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 join[1]; 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.

* HWWA-Institut fur Wirtschaftsforschung-Hamburg.

[1] Cf P Pissulla: Der Internationale Währungsfonds und seine Bedeutung fur die osteuropaischen Lander – Rumanien, Ungarn, Polen –, Hamburg 1983, pp. 16 ff.

[2] H. Hamel: Zur Frage der Mitgliedschaft der RGW-Lander im Internationalen Wahrungsfonds (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

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;

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[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.