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The IMF and the Countries of Eastern Europe

Rumania, Hungary and Poland

by Petra Pissulla, Hamburg*

The countries of Eastern Europe need to raise considerable finance not only in order to improve their balances of payments but also to adjust the structure of their economies over the long term to changed internal and external conditions. The adjustment measures require capital, but the Eastern European countries have only limited scope to broaden their own capital base. What actual or potential significance does the International Monetary Fund have for overcoming the difficulties of the CMEA countries in question?

In the late seventies Western observers not only thought it unlikely that the Soviet Union would be prepared to join the International Monetary Fund, but they also held the same opinion concerning the other Eastern European countries, with the exception of Rumania. In 1944 the founder members of the IMF had been at pains to integrate a state-trading country such as the USSR into the Fund and in 1978 the second amendment of the Articles of Agreement of the IMF incorporated some of the principles valued by the socialist countries so that it would be easier for them to decide to join¹; however, this was considered to offer "hardly any basis for the integration of the Soviet Union and the other CMEA countries in the world monetary system of the IMF".²

This probably continues to apply in the case of the USSR, which took an active part in the negotiations on establishing the IMF in Bretton Woods but never signed the IMF Agreement. Apart from the obligation to supply information to the Fund, which would give the West an insight into such matters as the Soviet Union's highly secret gold production and its policy on gold reserves and gold exports, one of the Soviet Union's main objections to the IMF is its abandonment of neutral gold as the main international reserve facility. In the Soviet view, the current practice of holding the currencies of only a few Western countries as official foreign exchange reserves constitutes unacceptable dominance of the international monetary system by these countries. The other CMEA countries, except Rumania, were still of the same mind at UNCTAD IV held in Nairobi in 1976, when they issued a joint declaration demanding a return to the gold standard and abolition of the "monopoly position of one or several national currencies in the international monetary

system".³ Since then, however, at least two CMEA countries besides Rumania have moved away from this position for various reasons. Hungary became a member of the IMF on 6th May 1982 and Poland, which had left the Fund in the early fifties, made what amounted to an application for re-admittance in November 1981.

The transactions whereby a member country can make use of Fund resources consist in the sale of its own currency to the Fund and the purchase of foreign currencies from the Fund; the member purchasing or drawing foreign currency pays in its national currency converted at the appropriate exchange rate. The national currency must be repurchased within a set time limit against special drawing rights or a freely usable currency nominated by the IMF. As a rule, the repurchase obligation comes into effect within three to five years from the drawing, and in the case of drawings under the various special facilities within three to ten years. A country qualifies for Fund resources if it can prove a so-called balance of payments need; such a borrowing requirement may be due either to a deficit on the current account or the inadequacy of the country's reserves. The amount of Fund resources that can be taken up is related to the drawing country's quota, which it is allocated upon joining the IMF and is generally paid into the Fund 25 % in convertible currency and 75 % in the country's national currency.

¹ Cf P. Pissulla: Der Internationale Währungsfonds und seine Bedeutung für die osteuropäischen Länder – Rumänien, Ungarn, Polen –, Hamburg 1983, pp. 16 ff.

² H. Hamel: Zur Frage der Mitgliedschaft der RGW-Länder im Internationalen Währungsfonds (IWF), in: A. Schüller (ed.): Außenwirtschaftspolitik und Stabilisierung von Wirtschaftssystemen, Stuttgart 1980, p. 192.

³ See: Joint statement by socialist countries, in: United Nations: Proceedings of the United Nations Conference on Trade and Development, Fourth Session, Nairobi, 5-31 May 1976, Vol. I, Annex F, New York 1977.

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Apart from drawings in the so-called reserve tranche, which are "unconditional", in other words they can be made without the Fund imposing economic policy requirements, and the partly conditional drawings in the first credit tranche or under the Compensatory Financing Facility to offset reductions in export receipts, the IMF provides balance-of-payments assistance only in conjunction with a strict stabilisation programme to remedy the balance-of-payments problems.⁴ As a rule, funds are extended under standby credit arrangements and are paid in instalments, the borrower being able to draw on the credit only if performance criteria laid down by the Fund are observed. The stabilisation programme agreed between the member country and the Fund consists mainly of fiscal, monetary, exchange rate, trade and balance-of-payments measures.

In recent years the IMF has greatly increased its members' drawing ability, particularly through the introduction of the supplementary financing mechanism (the Witteveen Facility) in 1979 and, as an extension of that, through the policy on enlarged access. These conditional resources linked to economic policy requirements were designed to enable member countries with serious balance-of-payments deficits to obtain loans for larger amounts and longer periods than were available for drawings in the normal credit tranches. It was originally intended that these enlarged access arrangements would be completely abolished when the recent increase in quotas was agreed, but in view of the scale of the international debt crisis it was agreed at the IMF Annual Meeting in September 1983 that the higher drawing facilities would be withdrawn gradually. From 1984 onwards maximum drawings of conditional resources in any three consecutive years may not exceed 102 % of the new quotas; hence in nominal terms the amount of drawings will remain at the old level.⁵

Rumania: Debt-servicing Problems

Rumania joined the International Monetary Fund on 15th December 1972, the first Eastern European member of the CMEA to do so. The main motive for joining was probably Rumania's intention to advance further along the path towards the greatest possible economic and political independence from the Soviet

Union that had been taken at the beginning of the sixties, for Rumania had no need of IMF membership on balance-of-payments grounds at that time. At any rate, in the early seventies Rumania had no critical balance-of-payments difficulties such as those experienced by Poland and, to some extent, Hungary at the beginning of the eighties.

Since then, however, the advantages Rumania enjoys as a result of IMF membership can no longer be dismissed lightly, given the balance-of-payments plight in which the country now finds itself. Nevertheless, it should be pointed out at this point that the IMF was clearly unable to prevent Rumania's foreseeable slide into payments default, despite the compulsory annual consultations, in the course of which the Fund analyses the country's debt situation – volume of debt, rate of growth, debt-servicing obligations, maturity structure, and so forth.

According to the IMF, there are essentially four factors that can lead a country into debt-servicing difficulties: (1) The country can have "pursued inadequate macroeconomic policies leading to balance of payment problems and undermining its ability to service debt; (2) it may have borrowed excessively, that is, beyond its current capacity to service the debt; (3) it may have borrowed on unfavorable terms (for example, it may have accumulated too much short-term debt) or it may have built up an unfavorable maturity profile, with a "hump" in repayments falling due; (4) it may be affected adversely by events that it cannot control", such as an unforeseen interest rate move, a decline in export earnings owing to natural disasters or world market developments, or restrictive reactions on the part of banks in the light of a critical turn of events in a neighbouring debtor country.⁶

In the case of Rumania it must be conceded that all the above-mentioned factors coincided: the country's development strategy had caused serious imbalance in the investment and consumer goods markets and the permanent excess of domestic demand during the seventies had thrown the overall supply and demand situation increasingly out of kilter; imports from the West, which had risen consistently faster than exports during the seventies, had led to an excessive rise in Western debts (the country's indebtedness doubled to \$ 10 billion between 1978 and 1981); the resulting trade deficits had been financed increasingly with short-term, high-interest loans; in 1981 and early 1982 the maturing of these short-term credits coincided with increasing redemptions of earlier medium and long-term loans, so that the annual redemption burden rose appreciably;

⁴ Cf. P. Pissulla, *op. cit.*, pp. 28 ff.

⁵ As a rule, a maximum of 306 % of the quota can therefore be drawn in future within a period of three years, with the cumulative net borrowing being limited to 408 %. In cases of hardship the annual borrowing limit is 125 %. See P. Pissulla, *op. cit.*, pp. 36 ff.

⁶ See: Debt rescheduling: what does it mean?, in: Finance & Development, Vol. 20 (1983), No. 3, p. 26.

finally, Rumania's problems were accentuated by external influences, such as the sharp increase in interest rates, the deterioration in the terms of trade as a result of the rise in oil prices, the persistent weakness of world demand and the reaction of banks to the Polish problem. The behaviour of the banks probably only precipitated and intensified the crisis. It can be assumed that Rumania would have become insolvent in the foreseeable future even if Western creditor banks had not imposed restrictions.

If situations arise that signal impending payments problems, the Fund can at least issue warnings and discuss measures that may help solve the problems. It is not known to what extent this happened in Rumania's case and whether such warnings were perhaps disregarded. Even though the IMF was unable to prevent the situation developing in this way, now that its balance-of-payments problems have become acute Rumania should nevertheless find that access to Fund resources makes it easier to bring its debt situation under control within a foreseeable period, even if Western banks and governments are still not prepared to grant new loans despite the increased Fund assistance to Rumania that is now under way.

Rumania's quota totalled 367.5 million SDRs in 1983 but rose to 523.4 million SDRs under the Eighth General Review of Quotas, which raised quotas by an average of 47.5 % at the end of November 1983.⁷

In the early years of its membership, Rumania made relatively little use of its drawing rights. The first larger drawings, including some under a standby arrangement, occurred in 1981, when Rumania's balance-of-payments position had deteriorated to such an extent for the reasons outlined above that insolvency was drawing dangerously near. By mid-December 1983 Rumania's cumulative net recourse to Fund credits had

risen to 905 million SDRs, of which 633 million SDRs consisted of outstanding drawings under the standby arrangement. This standby credit, which totalled 1.1 billion SDRs and was originally to have been disbursed in stages ending in mid-1984, was opened in June 1981. By the time it had taken up the full amount of the loan in 1984 Rumania would have drawn conditional Fund resources equal to about 210 % of its new quota.

Rumania will not be able to draw the full amount, however. In the past two years the country has made great efforts to implement the adjustment measures required of it primarily in the field of demand management by means of price, exchange rate and incomes policy measures to the detriment of the already low standard of living,⁸ but they are clearly more than it can manage. The Fund's hard line on conditionality has been strongly criticised of late by many of the countries affected. Rumania, which unquestionably was more than willing to adjust, is beginning to resist the measures. For example, in October 1983 Nicolae Ceauşescu rejected the further increase in energy prices demanded by the IMF as inflationary.⁹ In view of this non-fulfilment of one of the criteria laid down by the Fund, the IMF decided not to pay the final instalment of 285 million SDRs of the standby credit that had been planned for 1984. Rumania was compelled to accept the premature expiry of the standby credit agreement on 31st January 1984 and will therefore probably take up only 817 million SDRs (156 % of the new quota), not 1.1 billion SDRs.

Rumania's inability to comply with the Fund's requirements in all respects has not only prevented the full payment of the current standby credit but might also prejudice the Fund's future willingness to approve further loans that would be quite plausible in principle. With the maximum cumulative access to conditional Fund resources set at 408 % of quotas from 1984 onwards ($3 \times 102\%$ plus outstanding previous drawings), Rumania could theoretically draw a further 1.3 billion SDRs under a new standby credit in the next three years if the Fund decided to grant further financial

⁷ Cf. A. W. H o o k e : The International Monetary Fund, Its Evolution, Organization, and Activities, Washington, D.C., 1983, p. 73.

⁸ Cf. P. P i s s u l l a , op. cit., pp. 63 ff.

⁹ Cf. Der Spiegel, No. 43 of 24. 10. 1983.

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assistance in view of the fact that a lasting stabilisation of Rumania's balance of payments is unlikely to be achieved by 1984. If a further credit line were opened, and probably only then, Rumania might be in a position to repay maturing instalments of principal and interest to its Western creditors as announced without further rescheduling.¹⁰

Hungary: Accession Made Easier by Reforms

When Hungary unexpectedly applied for membership of the International Monetary Fund in November 1981 its external position was much more stable than that of Rumania or Poland; although for a time in 1981 Hungary was also faced with serious liquidity problems when Western banks unexpectedly declined to renew short-term loans and access to new medium and long-term credits was largely closed owing to the Polish crisis, maturing debts could still be serviced. Hungarian sources stress that the application for membership was not a consequence of the liquidity shortages but a logical extension of the reform policy initiated in 1968. Membership of the IMF is intended to bolster Hungary's efforts to achieve still closer integration in the world economy and to secure future sources of finance that widen the restricted scope for credit within the CMEA.¹¹ An important motive for both Hungary and Rumania was the fact that only by belonging to the IMF can a country become a member of the World Bank. As both countries are classified as developing countries by the IMF and the World Bank, they qualify for project-linked long-term credits and so-called structural adjustment loans granted by the World Bank.

Hungary's steady progress towards economic reform greatly facilitated its entry to the IMF, which came about on 6th May 1982. Measures that are currently being demanded of Rumania under the stabilisation programme were mostly implemented in Hungary during the seventies and early eighties in conjunction with the introduction of market-related management elements into the socialist economic order.

Upon entry to the Fund Hungary was allocated a quota of 375 million SDRs, of which 21.6 % was deposited in freely usable currencies and the remainder in national currency. Although Hungary is less than half the size of Rumania in terms of area and population, Hungary has the larger quota owing to the higher productivity of the Hungarian economy, which is reflected in such things as a higher per capita national product and higher per capita foreign trade. Hungary's new quota after the general quota increase in November 1983 amounts to 530.7 million SDRs.

Hungary made use of its drawing rights for the first time in December 1982. The Fund approved drawings totalling 547 million SDRs, of which 475 million was to be paid out in instalments over the following 13 months under a standby credit. This loan was closely associated with Hungary's liquidity shortages in the second half of 1981 and the early part of 1982, which had caused serious problems for the Hungarian economy in spite of evident success in stabilising the trade balance and the current account, as the IMF was at pains to emphasise.

In the case of Hungary too the standby credit is accompanied by an adjustment programme aimed at further consolidating Hungary's foreign trade. As in Rumania, the measures are designed primarily to reduce overall demand. Once the entire standby credit has been taken up, Hungary's drawings of conditional Fund resources will equal about 90 % of the country's new quota. With future maximum access to conditional Fund resources equivalent to 408 % of the quota, Hungary could in principle draw the annual maximum in the coming three years in the event of serious balance-of-payments problems. Hence in conjunction with a further standby credit arrangement, net recourse to Fund resources could conceivably amount to about 540 million SDRs a year from 1984 to 1986. This annual drawing volume should ensure that Hungary can meet its payment obligations even if access to new commercial bank loans is completely closed.

Poland: Continued Interest in Membership

By contrast with Rumania, Poland was under strong economic pressure at home and abroad when it applied for membership in November 1981. With debts totalling \$23 billion and a current account deficit vis-à-vis the West of \$2.3 billion (1980), Poland had already been unable to repay maturing loans at the beginning of 1981. When Poland opened rescheduling negotiations with Western banks and governments in early 1981, the fact that it was not a member of the IMF was seen as a further impediment in Western quarters, as the Fund had played an important part in restructuring the debts of member countries under earlier refinancing schemes of a similar kind. The commercial banks had feared that the lack of this tried and tested mechanism would seriously hamper the Polish rescheduling arrangements. Poland was therefore urged to apply for membership of the Fund before refinancing negotiations took place.¹² The banks hoped that Polish

¹¹ Cf. K. Schröder: The IMF and the Countries of the Council for Mutual Economic Assistance, in: *INTERECONOMICS*, No. 2 (March/April), 1982, p. 89.

¹² Cf. Internationales Zentrum für Ost-West-Kooperation (ed.): *Ost-West-Kooperation aktuell*, No. 4/1981, p. 65.

¹⁰ Cf. P. Pissulla, op. cit., pp. 69 ff.

membership would bring more than just financial assistance from the IMF; particular importance was also attached to the possibilities open to the Fund to set in motion a programme of economic reform. Unless Poland was willing to allow such an economic reconstruction programme to be monitored by an independent international institution, the banks were not prepared to grant Poland further unsecured loans.

The banks' hopes for a swift Polish accession to the IMF and equally rapid financial assistance appeared to be well founded in view of the series of preliminary discussions between the IMF and Poland's economic policymakers and the presence of an IMF observer at the rescheduling negotiations for the first time in September 1981, but they were dashed by the declaration of martial law in December of that year. Nevertheless, further talks on possible ways of overcoming the crisis by means of economic reform were held between IMF representatives and Poland during 1982; Poland's interest in IMF membership remained undiminished. Reforms in the field of price and exchange rate policy and action to curb domestic demand appear to have been implemented with the IMF in mind, whose economic stabilisation programme linked to the granting of conditional resources would follow the same pattern.

The scale of IMF balance-of-payments assistance that Poland could claim in future depends on the level of the quota allocated, which in turn depends on the country's productive capacity. The quota of between \$0.7 and 1 billion assumed by the Polish Minister of Finance Marian Krzak in November 1981 at the time of the application for membership was probably an overestimate, but it appears to be a realistic figure after the increase in quotas under the Eighth General Review; another reason for considering it unrealistic previously lies in the fact that the output of the Polish economy has declined further by comparison with 1981.

If Poland's gross national product and foreign trade turnover are compared with Hungary's to give some idea of the appropriate quota for Poland, it will naturally be found that they are both substantially larger than Hungary's on account of Poland's greater size in terms of area and population. However, the per capita figures for each country reveal that the Hungarian economy has the higher overall productivity; more important, Hungary's per capita foreign trade is significantly higher than Poland's.¹³ As Poland's output has declined since 1980, it must have fallen even further behind Hungary on a per capita basis in 1983. The ratio of exports to GNP (expressed in dollars) also shows that Hungary is

more highly integrated into international trade than Poland, with exports accounting for 19 % of GNP as against 12 %. It therefore seems improbable that under the quota structure valid in 1983 Poland's quota could have been expected to be roughly twice that of Hungary.

A possibly more realistic estimate can be made on the basis of Poland's original quota as a founder member of the IMF in 1945, namely \$125 million. Assuming that Poland had taken part in all the general increases in quotas since 1945 and that no special adjustments had been made, its quota would have been about 465 million SDRs in 1983. After the further increase in quotas at the end of last year Poland could reckon on a quota of 650-700 million SDRs at most if it were to join the IMF.

The scale of Poland's debts towards the West, the size of its annual debt-service payments of about \$ 10 billion (before rescheduling), especially in relation to its exports to the West, and the unquestionably protracted and difficult process of adjustment that Poland must undergo in order to consolidate and stabilise its foreign trade might give justification for the IMF to classify Poland as a "case of hardship". In such cases a country can draw not 102 % but 125 % of its quota in three successive years from 1984 onwards, so that in the three years following accession Poland could draw a maximum of about 875 million SDRs a year. In addition, drawings up to a maximum of 83 % of the quota might be feasible under the Compensatory Financing Facility to offset a fall in export receipts; these drawings, which do not count towards the drawing limit, would therefore come to about 590 million SDRs.

Given Poland's annual burden in loan redemptions and interest payments to Western creditors, which is put at about \$ 10.3 billion in 1984 before rescheduling, it is easy to see that IMF balance-of-payments assistance cannot substantially ease Poland's predicament even if it takes up its entire drawing entitlement. Taking into consideration the rescheduling schemes that are almost bound to follow in the next few years, Poland's payment obligations will initially decline, however, so that a substantially larger part of the amounts falling due could be paid out of IMF resources. However, this would of necessity provide only temporary relief. According to estimates made by Polish experts, a moratorium on redemptions and interest until 1990 would increase the country's debts from \$ 27 billion in 1983 to \$ 62 billion. Even if Poland paid one-third of the interest due on each occasion its total indebtedness would not be less than \$ 50 billion in 1990.¹⁴ If these estimates are realistic,

¹³ Cf. P. Pissulla, *op. cit.*, p. 88.

¹⁴ Cf. *Handelsblatt*, No. 176 of 13. 9. 1983.

Poland will be no more able to repay its debts in 1990 than it was at the beginning of the eighties.

The Polish economy is therefore in urgent need of fundamental reorganisation. At present, Poland's economic problems seem practically insoluble without outside help, but as matters now stand Poland's access to medium and long-term commercial bank credit is blocked. The only financial help forthcoming from the West at present is the revolving granting of credit for part of the due interest payments agreed as part of the rescheduling arrangements. Even though the maximum financial help available from the IMF seems to be little more than a drop in the ocean, it would probably be incomparably more difficult for Poland to solve its external and domestic economic problems without the IMF.

Since the official lifting of martial law Poland's application has won increased support, particularly from the EC. Whether Poland can become a member as early as this year might, however, depend partly on the Fund's liquidity position and the development of East-West relations in general. In spite of the necessary majority of Fund members that have now approved the increase in overall quotas to 90 billion SDRs and the provision of the long-debated 6 billion SDR credit line to the Fund to finance its credit commitments to members in payments difficulties, the Fund's liquidity is as tight as ever. This situation might ultimately prejudice the negotiations on Poland's entry, as Poland would undoubtedly desire substantial drawings.

Moreover, it should not be forgotten that the USA still holds great influence over Fund decisions through its voting share of about 20 % and that lending to socialist countries is a highly controversial subject in the US Congress at present. Admittedly it is incompatible with the Articles of the Fund to discriminate against a country because of its economic or social system, but it cannot be ruled out that resistance on the part of the USA will at least delay Poland's entry.

However desperately Poland might need the financial assistance of the Fund to overcome its balance-of-payments problems, the question arises whether the country would even be in a position to cope with the severe adjustment measures that would undoubtedly be required. However necessary the measures to curb demand that were also required in the case of Rumania and Hungary may be for an economy that has got into internal and external imbalance as a result of years of excessive demand at home, it has been shown lately that measures of this type always place a particularly heavy burden on the population. In Poland a further

lowering of the standard of living could easily lead to a renewed wave of protests.

Increased Co-operation Desirable

The emerging inability of Rumania and other countries to fulfil the economic conditions imposed by the Fund might indicate that the time-scale of the IMF's attempts at consolidation is not sufficiently long. For example, the rigorous demand-curbing measures taken under the Rumanian three-year stabilisation programme have in any case caused a further contraction in the country's trade with the West in goods and services, thereby exacerbating the existing crisis. On the other hand, the IMF does not have adequate resources to undertake long-term financing. It therefore seems all the more important to avert the danger that the IMF will become merely a lifeboat service which comes to the rescue only if a country's balance-of-payments problems have become practically unmanageable and which is therefore overstretched, at least in the present time of endemic debt crises. Within the framework of the regular consultations with all member countries it should take steps in good time to prevent individual countries from contracting excessive debt. In the case of Rumania, however, the Fund was clearly unable to do this.

Whatever criticism one might make, the following point should be remembered: even though the socialist members of the IMF (Hungary, Rumania, Yugoslavia, China and Vietnam) are confined at present to the position of debtors for economic and system-related reasons (their currencies are inconvertible) and though they can undoubtedly exert little influence on Fund policy with their share of just under 5 % of the votes, increased co-operation in the IMF on the part of Eastern Europe nevertheless appears desirable. The IMF is not an institution whose objectives are to promote trade directly between member countries, as are UNCTAD and GATT, but efforts to stabilise international monetary relations and to achieve balanced growth in world trade will undoubtedly have a beneficial effect on trade over the long term. Particularly in the present situation, in which the Eastern European members of the CMEA are endeavouring to overcome their shortages of hard currency and their indebtedness to the West mainly by means of trade restrictions, in other words by curbing imports and strengthening CMEA integration, increased participation by these countries in the international economic and monetary organisations seems desirable if the gulf between the two economic blocs is to be prevented from widening and being perpetuated for economic and political reasons.