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The IMF and the Countries of the Council for Mutual Economic Assistance

by Klaus Schröder, Ebenhausen/Munich*

In November 1981 Hungary and, one week later, Poland applied for membership of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (World Bank). These applications have highlighted a subject which had been neglected for quite some time. This analysis deals with the problems and consequences which arise from the membership of countries of the Council for Mutual Economic Assistance (Comecon) – the economies of which largely conform to principles of central economic planning – in IMF, an institution organized according to market principles.

The only Comecon countries which presently are members of the IMF and the World Bank are Romania (since 1972) and Vietnam (since 1976); other socialist member countries are Yugoslavia, Laos, Cambodia, and China (since 1980 – replacing Taiwan).

In 1944 the Soviet Union participated in the Bretton Woods negotiations leading to the establishment of an International Monetary Fund. It was even allocated a quota¹ but did not become a member, and after its refusal to join the organization never indicated any interest whatsoever in taking part in the Western monetary system. In the Soviet view, the IMF constitutes an "instrument of imperialism and neo-colonialism".

The negative Soviet attitude has had the following consequences:

- the withdrawal of Poland (1950) and Czechoslovakia (1954) from the IMF. Both had been founding members of the organization;
- the foundation of two Comecon institutions, the International Bank for Economic Cooperation and the International Investment Bank (founded in 1964 and 1971 respectively), which were meant to assume functions similar to those of the IMF and the World Bank. The two Comecon banks were only a very inadequate substitute as they have been associated with an increase in bilateralism, a currency – the transferable rouble – with unrealistic conversion rates and which has had the effect of limiting trade, as well as a process of delinking from the world economy.

The decision by Romania to join the IMF was a political gesture designed to demonstrate a measure of

independence from the Soviet Union. Vietnam owes its seat to the former membership of South Vietnam.

The impression, conveyed by the recent applications for membership by Hungary and Poland, that the Soviet Union has changed its position, is probably wrong. Hungary reportedly did not formally ask Moscow for permission prior to its application and the Soviet consent to Poland's application was given only after long discussions and delay. Also, in view of the Polish economic crisis and the scale of its debts, the Soviet consent would appear to be pure pragmatism. Moreover, the experience with Romania shows that the influence of the IMF, even when it does get involved in the economy of a particular country, remains moderate, that only small and predictable effects on bilateral intra-Comecon relations can be expected and that the basic principles of a planned economy are hardly affected by IMF conditions.

To this have to be added the following facts:

- IMF credits to Poland would increase not only Poland's creditworthiness but also that of the other Comecon members;
- the burdens which are assumed by the IMF do not fall upon the Soviet Union and hence contribute to an improvement of the Soviet reserve position;
- the drawing on IMF resources alleviates competition between Comecon countries on Western financial markets;
- the IMF would exert a positive influence on economic development in Poland; and

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¹ The quota determines the subscriptions, the drawing rights, the allocation of special drawing rights as well as the weighting of individual country votes.

□ the two Comecon banks are not in a position to extend the financial aid necessary.

Due to these circumstances and despite its negative attitude in principle, financial cooperation by Poland and Hungary with the IMF must appear to the Soviet Union to be preferable to growing economic instability in its sphere of influence. Further, collective IMF-membership of Comecon, or further individual applications, are not to be expected.

Romania as an IMF Member

In the past ten years, Romania has received manifold advantages from its membership of the IMF and the World Bank. Until the summer of 1981, when the Romanian quota amounted to SDR 367.5 million, its drawings to the amount of US \$ 0.4 billion were comparatively low. In the autumn of 1981, the IMF agreed to extend a mixed currency loan amounting to US \$ 1.46 billion at interest rates between 6.25 % and 13.5 %. Once this loan has been taken up the possibilities for further drawings (as a rule 450 % of the quota) will have been largely exhausted.

Reliance on IMF funds has been intended to serve the purpose of alleviating balance of payments problems; in 1975 they were also used in connection with large-scale flooding and in 1977 in connection with an earthquake.

The super credit of 1981 which can be taken up in several instalments within a period of three years, was apparently necessary because of the generally very bad economic situation, resulting in particular from increasing oil prices, but also because of the high external debt (approximately US \$ 11 billion at the end of 1981) and the growing problems of repayment vis-à-vis Western debtors. Due to the extraordinarily high IMF commitments it might be possible to forestall a rescheduling of debts according to the Polish pattern, and relatively short-term, high-interest bank credits might be substituted by long-term credits.

The question of conditionality does not seem to have played any role until summer 1981. That part of the super credit which has its origin in the fund for export stabilization, too, was granted without strings attached. The remaining part of this credit is reportedly tied to punctual repayment, an adjustment of prices to costs as well as a decrease in the investment ratio. Nothing is known of any conditions which might contribute to a departure from the inefficient planning mechanism and which could initiate a substantial reformist policy. In 1981 the IMF for the first time published figures on the Romanian balance of payments².

² See Exchange, Price Reform are Key Elements in Romania's New Stabilization Program, in: IMF Survey, September 7, 1981, p. 262 ff.

From the World Bank Romania received 31 loans to the total amount of US \$ 2.1 billion. These loans, which are tied to specific projects, are extended to Romania because of its status as a developing country. The first loan of this kind was made available in 1974 for the construction of a fertilizer plant.

Romania's most important sources of long-term credit are drawings on the IMF and loans from the World Bank. Yet despite such financing with relatively low interest rates and long periods of repayment not granted to the other European Comecon countries Romania, according to the IMF, has developed payment problems.

Reasons for Hungary's Application

Quite unexpectedly, on November 4, 1981, Hungary applied for membership of the IMF and the World Bank. The official announcement stated that the settlement of relations between the two financial agencies and Hungary was justified by Hungary's active participation in international credit and financial transactions, her wide-ranging external economic relations, and the continuing development of the necessary conditions for her economic expansion.

In stark contrast to Poland, Hungary's application was made at a time of high economic and political stability, without pressure and without any symptoms of ailing. It represents a further step forward on the reformist road taken in the last decade. Hungary's market socialist system increasingly assumes the traits of an open economy and is characterized by:

- market-oriented planning mechanisms;
- participation in the international division of labour;
- domestic prices which are adjusted step by step to world market prices;
- the consolidation of several exchange rates into one single rate valid for private as well as for official business.

For the improvement of the efficiency of the Hungarian economy subsidies have been curtailed, unprofitable enterprises eliminated, investments have been concentrated primarily in export-oriented plants and monopoly-type enterprises have been disbanded. Moreover Hungary is well on its way towards achieving foreign exchange convertibility of the Forint.

For Hungary the IMF constitutes an instrument for the long-term financial safeguarding of its reformist course and forms the basis for an even closer cooperation with the world economy. The possibility of drawing further loans from the IMF plays an important role here as it

guarantees the kind of financial resources necessary to evade, at least partially, Comecon constraints³. But despite its sound economic policy and the high reputation of Hungarian financial managers this country, too, sees itself confronted with financial difficulties, not least due to its Comecon membership.

Hungary, in contrast to Romania, cannot expect to receive money from the World Bank as its per capita income is too high. Membership of the World Bank is, however, important as this is an indispensable precondition for the participation of Hungarian enterprises as subcontractors in World Bank financed projects in developing countries.

Hungary's unexpected application for membership can be explained by the realisation that Comecon countries would have great difficulty in obtaining new credit on Western capital markets⁴ and that Hungary had to apply earlier than Poland so as not to be tainted with the same brush.

Comparing Hungary with other countries with a similar per capita income, one would expect her to receive a quota amounting to approximately US \$ 450 to 650 million.

It is probable that Hungary will become a member of the IMF in the summer of 1982. Information concerning economic development and the balance of payments is available and the analysis of the Hungarian economy by IMF experts for the purpose of setting the quota should be relatively simple. Nor should the problem of the convertibility of the Forint prove to be a stumbling block. On the whole, Hungary is probably closer to the principles and goals of the IMF than many other countries.

The Rationale for Polish Membership

Poland applied for membership at a time of high political and economic instability which manifested itself above all in its inability to meet its obligations for debt repayment on schedule. The expectations connected with Poland's membership in the IMF in the country itself and abroad are of a similar nature but nevertheless differing.

As for Poland, prior to December 13, 1981 the following rationale for membership was put forward: membership would enhance the international reputation of Poland, but it would also be an insurance against a relapse into autarky; at the same time it was hoped that

Poland would be able to gain access to additional management expertise; finally, it was thought that the economic remedies suggested by the IMF would help to show a way out of the economic crisis, and that such remedies would not be overly harsh but merely express the concern of the creditors to get back on schedule the credits extended. Whether or not this rationale still applies after the imposition of martial law is another matter.

Expectations held in the West included the following:

- the more favourable position, in comparison to Western banks and governments, of the IMF for coming to an agreement with the Polish authorities on a long overdue programme for the reconstruction of the Polish economy;
- the prospect that any strings the IMF might attach would be accepted by Poland;
- the possibility that the IMF might assume a coordinating function in negotiation on the rescheduling of debts and make available financial resources of its own.

After several preliminary talks and after IMF representatives, in September 1981, had participated for the first time as observers in negotiations on the rescheduling of debts between Poland and Western banks, and even more so directly after the Polish application for membership, expectations were very high that agreement could be reached in the form of a substantial credit extended on the basis of a jointly formulated recovery programme. Such an agreement would have satisfied Western creditors that major corrections in the Polish economic system would in fact be made. These expectations received a major blow with the imposition of martial law and the assumption of power by a military council in December 1981. Although the application itself still remains on the books the processing of Poland's application for membership was stopped. In the present circumstances agreement between Poland and the Western banks and governments as well as the IMF on a programme of financial consolidation does not appear likely in the near future.

Equally unlikely, however, is a negative decision on Poland's application. Because of the desperate situation of the country, Poland needs membership in the two United Nations organizations more than ever. The guardians of currency should act upon this, strive to free their thoughts somewhat from the present chaotic political conditions in Poland and consider the more fundamental and long-term aspects of Polish IMF membership.

³ Cf. A. Köves: Turning Inward or Turning Outward: Reflections on the Foreign Economic Strategy of CMEA Countries, in: Acta Oeconomica, Vol. 26 (1-2), 1981, p. 51 ff.

⁴ Cf. K. Schröder: Aspekte zukünftiger Finanzbeziehungen zwischen Ost und West (Aspects of future financial relations between East and West), in: Osteuropa Wirtschaft, 27th year, No. 1/1982, p. 35 ff.

It is very difficult to estimate precisely when the negotiations between Poland and the IMF will be ended. A decision on membership, which was originally expected by the autumn of 1982, will probably not be reached by that time. This is due, among other things, to the difficulty of obtaining reliable statistics, since such statistics on, for instance, the pattern of economic development, including important macroeconomic data, and the nature of past and future Polish economic policy, are essential for determining the basic conditions of the recovery programme required to obtain stand-by credits from the IMF. These difficulties were increased dramatically by the enormous political changes in Poland, and it is not known what conditions the Polish authorities are likely to accept. No decision can be made on the processing of the application, the timing of formal membership or the time when the first credits can be made available as long as the Polish regime is unwilling to provide the necessary economic data.

Potential Drawings

It is very unlikely that the first drawings on the IMF will be able to take place before the middle of 1983. A special problem is the determination of an appropriate Polish quota, which in turn determines the extent of potential drawings. In 1981 Poland's Minister of Finance estimated a quota between US \$ 700 million and US \$ 1 billion. In theory, with a quota of US \$ 700 million and a credit line of 450 percent of the quota, Poland would be able to borrow up to a limit of roughly US \$ 3 billion. The actual volume of withdrawals would depend on such factors as the conditions imposed by the IMF, Poland's willingness to accept those conditions, and the overall demand for IMF resources by other members.

Even if we assume that under the best of circumstances Poland were to be able to withdraw an annual maximum of US \$ 1 billion between 1983 and 1985, that would still represent only a small portion of the total hard currency required for the repayment of debts and the payment of interest, which are estimated to amount to US \$ 10 billion p.a. for 1982 and 1983.

If, however, the payments of US \$ 10 billion required in 1982 could be rescheduled so that only US \$ 4 billion were due in that year, drawings from the IMF could account for fully 25 % of the necessary payments.

In addition to providing financial help, which could be an important factor in Western estimates of Polish creditworthiness, the IMF can play a substantial role in working out a reorganization programme. In order for this to be done, clear political signals will first be required from Poland. The IMF role depends primarily on the

willingness and readiness of the Polish government to cooperate and on the nature of the proposed stabilization programme.

Membership of the World Bank could bring Poland, like Hungary, indirect advantages, if Polish enterprises were permitted to participate as subcontractors in projects financed by the World Bank. Even if such advantages are only indirect, they can still make a considerable contribution to the promotion of so-called "trilateral cooperation" with developing countries.

Prospects

Ever since its foundation, the IMF, in granting credits and in determining conditionality, has taken into account the problems specific to each country. It has *not*, however, set conditions likely to affect the structural elements of that country's economic system. Yet the application for membership by Hungary and Poland has made it necessary for the IMF to develop a concept of how to cope with the Comecon countries. In particular, it has to provide guidelines as to how to respond to the economic goals and mechanisms of planned economies. Among other issues the following problems need to be taken into consideration:

- the principle of taking into account risks specific to each country of Comecon;
- the room for manoeuvre required. Evidently, countries such as Hungary which are striving for close cooperation within the framework of the world economy and are conducting their economic policies accordingly should be regarded as having a much stronger claim on the resources of Western financial institutions than countries which regard the IMF merely as a cheap source of credit;
- the specific features of the Comecon region (principles of the planning mechanism, intra-Comecon coordination and specialization, etc.);
- clarity concerning the criteria according to which conditionality should be formulated. More specifically, the IMF must decide whether it should look upon, say, Hungary as its model for economic reform within Comecon or, say, the GDR.

The IMF is an organization whose financial aid programmes often make an important contribution to the stabilization of such countries which are in need of help because they are, for instance, in a difficult phase of economic development, or about to embark on a more fundamental reorientation of economic priorities. There is no obvious reason why the IMF should exclude from this kind of help those Comecon countries which have applied for membership.