to receive World Bank financing beginning in 1986, the World Bank staff had suggested that the first disbursements would not be made before 1987. Project proposals had been considered in three areas--namely, agriculture, the power sector, and transportation--and a project identification mission was currently in Romania to consider possible undertakings in the power sector. Another project identification mission was scheduled to visit Romania in November 1985 to consider possible undertakings in agriculture.

In assessing the possible means of increasing productivity in Romania, Executive Directors should remember that full employment was a major aim of the authorities, the staff representative said. The authorities had in mind shedding some labor to the cooperative sector and smaller industrial enterprise sector, but there were no plans to shed labor in the major industrial sector as a whole. Indeed, if the planned targets were met, there would be no shedding of labor in the overall economy.

The projected increase in exports in the medium term of 4 percent per year might be somewhat ambitious, as the present level of exports was already very high, the staff representative from the European Department commented. Future export performance would depend to a considerable extent upon the authorities' ability to improve product quality in the medium term. In that context, the authorities' goals were ambitious: they hoped that by 1990 some 95 percent of export products supplied to Western countries would be equal in quality to the products of Romania's competitors in those markets.

The Director of the European Department remarked that it had to be remembered that there were significant differences between planned economies. Indeed, the differences between planned economies were at least as great as those between market-oriented economies.

The staff report stressed two policy priorities--namely, repayment of the external debt and the maintenance of price stability. However, there were two additional important objectives--namely, rapid industrialization of Romania and avoidance of any significant changes in income distribution, the Director continued. Because of those objectives, the authorities had relatively limited room in which to introduce market-oriented policy instruments. In Romania, as in any economy, rapid industrialization combined with the repayment of external debt involved substantial social costs. It was difficult to measure living standards in Romania, where prices were controlled, many goods were not freely available, and the interpretation of statistical data might not be identical to that used for data on market-oriented economies.

It had also to be remembered that the authorities, when considering adjustments to the exchange rate system, had to have in mind their obligations under regional arrangements, the Director of the European Department said. Making the relatively small change in the present exchange rates which would be needed to unify the rates might call into question other relationships that were of primary importance to the Romanian authorities.

Mr. Wijnholds remarked that the Romanian economy was unique. The Director of the European Department had correctly stressed that there were significant differences between centrally planned economies. In assessing the Romanian authorities' policies Executive Directors should bear in mind that the degree of decision making by the central administration in Romania was much greater than that in many other centrally planned economies. He agreed with Executive Directors who had underscored the usefulness of a discussion--preferably in a seminar--of the staff paper on the design of adjustment programs in centrally planned economies, and he hoped that the discussion could be held soon, as it would probably help to highlight the differences between the various centrally planned economies.

The allocative role of the exchange rate in a centrally planned economy was difficult to assess, Mr. Wijnholds commented. The Romanian authorities had deliberately kept the rate of inflation to nearly zero. Accordingly, following the revaluation of the leu there had been a steady decline in the real effective exchange rate; the index of the real effective exchange rate had fallen from 125 in the first quarter of 1985 to the present level of 121.6.

He agreed with Mr. Schneider that the Fund was capable of providing useful policy advice to the authorities of centrally planned economies, Mr. Wijnholds said. However, in assessing members' economies and in providing such advice the Fund must bear in mind the significant difference between centrally planned economies.

He did not agree that Romania was moving back toward a more closed economy, Mr. Wijnholds stated. There had been considerable import substitution in Romania, and the process had perhaps reached its limit. In addition, the authorities clearly intended to increase imports; indeed, they had indicated that if the projected strengthening of reserves were to materialize, they might well permit an even larger increase in imports than had initially been planned.

Executive Directors apparently endorsed the authorities' policy of seeking medium-term foreign credit, Mr. Wijnholds remarked. He agreed with Ms. Bush that the authorities should follow conservative borrowing policies while keeping a comfortable level of reserves, and there was every indication that the authorities had those intentions in mind in seeking some additional borrowing. There were also indications that there had been a significant improvement in Romania's creditworthiness in international financial markets. For example, Romania's credit ranking by the Institutional Investor had recently been considerably increased; that rating was based on a survey of a large number of banks. In addition, banks had shown considerable interest in the recent medium-term loan for Romania; indeed, the loan might well be oversubscribed. The authorities were attempting to overcome the recent tightness in Romania's foreign exchange position in a way that would not require further cuts in imports.

Mr. Lankester commented that the terms that the commercial banks had exacted for the latest syndicated credit for Romania--namely, London interbank offer rate (LIBOR) plus 1 1/4 percent for the first three years of the loan, and LIBOR plus 1 3/8 percent for the remaining years of the loan--were relatively stiff and should not make the authorities feel complacent about their prospective borrowing ability.

The Acting Chairman made the following summing up:

> Directors noted the further large increase in Romania's convertible current account surplus in 1984 that had made possible a further reduction in its foreign debt. They welcomed the fact that this improvement in the external accounts was aided by an easing of supply constraints as both exports and imports had recovered and GDP growth had accelerated.
>
> All Directors noted the role that central planning played in the Romanian economy. This was reflected in the cautious approach that Directors took in drawing strong analytical or policy conclusions about economic developments in Romania. In emphasizing the difficulty in assessing economic and policy

developments in Romania, Directors urged the staff to make special efforts to improve the evaluation and design of adjustment programs in the context of planned economies and looked forward to the staff paper on that subject which will be made available toward the end of this year for Board discussion.

Most Directors regretted what appeared to be a reversal in Romania's economic policies from those followed in recent years that placed greater emphasis on the pricing mechanism--including the exchange rate, interest rates, and prices of goods and services generally--in the allocation of resources. Some other Directors, however, viewed the very recent policy actions as consistent with the centrally planned character of the Romanian economy and noted that financial and pricing policies played only a subordinate role in economic decision making. These Directors stressed that an individual economy, in this case the Romanian economy, should be evaluated on the basis of the goals of the authorities and the methods for achieving those goals, and not on the basis of a particular set of policy tools. Those Directors who tended to be critical of the recent reversal away from more flexible pricing policies in Romania expressed concern about the implications that this recent shift would have for economic efficiency, economic growth, and the standard of living within Romania over the short and medium term.

Directors generally noted the desire of the authorities to reduce sharply their external debt and stressed that further large convertible current account surpluses would be required in 1985 and beyond, given the continued large debt repayment obligations. While no Director questioned the desirability of reducing external debt, a number of Directors suggested that a more gradual reduction might have a less negative impact on the growth prospects for the economy and the living standards of the Romanian population. In addition, a number of Directors supported the view that a more flexible borrowing policy--as reflected in the shift in borrowing, and in the seeking of medium-term financial credits earlier this year by Romania--would relieve the strains on Romania's external liquidity position. It was noted by Directors that such strains during 1985 were aggravated by the impact of the severe winter on the trade balance. Directors thought it appropriate for the Romanian authorities to seek medium-term credits from foreign banks to rebuild reserves to a level that would provide greater protection against payments difficulties, and thus obviate the need to restrict essential imports should there be unforeseen shortfalls in foreign exchange receipts.

Focusing on the policy measures introduced in November 1984, most Directors questioned the appropriateness of the large revaluation which reversed the devaluations of 1983 and early 1984.

These measures suggested to Directors that the Romanian authorities had moved away from their earlier stated intentions of pursuing price reform, and that the exchange rate was being used to achieve domestic price stability rather than as an instrument for achieving balance of payments objectives.

Most Directors stressed the importance of basing policy decisions on a structure of domestic prices and an exchange rate that reflected resource scarcities, and, in that context, they noted with regret severe and apparently increasing domestic supply bottlenecks and a decline in living standards. Similarly, the recent revaluation of the currency and the emphasis on administered prices in investment appraisal and other economic decisions ran counter to the need to improve economic efficiency of investment and to improve resource allocation.

Noting the official medium-term projections, which show continued large convertible current account surpluses in 1986-88 to permit the repayment of large debt obligations, some Directors emphasized that Romania would need to improve the quality of export products to suit markets in industrial countries in the convertible area and to improve cost efficiency in their production. Noting the sharp increase in recent years in arrears on export credits repayable to Romania, some Directors urged that greater caution and a more commercial approach be applied in extending such credits in the future.

Several Directors urged the Romanian authorities to eliminate as soon as possible the multiple currency practice implicit in the maintenance of a more appreciated exchange rate for noncommercial transactions in relation to the commercial exchange rate.

Directors noted Romania's efforts to meet staff requests for additional statistical data but added that data, particularly on domestic economic and financial developments, remained inadequate to facilitate a comprehensive appraisal of the Romanian economy.

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 decision:

1. The Fund takes this decision relating to exchange measures of Romania subject to Article VIII, Sections 2 and 3, in concluding the 1985 Article XIV consultation with Romania and in the light of the 1985 Article IV consultation with Romania conducted under Decision No. 5392-(77/63), adopted April 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. 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 to continue its efforts to reduce reliance on bilateral payments arrangements with other Fund members.

Decision No. 8115-(85/157), adopted
October 28, 1985

2. ST. LUCIA - 1985 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1985 Article IV consultation with St. Lucia (SM/85/265, 9/24/85). They also had before them a report on recent economic developments in St. Lucia (SM/85/277, 10/9/85).

The staff representative from the Western Hemisphere Department said that St. Lucia's overdue obligation to the Fund of SDR 111,309 had been fully eliminated as a result of a payment on October 25, 1985. St. Lucia was fully current in its obligations to the Fund.

Mr. Leonard made the following statement:

The authorities in St. Lucia are in general agreement with the findings of the staff report and with the thrust of its recommendations. The economy of the island has recorded further progress over the last year or more as illustrated by the following: in 1984 and 1985, GDP growth accelerated to an average annual rate of 4 percent compared with 2 percent in 1983. All main sectors of the economy, except manufacturing, participated in the higher growth, which is expected to continue into 1986 when a recovery in industrial production will help to sustain progress. Inflation continued to decline and the price level is now virtually stable. The overall external balance was again positive in 1984, although the current account deficit, before official grants are reckoned, deteriorated to about 14 3/4 percent of GDP, mainly because of a rise in imports. There are also indications that unemployment has fallen; according to the authorities it could now be less than 20 percent of the labor force. The liquidity and net foreign asset positions of the commercial banks have significantly improved.

It remains the intention of the authorities to promote rapid economic growth through an extensive, well-directed program of capital expenditure which will appropriately balance infrastructural and social investment and encourage directly productive private investment. A corollary of this objective is the containment of the tax burden and the furthering of national competitiveness.

Although the rate of increase in pay in both the public and private sectors has moderated for some time, it continues to provide a margin for the improvement of the living standards of those in employment. Higher productivity and falling or stable import prices have mitigated the effect on domestic prices so that, as noted above, inflation has been brought almost to a halt. The authorities believe that the island remains externally competitive and provides an attractive base for industrial development.

The main disadvantage of what are still appreciable nominal pay increases is in the public sector, where there is a tendency to absorb the benefits of tax buoyancy and to inhibit public saving. The authorities accordingly agree with the staff that the public sector pay bill needs to be more tightly curbed and this, they have indicated, is being done by the nonreplacement of retirees other than those at top levels and the maintenance of present agreed pay levels for an indefinite period ahead.

An important aim of the authorities is to support national investment through the generation of substantial public sector savings. There has been a recovery in such savings following their fall to a negative figure in 1982, but there is still some way to go toward the authorities' goal. Limited progress was made in 1984/85 when the Government's current budget deficit was reduced to less than 1 percent of GDP. The performance of the public sector overall was somewhat better, with a doubling of savings from 2 1/2 percent of GDP to almost 5 percent. In 1985/86 Government revenues are expected to rise by about 11 percent mainly as a result of better tax administration. The small fiscal deficit will remain unchanged, however, as expenditure is expected to increase at a similar rate largely because of pay increases. Public sector savings in general are expected to weaken somewhat before rising again as a proportion of GDP in FY 1986/87 in accordance with the Government's medium-term intentions.

As the staff report points out, arrears continued to build up in 1984 despite improvements in the public finances and domestic borrowing. Rather more than half the arrears are owed to domestic creditors, for the most part the National Insurance Scheme, state bodies, and the Eastern Caribbean Central Bank. Of those owed abroad, about half are for contributions to international bodies and the Caribbean Development Bank. A further build-up could occur in 1985/86 in view of a prospective financing gap of 3.2 percent of GDP. The gap arises largely from the considerable domestic contribution to the public sector investment program for the year, which the authorities are reluctant to reduce because of the importance of investment for future growth. To the extent that a financing gap emerges, they believe that the accrual of arrears, though open to a number of criticisms, offers a manageable way of bridging it. Such arrears would be of limited duration and would be eliminated as economic growth picks up; while arrears continue, payments, as at present, would be rolled over and the overall position of creditors kept as up-to-date as possible.

Members of the Board will be aware that delays have occurred in meeting St. Lucia's obligations to the Fund as they fall due. The delays are attributable not to a lack of recognition by the authorities of the importance of these obligations or a lack of commitment to meeting them but to cash-flow problems that arise as a result of the Government's tight fiscal situation. Despite these problems, the authorities are making every effort to be up-to-date in their Fund payments.

Wide variations in St. Lucia's current external deficit since 1982 have been more than offset by the strength of the capital account, so that the overall balance has been positive since that time. The positive balance is projected to continue into the medium term supported mainly by rapid export growth, a buoyant tourism sector, and substantial private capital inflows. Evolution of the external account along the projected lines will allow the early elimination of any outstanding external arrears and should see a further reduction of the debt service ratio, which is already manageable at less than 6 percent.

In the light of these prospects, low domestic inflation, and the downward trend in the exchange rate of the U.S. dollar, to which the EC dollar is linked in a fixed ratio, the St. Lucian authorities do not favor any change in the parity of the EC dollar. They are nevertheless collaborating in the Eastern Caribbean Central Bank's study of the matter and, indeed, believe that its findings are likely to support their position.

Extending his remarks, Mr. Leonard said that he hoped that the authorities' latest payment to the Fund would give renewed confidence in their ability to remain current in their obligations to the Fund.

Mr. Hospedales remarked that the staff had underscored the substantial progress that the authorities had made following the serious dislocations caused by the hurricane in 1980. He generally agreed with the staff appraisal. The authorities were to be commended for the determined efforts to consolidate and extend the progress they had made while maintaining appropriate policies designed to restructure the economy and to place it on a path of self-sustained growth.

Over the previous three years, real GDP had increased by 3 1/2 percent per year as a result of the strong recovery in agriculture and the satisfactory performance of the tourist sector, Mr. Hospedales continued. In addition, the rate of inflation had fallen significantly. However, there had also been some worrying developments. For example, the rate of unemployment had been growing; it was currently estimated at more than 20 percent. In addition, St. Lucia, a small island economy, was extremely vulnerable, and the structural deficits in the government accounts and the external current account had been consistently aggravated by external shocks. The effort to correct the structural imbalances had been supported by Fund financing and other concessional resources. However, in the light of the declining overall external capital inflows and the current level of savings--9.5 percent of GDP--it was essential for the authorities to take early and resolute action to mobilize domestic financial resources.

He agreed with the staff that the first requirement was to strengthen public sector finances, particularly in the light of the emergence of overdue financial obligations, Mr. Hospedales went on. Priority also should be given to increasing the extent to which investment--which at present comprised 30.9 percent of GDP--was financed by domestic savings. The authorities should maintain their efforts to strengthen tax administration; they had improved revenue performance by increasing the ratio of tax revenues to GDP by 5.8 percentage points over the previous four years. At the same time, recurrent expenditures must be closely monitored, especially wage settlements, the recent evolution of which had been inconsistent with adjustment requirements. Adequate public sector wage restraint would send the correct signal to the private sector and would facilitate an improvement in the international competitiveness of the economy and the growth of exports.

It was unfortunate that the authorities' efforts to implement an appropriate public sector investment program had resulted in the emergence of overdue financial obligations, Mr. Hospedales commented. The improvement in confidence and the increase in creditworthiness that would ensure the continuation of capital inflows on which St. Lucia depended could not occur in the absence of the re-establishment of normal relations with creditors. That St. Lucia had recently become fully current in its obligations to the Fund was welcome.

He hoped that the public sector investment program could be financed from both bilateral and multilateral sources, Mr. Hospedales continued. That combination of financing would help St. Lucia to overcome the financial constraints on development and to improve its debt structure. The overall public sector was generating considerable savings--approximately 3.5 percent of GDP in 1985--which, however, were being absorbed by the public sector investment program, thereby making it difficult for St. Lucia to meet all its financial obligations. Appropriate financial assistance from the international financial community would contribute significantly to St. Lucia's capacity to service its financial obligations. Donors and creditors should make every effort to provide appropriate resources so that the Government could maintain its long-term structural adjustment effort. In that connection, the World Bank could help by catalyzing resources for St. Lucia.

Mr. King commented that there were clear signs that the authorities had continued to make progress since the previous discussion on St. Lucia in mid-1984: output had increased by 4 1/2 percent in 1984 and a further healthy rise was expected in 1985; the rate of inflation had remained low; the level of unemployment had been reduced; and, aided by significant direct investment, the authorities had continued to implement successfully their policy of diversifying the economy. The authorities were to be congratulated on the number of encouraging developments in their policies and in the performance of the economy.

However, the fiscal position remained a cause for concern, Mr. King continued. An appropriate fiscal policy was essential for continued external adjustment, as St. Lucia's membership in the Eastern Caribbean Central Bank constrained the ability of the authorities of St. Lucia to maintain an independent monetary policy. The widening of the central government fiscal deficit projected in the 1985/86 budget seemed to be a step backward; moreover, the staff felt that the authorities' estimates of current expenditure and revenue under that budget were somewhat optimistic. The staff's suggestions for improving the fiscal position were appropriate. In particular, public sector wage restraint was essential to limit total public sector expenditure and to encourage moderation in prices which, in turn, would help to increase competitiveness. Hence, the authorities' commitment to hold the public sector wage bill in the coming fiscal year to the level evident in the current fiscal year was welcome. He wondered whether the authorities planned to reduce the wage bill partly by transferring some employees to the private sector as a part of the privatization of public enterprises.

The second major cause for concern was the external arrears, which were estimated to be equivalent to 1/2 percent of GDP at the end of 1985, Mr. King remarked. The authorities had been in arrears to the Fund on several occasions over the previous two years, although they had become current as a result of a recent payment. The external arrears were a cause for concern not only because of their adverse effect on the country's position in the Fund, but also because of the damage they caused to the overall economy. The authorities had occasionally justified the arrears by referring to the need to maintain the public sector investment program. However, that program was expected to be the equivalent of about 10 percent of GDP in the coming year, and the relatively small reduction in it required to eliminate the arrears would significantly benefit the economy by improving the country's credit rating and by increasing its attractiveness to potential foreign direct investors. The public investment program should not be given a higher priority than the need for St. Lucia to meet its obligations to the Fund. He looked forward to discussing the appropriate response of the Fund to countries in persistent arrears to the institution. Finally, the study on the exchange system being conducted by the Eastern Caribbean Central Bank was welcome, and he wondered when it was likely to be completed.

Mr. Goos said that while there had been some welcome developments since the previous consultation discussions, the lack of a decisive shift in central government finance--one of the major causes for concern in the past--was disappointing. Indeed, the staff's projections suggested that the central government deficit would even further increase, thereby perhaps causing an additional accumulation of domestic and external payments arrears. The possibility of such an outcome and the present underlying policy stance were clearly a cause for great concern, particularly in view of the recurring overdue obligations to the Fund. The recent payment that had made St. Lucia current with the Fund was welcome, but the authorities' belief expressed in Mr. Leonard's introductory statement that the accrual of arrears was an acceptable means of bridging an emerging financing gap was alarming: the deliberate use of arrears as a financing instrument was inconsistent with a member's obligations under the Articles. The St. Lucia authorities' attitude toward arrears had led him to doubt whether they were serious about their commitment to remain current in their obligations to the Fund.

The underlying causes of the unsatisfactory performance were clearly presented in the staff report, and the authorities should give first priority to implementing the staff's various policy recommendations, Mr. Goos commented. He agreed that the external payments constraints--including the arrears--were a reflection of fiscal developments rather than of weaknesses in the external position. Indeed, the balance of payments position was fairly strong and had greatly benefited from sizable private capital inflows in recent years; moreover, those inflows were projected to increase in coming years. However, it would be imprudent to take the projected inflows for granted, especially if the authorities were unable to reduce the central government deficit. A further, and in particular deliberate accumulation of domestic and external arrears by the Government would certainly impair investors' confidence sooner or later, thereby causing current financing difficulties of the Government to become a balance of payments crisis in coming months. In the circumstances, Mr. Leonard's conclusion that "evolution of the external accounts along the projected lines would allow the early elimination of any outstanding external arrears" seemed optimistic.

Ms. Lundsager remarked that considerable progress had been made in St. Lucia over the previous several years. However, the authorities continued to face some difficult economic management problems owing to the inconsistent implementation of fiscal policy, which had resulted in ad hoc financing of deficits through such means as the accumulation of arrears. In his opening statement Mr. Leonard had mentioned that the authorities believed that the accumulation of arrears offered a manageable way of bridging a budgetary financing gap. In her view, that method of fiscal financing was entirely unsatisfactory; it was very costly, and by not paying their domestic bills the authorities created cash-flow problems for domestic suppliers, who then had an incentive not to pay their tax bills. In addition, foreign creditors could increase fees and interest rates and shorten terms on future loans, thereby raising the effective cost even of normal trade financing. The Government had just received a domestic commercial bank loan at an interest rate of 13.5 percent, and she wondered whether that relatively high rate was a reflection of the Government's weakening credit rating.

The authorities' policy stance merely postponed the fiscal adjustment that must eventually occur if a stable equilibrium--including adequate domestic savings to finance investment--were to be restored, Ms. Lundsager continued. Retrenchment was required in the capital budget, transfers to other public entities, and the public sector wage bill. Recent wage adjustments had been substantial, especially in view of the very low rate of inflation, and she wondered how the authorities planned to deal with the wage problem; it would be difficult to reduce nominal or real wages. In any event, inflationary financing of the deficit certainly would be unacceptable.

An exchange rate adjustment might reduce real wages, Ms. Lundsager remarked, but it was difficult to argue forcefully for such a move given the fairly strong performance of banana exports and tourism. The investment plan was aimed at developing industrial estates for export-oriented manufacturing. That approach seemed wise, especially in the light of the very high unemployment rate, and it would be useful to know more about the interest shown by foreign investors in that effort. The indication of such interest had a bearing on the need for an exchange rate adjustment: a lag in foreign investor interest could be an indication that wage costs in St. Lucia were excessive. Such points should be borne in mind during the examination of the exchange rate by the Eastern Caribbean Central Bank.

The staff should comment on the role that the World Bank expected to play in St. Lucia, Ms. Lundsager said. The World Bank apparently provided advice on the investment budget, and she wondered whether a more active role was not called for, especially given St. Lucia's continuing development needs. Finally, St. Lucia's recent payment to the Fund--which had brought the country current in its obligations--was welcome, and the authorities should improve the fiscal balance in order to avoid further arrears.

The staff representative from the Western Hemisphere Department remarked that there was little likelihood that savings in the National Insurance Scheme could be tapped to help finance the central government deficit. There were surpluses in the National Insurance Scheme and they were deposited in the banking system, but resort to those savings by the Government required parliamentary approval. Accordingly, the authorities had preferred to strengthen the finances of the Central Government rather than to try to gain access to the savings of the National Insurance Scheme.

The authorities were considering the possibility of encouraging the transfer of public employees to the private sector as a part of the effort to reduce the public sector wage bill, the staff representative commented. Such an effort would be facilitated by the overall plan to develop industrial estates. The authorities hoped that their efforts to broaden the economic base in the private sector would facilitate labor absorption by the private sector.

The commercial loan recently obtained by the Government was essentially a refinancing operation, the staff representative explained. The authorities had a substantial overdraft line with the domestic commercial banks. Under the recent loan arrangement, the authorities' very short-term obligation to the banks--which had carried an interest rate of 15 percent--had been converted into a medium-term obligation with an interest rate of 13 1/2 percent. Hence, the new arrangement had resulted in only a marginal net increase in the Central Government's net indebtedness to the commercial banks and had permitted a reduction in the Government's interest burden.

The authorities had been fairly successful in attracting investors in the industrial estates, the staff representative commented. Three factories had been established in the industrial free zone in 1984-85. The authorities were currently in the process of expanding factory space by approximately 150,000 square feet, and they had fairly firm commitments by three additional foreign concerns to invest in the industrial free zone: for example, a computer firm was interested in producing equipment, and another firm intended to produce automobile batteries. Additional investments were being discussed. Apparently St. Lucia had relatively little difficulty in attracting foreign investors.

The Central Bank had produced a preliminary draft of its study on the exchange rate at the previous meeting of the Monetary Board, the staff representative from the Western Hemisphere Department said. The Central Bank had undertaken individual country studies to determine the likely impact of a movement in the exchange rate on individual members of the regional currency arrangement. Five of the studies had been completed and two more were in preparation. The results had not yet been officially announced, and the staff hoped to receive further information about the progress of the study on St. Lucia.

Mr. Leonard commented that the authorities had made significant progress over the previous year and were fully aware of the undesirability of accumulating payment arrears. They were making every effort to encourage economic development and in so doing had sometimes encountered difficulty in keeping all payments current. To the extent that they might have overreached themselves in pursuing development, it was important to remember that most of the payments were owed to domestic creditors--namely, the National Insurance Scheme, state bodies, and the Eastern Caribbean Central Bank. The authorities could conceivably have reduced the arrears by floating a bond issue with an appreciable take-up by the National Insurance Scheme, but for several reasons they had chosen not to do so. The authorities had taken steps to ensure that they would not remain in arrears to any single creditor for an excessively long period. Indeed, they had already reached an agreement on the arrears to one external creditor, and similar understandings were being worked out with others. The continuation of the arrears would not have a significant adverse effect on St. Lucia's credit standing, Mr. Leonard considered. The authorities were coping with the problem in a positive manner, and the country's creditors could feel reassured by the genuine progress that was being made in the real economy as indicated by the fact that St. Lucia was becoming one of the better developed islands in the Caribbean. Accordingly, while he shared other Executive Directors' view on the undesirability of using arrears as a means of financing, he saw that as a temporary expedient and did not feel that he could be overly critical of St. Lucia for resorting to it at the present juncture. The authorities were clearly determined to make further progress in meeting all their bills on time as the economy continued to improve. They were aware that further substantial inflows of private capital could not be taken for granted, and he was confident that they would take that into account in handling the arrears situation.

Pay developments constituted a significant potential danger and had been carefully examined during the consultation discussions, Mr. Leonard remarked. The authorities had stressed that pay developments in one Caribbean island had a strong demonstration effect on other islands in the region; for example, civil servants' pay in Martinque and Guadelupe was significantly higher because those islands were still a part of Metropolitan France. However, the St. Lucia authorities realized that pay levels elsewhere could not be a dominant consideration in their decisions and that failure to contain the growth of incomes would have to be accompanied by policy adjustments in other areas. At the same time, the Prime Minister had stated that existing pay levels were effectively three years in advance of what the economy could afford; therefore, he was determined to limit public sector pay increases for some time.

The Acting Chairman made the following summing up:

Executive Directors generally agreed with the thrust of the staff appraisal in the report for the 1985 Article IV consultation with St. Lucia.

They noted that the economy had recovered markedly from the devastation caused by Hurricane Allen in 1980, that the rate of inflation had been reduced substantially, and that unemployment, although still high, appeared to be declining. Directors welcomed the efforts of the authorities to improve the public finances in the last two fiscal years. However, they observed that this improvement had not been sufficient to stem the buildup in arrears in payments on government debt, and they expressed concern about the likelihood of a further buildup of arrears in the period ahead.

Directors stressed that prompt action was needed to strengthen central government revenues, to curb current expenditures, and to seek means for an orderly settlement of overdue obligations. The deliberate use of payments arrears as a method of government financing was viewed with great concern because it risked undermining confidence in the Government's policies and would ultimately affect St. Lucia's credit rating and raise the cost of foreign borrowing. Directors emphasized that a coordinated and comprehensive approach to the fiscal and arrears problems was necessary and believed that more realistic medium-term fiscal and investment programs would need to be developed to that effect as soon as possible. Directors also expressed concern about the size of the 1984 wage settlement for central government employees, and emphasized the need to bring public sector wages under tighter control; restraint on public sector wages would improve the public finances and also foster external competitiveness and employment creation through its moderating effect on private sector wages.

Directors agreed with the staff that exchange rate policy warranted close attention, and urged the authorities to continue collaborating closely with the Eastern Caribbean Central Bank in its review of the appropriateness of the external value of the East Caribbean dollar.

Directors welcomed the recent efforts of the authorities to be current with the Fund, and urged them to adopt the necessary measures to ensure that St. Lucia remained current in its obligations to the Fund.

It is recommended that the next Article IV consultation with St. Lucia be concluded before the end of April 1987.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/156 (10/25/85) and EBM/85/157 (10/28/85).

3. TONGA - DESIGNATION OF DEPOSITORY

The Fund accepts the Treasury of Tonga as the depository, under Article XIII, Section 2(a), for all the Fund's holdings of the currency of Tonga. (EBD/85/263, 10/22/85)

Decision No. 8116-(85/157), adopted
October 25, 1985

4. TONGA - REPRESENTATIVE RATE FOR THE PA'ANGA

The Fund finds, after consultation with the authorities of Tonga, that the representative rate under Rule O-2(b)(ii) for the pa'anga against the U.S. dollar is the rate obtained on the basis of the fixed relationship of the pa'anga to the Australian dollar and the representative rate for the Australian dollar. Tonga will immediately inform the Fund of any change in the representative rate. (EBD/85/264, 10/22/85)

Decision No. 8117-(85/157) G/S, adopted October 25, 1985

5. ADVISOR TO EXECUTIVE DIRECTOR - EXTENSION OF PERIOD FOR A REPATRIATION

The Executive Board approves the recommendation concerning the extension of the period for a repatriation of a relative of a former Advisor to an Executive Director as set forth in EBAP/85/254 (10/23/85).

Adopted October 25, 1985

6. ADVISOR TO EXECUTIVE DIRECTOR - WAIVER OF ACCELERATED REPAYMENT OF SALARY ADVANCES

The Executive Board approves the proposal to waive the accelerated repayment of a salary advance of an Advisor, formerly a member of the staff, to purchase a home as set forth in EBAP/85/255 (10/23/85).

Adopted October 25, 1985

7. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 85/9 and 85/10 are approved. (EBD/85/261, 10/18/85)

Adopted October 25, 1985

8. <u>EXECUTIVE BOARD TRAVEL</u>

Travel by Executive Directors as set forth in EBAP/85/257 (10/24/85) is approved.

APPROVED: June 11, 1986

LEO VAN HOUTVEN
Secretary