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The Director of Central Intelligence  
Washington, D.C. 20505

National Intelligence Council

NIC No. 04804-84  
21 August 1984

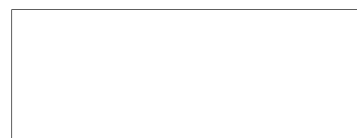
MEMORANDUM FOR: Acting Director of Central Intelligence  
FROM: George Kolt  
National Intelligence Officer for Europe  
SUBJECT: Poland and IMF Membership

1. In response to the Polish government's recent release of most political prisoners, the USG has agreed to lift two sanctions: the bans on scientific and cultural exchanges and on Polish airline flights to the US. The US has also suggested that it might be ready to drop its opposition to the renewal of Polish negotiations with the IMF over membership. I suggest that you discuss the IMF issue with the Secretary of State and with Mr. McFarlane. My personal belief is that it would be premature to support Poland-IMF negotiations now.

2. The Polish application to join the IMF has been in abeyance since December 1981 when the imposition of martial law forced an IMF delegation to leave Warsaw. Simultaneously the USG made the renewal of these negotiations (as well as the lifting of the other sanctions it imposed) contingent upon Jaruzelski meeting three basic conditions. The USG has gradually lifted its sanctions as Jaruzelski moved to satisfy the form although not the essence of these conditions. Thus, he

--lifted Martial Law . . . but in such a way as to keep most of its control features alive in new legislation.

--Freed the majority of political prisoners . . . but on conditions that seem to guarantee there will be new political prisoners before the year is out.



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--Has been fairly conciliatory towards the Church . . . but remained steadfastly opposed to any sort of dialogue which might put limits on his power.

3. Still, we are now at a stage where we are discussing measures that would again allow some Western credits to flow into Poland - in the IMF case about \$2 billion in the next 18 months. Those inside and outside government who argue that the US should drop its opposition to the renewal of IMF negotiations believe the Polish government needs new credits so badly it could be made to accept IMF conditions that would in effect bring about economic and political reform.

4. I agree that in some circumstances outside sources of financial support can influence an East European governments actions. Indeed, the USG sanctions probably have had an effect in mitigating and undoing some of the worse aspects of Jaruzelski's crime of 13 December 1981. But I do not think that IMF negotiators can now push the Jaruzelski regime into a positive direction:

- The regime's top priority remains political control. It is highly unlikely to agree to any economic reforms which could undermine that political control.
- As we wrote in our recent NIE on Eastern Europe, ". . .the West almost certainly will not itself be able to create the conditions that give rise to East European moves toward economic flexibility and independence. Postwar history . . . suggests that the initiative for change in Eastern Europe must arise in the main from within." Polish society is certainly more than ready for initiatives for change. But the regime is not. Although there probably are some proponents of change within the government, I do not think that even the support of IMF negotiators would allow them successfully to press their arguments in the security minded Jaruzelski regime.

5. The proponents of INF negotiations would undoubtedly reply that the USG would only be agreeing to the start of negotiations: IMF membership -- and money -- would come only if the Polish government would meet the IMF conditions. But we must keep in mind that, once negotiations start, the US government, in effect, will pretty much lose control of the process to the international servants in the IMF. And, when the issue comes up for a vote, it will be harder to recreate a United Western opposition to Polish membership (IMF membership issues are decided by majority rules, with each nation voting shares based on its financial contribution. Thus the US controls 19.2% of the vote).

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6. In sum, I do not think that the time is ripe for the USG to support the renewal of negotiations over Polish membership in the IMF. Proposed talking points for your discussion of this issue with the Secretary of State and with Mr. McFarlane are attached.

  
George Kolt

Attachment

1. Talking Points
2. DDI Report Dtd 28 June 84;  
Poland and the IMF

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NIC No. 04804-84  
21 August 1984

MEMO FOR: Acting DCI  
FROM: George Kolt  
NIO/EUR  
SUBJECT: Poland and IMF Membership

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NIO/EUR/GKOLT/[ ] (21 August 84)

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NIC No. 04804-84/1  
21 August 1984

Proposed Talking Points for ADCI Meeting  
with Secretary of State Shultz and  
National Security Advisor McFarlane

--The USG has suggested it would consider dropping its opposition to the renewal of negotiations over Polish membership in the IMF if the Polish government implemented its pledge to free all political prisoners.

--In my judgment this would be a mistake:

- First, Jaruzelski is freeing prisoners under conditions that seemingly guarantee there will be more arrests before the year is out.
- Second, I disagree with the argument that IMF negotiators could push the regime toward meaningful economic and consequently political reform. As we wrote in our recent NIE on Eastern Europe, "the initiative for change in Eastern Europe must arise in the main from within." Jaruzelski regime's top priority is political control. Although there probably are some proponents of change within the government, I do not think that even the support of IMF negotiators would allow them to successfully press their arguments in the security-minded Jaruzelski regime.
- Third, we must keep in mind that once IMF negotiations start we are likely to lose almost all control over the process to the negotiators and to other nations.

--In sum, I believe IMF negotiations at this time are unlikely to yield the results we would want. Thus, I do not think the time has come to drop our opposition to these negotiations.

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Central Intelligence Agency

Washington, D.C. 20505

## DIRECTORATE FOR INTELLIGENCE

28 June 1984

Poland and the IMF

## Summary

The issue of Polish membership in the IMF is receiving increased attention in the West. Although Poland's dormant application could be revived soon, some technical problems--such as sizable arrears--are likely to prevent its quick approval. Once a member, Poland could receive an estimated \$2 billion in credits the first year. To draw most of these funds, however, Warsaw would have to agree to implement a strong adjustment program that might include restraints on wage increases, hikes in retail prices, and cuts in enterprise subsidies. Warsaw has been unwilling to impose tough measures in these areas, but might do more in response to IMF prodding. The Fund would not insist on systemic reforms since it considers these outside its purview. But IMF pressures on Poland to promote efficiency and greater reliance on market forces would bolster the arguments of reformers in Warsaw. Polish membership in the Fund would not dilute significantly US voting strength in the organization.

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This memorandum was prepared by [redacted] East European Division, Office of European Analysis. It was requested by Paula Dobrianski, Deputy Director, European and Soviet Offices, National Security Council. Comments and questions are welcome and should be addressed to [redacted] Chief, East European Division, EURA, [redacted]

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Poland and the IMF

There are some signs that Poland's membership bid to join the IMF may soon be revived. This paper briefly explores the numerous issues involved with such an event. It begins by examining the IMF in general and discussing some of the basic problems the Fund has had with centrally planned economies. The paper next explores some of the specific issues that would apply to Polish membership, drawing on the Fund's experiences with other East European countries, and concludes with a short section on the implications for the US.

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The IMF - An Introduction

The purpose of the IMF is to promote economic and financial cooperation among its members in order to facilitate the expansion and balanced growth of international trade. The Fund seeks, in particular, to reduce the intensity and duration of any disequilibrium in a member country's international balance of payments. To this end, the IMF promotes exchange rate stability, assists in the establishment of a multilateral system of payments, and works to eliminate foreign exchange restrictions.

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Membership in the IMF is open to any sovereign state that is prepared to fulfill the obligations of membership laid out in the Articles of Agreement (see Box 1). The decision to admit a country resides with the Board of Governors (comprised of one

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## Box 1

Procedure for Membership

1. Informal contact may be made between a prospective applicant and the IMF in order to acquaint the country with its likely duties and responsibilities. (The managing director of the IMF can send a staff team to answer questions and offer technical assistance.)
2. These talks are followed up with a letter of application addressed to the Managing Director of the Fund, submitted by an official acting on instructions of his government.
3. The Managing Director places the application before the Executive Directors, (the decision-making body of the IMF) who appoint a special committee to discuss membership in detail with the applicant. The committee essentially draws up a "resolution of acceptance" that spells out the prospective applicants':
  - quota in the Fund; the quota determines the prospective member's voting power and sets limits on financial assistance;
  - subscription of currency and its date of payment (equalivalent to the quota with one-fourth payable in hard currency and three-fourths payable in the applicant's currency);
  - par value of the country's currency and various exchange rate issues;
  - date when transaction with the Fund may begin; and
  - procedures for acceptance of membership.
4. Once the staff's work is approved by the Executive Directors, the application is passed on to the Board of Governors. The Board of Governors accepts membership by a simple majority of the votes, though "voting" is weighted to reflect the size of the member. (At present votes are allocated on the basis of 250 votes each plus 1 vote for each 100,000 SDRs of a member's quota.)
5. The applicant usually has six months to accept membership but a longer period may be granted in special cases. If the applicant accepts, it must deposit an "instrument of acceptance" that states it has taken the necessary steps to enable it to carry out all obligations under the Articles of Agreement and the "resolution of acceptance." Finally, the applicant signs the Articles of Agreement.



representative from each member), though the application is first placed before the Executive Directors<sup>1</sup>. The Directors--in consultation with the applicant--work out the terms of membership and pass along their recommendations to the Board of Governors. The Board of Governors seldom rejects the Executive Directors' recommendations because difficulties are usually ironed out before the application is formally submitted. The Executive Directors can block a membership bid by refusing to proceed with the formal investigation of an applicant.

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Once a member, the country can draw "temporarily" on Fund resources "under adequate safeguards" to help correct balance of payments difficulties (see Box 2). The IMF sets "conditions" for the use of its resources to help ensure that the country can overcome its balance of payments difficulties within a reasonable period of time, and to enable it to sustain financial equilibrium without continued reliance on Fund resources. These conditions are negotiated with member countries and must be agreed on before applications for use of IMF resources are forwarded to the Executive Directors. Conditionality is progressive, however, and a country may draw considerable resources from the Fund before having to contend with particularly tough IMF demands, especially if the borrower can point to external factors beyond its control as the reason for its financial problems. Only when a country seeks credits extending beyond the second or third credit tranches does the Fund require extensive and onerous adjustment

<sup>1</sup> Comprised of representatives of the six member countries with the largest quotas plus 16 other Directors representing the other members of the IMF.

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## Box 2

Commonly Used IMF Facilities

Type of Credit	Percent of Quota <sup>1</sup>	Conditions of Recipient
Reserve Tranche	25	Demonstrate balance of payments need.
First Tranche	25	Demonstrate balance of payments need and show the Fund that reasonable efforts are being made to solve the problems.
Upper Tranches	50-100	Demonstrate "substantial" justification of need and agree to conditions worked out with the Fund. Program duration is usually up to one year.
Standby or Extended	140 <sup>2</sup>	Demonstrate serious balance of payments needs over an extended period of time. These facilities are made available for up to three years subject to strict conditions worked out with the Fund. Usually involving structural adjustments.
Compensatory Financing Facility	83-105	Demonstrate temporary balance of payments need due to circumstances beyond the member's control. This facility primarily applies to countries exporting primary products but also has been extended to include excessive costs of cereal imports.
Buffer Stock Financing Facility	45	Demonstrate balance of payments need related to participation in arrangements to finance approved international buffer stocks of primary products.

<sup>1</sup> A member's "quota" is denominated in Special Drawing Rights (SDR as of May 1984, = \$1.047) and is determined by "the member's economic characteristics relative to other members of comparable size."

<sup>2</sup> Under special circumstances, the Fund can approve stand-by or extended arrangements in excess of the limits.

source: The IMF's International Financial Statistics, June 1984.

programs as "conditions" for using its resources. [REDACTED]

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IMF adjustment programs focus largely on demand-management policies, particularly on fiscal, monetary, and exchange rate measures aimed at balancing domestic demand with available resources. The programs establish quantitative performance criteria that set targets for:

- net domestic assets of the banking system,
- gross convertible international reserves,
- short-term foreign debt, or possibly total debt, and
- trade or current account balances.

In addition, IMF programs include four "restrictive" measures that prohibit the borrower from:

- imposing or intensifying restrictions on payments and transfers for current international transactions,
- introducing or modifying multiple currency practices,
- concluding bilateral payments agreements that are inconsistent with the Fund's Articles, and
- imposing or intensifying import restrictions for balance of payments purposes.

Finally, the Fund requires a "Letter of Intent" drawn up by the borrowing country that specifies the quantitative targets to be met over the duration of the program and outlines the policies the country plans to adopt in order to achieve the goals of the program and to meet performance criteria. [REDACTED]

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The IMF seeks to tailor its programs and conditions to take into account the particular concerns and institutions of different members. Conditionality also has changed recently as

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the Fund finds itself strapped for resources and reeling from criticisms that its supervision of debtor nations has been far too lax. Thus, the Fund has broadened the concept of conditionality and more frequently proposes that a country commit itself to "supply side" measures. The IMF programs also now focus more on microeconomic causes of balance of payments problems in addition to traditional reliance on macroeconomic adjustment policies. The Fund does not try to impose reforms that would alter the basic structure of a member's economy or insist on changes in the allocation of GNP. [redacted]

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#### Problems with Centrally Planned Economies

Debates dating back to Bretton Woods have focused on whether centrally planned economies (CPEs) belong in the IMF. Critics argue that the economic distortion inherent in such economies--unrealistic export prices, multiple exchange rates, nonconvertible currencies--make it very difficult for the Fund to help devise programs that would correct balance of payments problems. The East European countries, for their part, have had political reservations about dealing with an organization that is controlled by the developed capitalist countries and that demands certain economic policies as a condition for its credits. They also have been reluctant to provide the economic data required under article VIII of the Fund's basic provisions, largely because they regard such information as state secrets [redacted]

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Despite these issues, the IMF has not prevented states with centrally planned economies from becoming members. The Fund

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argues that it can better promote international monetary cooperation and world financial stability if it allows all countries to become members. Moreover, the Fund preserves its neutrality regarding the institutional arrangements of its member countries and stresses that its policies are formulated with "due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members." Thus Poland, Czechoslovakia, and Yugoslavia were founding members of the IMF, while Romania (1972) and Hungary (1982) joined later. Both Poland and Czechoslovakia eventually withdrew--in 1950 and 1955 respectively--after disputes with the Fund over the provision of economic information [redacted]

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#### Poland's Membership Status

Poland showed interest in rejoining the Fund beginning in the mid-1970s, but did not announce its intentions until November 1981. Forseeing few major stumbling blocks, Warsaw fully expected to gain membership by the fall of 1982, at the latest. The Polish declaration of martial law in December 1981 and the subsequent imposition of Western sanctions derailed the Polish application. Although IMF technical teams visited Warsaw in 1982, Warsaw's application was shelved by the Fund's Executive Directors. [redacted]

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There are signs that Poland's application for membership soon may be revived. Some Western governments view it as one of the carrots they can offer Warsaw, especially in response to any political concessions by the Jaruzelski regime. Other

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governments consider IMF membership necessary to force the Poles to impose a meaningful stabilization program and thus to help ensure that Warsaw eventually repays its long overdue debts. For its part, Warsaw seems eager to receive IMF loans and the Polish delegation to the Paris Club repeatedly has brought up membership as a condition for their agreement to a rescheduling accord. As recently as mid-June, the Poles' list of demands to the Paris Club included IMF membership. [REDACTED]

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It is not clear, however, how seriously Poland is considering membership, even if the Fund's Executive Directors are willing to take up the matter again. We have no information to suggest that Warsaw has directly prodded the Fund about moving along its application. Polish requests to the Paris Club may be just a bargaining ploy or may reflect only the desires of some officials in the Ministry of Finance who are known to favor membership. [REDACTED]

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Possible Soviet opposition could stall a Polish membership application. Moscow reportedly approved Poland's membership drive in 1981, probably out of a calculation that IMF financial assistance could help reduce Moscow's costs of propping up the foundering Polish economy. But Moscow might be far less agreeable this time around. The Soviet Union is trying to draw its allies closer together and to seek solutions to the region's economic difficulties through CEMA integration. In particular, Moscow has criticized--either directly, or indirectly through close allies such as Czechoslovakia--some East European countries for maintaining too many economic ties with the West. Such

dependency, according to Moscow, has resulted in the unwarranted intrusion of "international financial institutions" into the internal affairs of these sovereign states. In addition, unconfirmed reports continue to surface that Moscow has offered Poland considerable economic incentives to turn eastward. Even if all sides--Warsaw, Moscow, and Western governments--eventually give the green light to a Polish application, formal membership proceedings would probably take at least six months. [REDACTED]

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Poland's application probably would not be hindered by the traditional issues that have been raised over CPEs, such as multiple exchange rates, nonconvertible currencies, or the release of information. Romania's admission in 1972--and to a much lesser degree Hungary's entry in 1982--shows that the Fund is willing to ignore, at least temporarily, currency and exchange rate issues and to tolerate some stinginess with official data. Moreover, Poland is regarded as one of the more open communist regimes when it comes to publishing statistics. In recent years Warsaw has even supplemented open source material with more detailed economic memoranda to its creditors. [REDACTED]

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Warsaw's large arrears owed Western governments--presently over \$7 billion and climbing daily--could pose a problem. The IMF probably would require Poland to settle these accounts before granting any sizable credits and possibly before allowing membership.<sup>2</sup> Both Romania and Yugoslavia have had trouble with the Fund over arrears; Romania, for example, was forced to delay

<sup>2</sup> Arrears are technically a violation of the IMF Articles which states "no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions." [REDACTED]

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a drawing until it had made arrangement to cover them. [redacted]

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The IMF probably would not force Poland to pay all arrears immediately, but might insist that it work out a tentative settlement of outstanding claims. Romania resolved its dispute with the Fund by paying off some claims and incorporating others into rescheduling agreements. Warsaw probably could handle the majority of its arrears this way--it already has agreed with its Paris Club creditors to a schedule for paying 1981 arrears. An additional problem, however, is the sizable claims owed creditors not included in current rescheduling talks. Warsaw would probably find it difficult to make the downpayment of several hundred million dollars needed to resolve its disputes over arrears. [redacted]

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Poland could experience problems in paying the subscription required for membership.<sup>3</sup> Warsaw would have to make a hard currency downpayment of about \$225 million, based on our estimate that its quota would be around \$900 million (give or take 10 percent). This payment can be withdrawn later by the member and used without any strings attached, so it does not represent a permanent loss, but it does temporarily tie up Poland's very limited funds. [redacted]

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<sup>3</sup> New members are required to pay a subscription to the IMF equal to their "quota," with 75 percent payable in domestic currency and 25 percent due in gold or hard currencies. The average hard currency subscription paid by existing members is closer to 22 percent. Hungary paid only 22 percent when it joined, arguing successfully that it should pay the average. Poland's subscription might be less and could be paid in installments--if exceptional circumstances exist--but it probably could not justify paying much less than the current average. [redacted]

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An IMF Program for Poland

Poland presumably would begin immediately to draw funds. Though precise numbers are hard to determine at this stage, Warsaw possibly could draw about \$2.2 billion in hard currency credits during the first 12 to 18 months. These would include:

- \$225 million from the reserve tranche;
- \$225 million from the first credit tranche;
- \$450 million from the compensatory financing facility;  
and
- \$1.3 billion from the first year of a 3-year stand-by program.

Technically, Warsaw's maximum eligibility is higher but the above figures represent the amount it is likely to receive (see Table 1)

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The Poles possibly could draw about \$900 million (including the return of the \$225 million subscription payment) before encountering tough IMF conditions. When the Poles seek credits under a standby program, the IMF probably would compel Warsaw to devise and implement a comprehensive stabilization program. The severity of Poland's problems, as well as the increasingly tough attitude of the Fund suggest that the two sides will have trouble agreeing on stabilization measures. In recent dealings with other East European countries, the IMF has demanded more restrictive and austere policies, probably because its earlier Fund programs and advice failed to keep Romania and Yugoslavia from rescheduling (see Appendix 1). Moreover, the IMF has been publicly criticized in the press by bankers for the softness of

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- 10 -

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Table 1

Estimated IMF Assistance to Poland<sup>1</sup>

Type of Credit	Percent Of Quota	Amount (US\$ Million)	Conditions for Poland
Reserve Tranche	25	225	Demonstrate balance of payments need.
First Credit Tranche	25	225	Demonstrate "substantial" justification of need and agree to conditions worked out with the Fund. Program duration is usually up to one year.
Compensatory Financing Facility	50	450	Demonstrate an export shortfall, not necessarily related to primary product production difficulties. Other CPEs have used it but have not drawn the limit.
Standby or Extended	140	1,260	Adhere to relatively strong IMF mandated stabilization program.
<b>TOTAL</b>		<b>\$2,160</b>	

<sup>1</sup> Estimates based on assumed quota of \$900 million. The exact quota is determined by "the members economic characteristics relative to those of other members of comparable size."

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its East European programs. The IMF is unlikely to grant Warsaw time just to "tinker" with its economic problems. [REDACTED]

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Although each IMF program is unique, recent stand-by arrangements concluded with other East European members point to the likely provisions of such a program for Poland. In addition to the usual "restrictive clauses" included in all programs (see page 4), the Fund will seek to impose:

- targets for balances on hard currency trade and current account balances;
- limits on net hard currency debt;
- a target level for minimum hard currency reserves; and
- limits on net domestic assets of the banking system.

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[REDACTED]

Annual or quarterly targets for these criteria will be agreed upon with Warsaw. In addition, the Fund is likely to urge simplification of the foreign trade and exchange systems and will advise Warsaw of the benefits to be gained for efficiency from greater reliance on market mechanisms in preference to administrative controls. Other specific criteria will depend on how the Poles describe their economic policies in their "Letter of Intent." The Fund probably will push for Warsaw to impose greater domestic austerity in order to shift resources to the external sector. Consequently, the IMF may try to persuade Warsaw to reduce the planned growth of investment and consumption. The IMF also will look at ways to increase domestic supplies, and will focus on wage and price policies, interest rate hikes, and budget subsidies. [REDACTED]

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We believe that Poland will have great difficulty agreeing to an IMF stabilization program that would allow it maximum access to IMF credits. Warsaw would find it hard to accept required conditionality. Some Polish officials--particularly in the Ministry of Finance--have argued that Polish reform measures adopted in 1982 would go far toward meeting IMF demands for stabilization program. In our view, the seminal reforms will do little to ensure achievement of any reasonably stringent performance criteria. Although some Poles would like to use the Fund as a scapegoat for imposing tough austerity measures, the regime probably will be very unwilling to accede to very tough IMF demands. If this is true, Poland will try to raise the facilities of the IMF that require easier conditionality. Use of these facilities would yield Poland some \$900 million in the first year, still a considerable amount of financing. [REDACTED]

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It is still questionable as to whether and to what extent the Polish regime will choose to follow Fund recommendations. East European members of the IMF have reacted differently to the Fund's guidance. Hungary appears to be working quite closely and amicably with Fund officials, but Budapest has been reforming its economy for most of the last 16 years and is eager to implement further reforms. On the other hand, Bucharest has mechanically implemented some price and exchange rate adjustments demanded by the Fund, but the changes have not led to major improvements in economic performance, largely because they have not been accompanied by any reduction in the regime's tight administrative controls over the economy. Yugoslavia has accepted some

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IMF recommendations while arguing against others, but, as with Hungary, the impetus for economic reform comes from domestic sources. In Poland's case, the regime might agree to policies but then not follow through in their implementation. If performance criteria are not met, the IMF will have to decide how tough it wants to be.

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#### Other Benefits of Membership

Membership in the IMF can provide other indirect benefits to Poland--including membership in the World Bank and an improved credit rating--but these rewards may not be as great as Warsaw believes.

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World Bank. Poland almost certainly would seek World Bank membership after joining the Fund. Advantages do exist, but the gains are not as great nor as immediate as those from being in the Fund. Poland would be eligible to bid on construction projects financed by the World Bank in other member countries. Such contracts could provide some net inflows to the trade and service accounts over the longer term. Warsaw also could tap the bank for various project loans to help modernize key sectors of the economy, although it would not obtain very favorable interest rates because of its high per capita income. Yugoslavia, Romania, and more recently, Hungary, have used such loans, especially to finance energy-related projects. Budapest, for example, has drawn over \$400 million in these loans in its first two years of membership.

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Improved Credit Standing. Foreign creditors generally are

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more receptive to rescheduling the debts of a country that is receiving IMF funds and following an IMF stabilization package. The recent rescheduling packages for Yugoslavia and Romania have been made conditional on these countries signing and adhering to IMF programs. Moreover, IMF technical expertise often has proven invaluable in aiding both sides during rescheduling negotiations. For example, the IMF was instrumental in helping the Romanian financial team overcome its inexperience and, at times, incompetence during the early stages of the first rescheduling talks. [redacted]

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IMF membership might not have much of an impact, however, on Poland's current efforts to reschedule debt payments. The banks and Poland are close to concluding a multiyear agreement that would cover most, if not all, remaining debts and leave little work for the Fund. Serious rescheduling talks with the Paris Club have only resumed, but they could be well advanced by the time Poland joins the Fund. Moreover, political factors--rather than economic--have delayed Paris Club negotiations. [redacted]

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The IMF could play an important role in future debt reschedulings. Poland's seemingly insurmountable debt troubles suggest that Warsaw will be unable to meet its rescheduled obligations when they come due. The rescheduling of "reschedulings" is rare, so the Fund might find itself breaking new ground in this area. [redacted]

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Finally, IMF membership might aid Poland's never-ending search for "new money," whether as part of rescheduling agreements or outside of these formal packages. Though unlikely

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to be large, some new money might be more readily available if Poland were in the Fund. [REDACTED]

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### Implications for the US

US support for IMF membership alone probably would not lead to an immediate improvement in US-Polish relations. Earlier this year, Foreign Minister Olszowski told the Polish parliament that improved relations depend upon the US dropping its policy of discrimination toward Poland, ending its interference in Polish domestic affairs, halting its propaganda attacks, and compensating Poland for the damages caused by the sanctions. The Jaruzelski regime might try, however, to use continued US opposition to Polish IMF membership to drive a wedge between the US and its allies at the Paris Club. [REDACTED]

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Polish membership in the Fund could raise some troublesome voting issues for US representatives. The Gramm Amendment, passed in late 1983, compels the US to vote against aid to "communist dictatorships" unless the money will help facilitate the flow of labor and capital, will ease balance of payments problems, and is in the best interest of the majority of the people in the country. While the amendment was not a hindrance to US voting on the recent Hungarian and Yugoslav packages, the case of Poland could prove more troublesome. [REDACTED]

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The admission of Poland would not seriously dilute US voting strength in the IMF. Poland's voting share would be just around 1 percent (given a quota of \$900 million), and would cause the US voting strength to drop only marginally from 19.2 to 19

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percent. Even the combined voting strength of all four East European members would be less than three percent. The US would retain its veto over crucial decisions pertaining to the structure of the Fund, which require 85 percent of the votes for approval. Moreover, the US and its allies would retain more than the 70 percent majority vote required on other key operational issues.

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- 16 -

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Appendix I

The following are more detailed assessments of the use of Fund resources by the individual East European members of the IMF.

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Yugoslavia Belgrade has been a member of the IMF since its inception and has drawn on several of the Fund's credit facilities over the years. Early drawings were modest but increased somewhat in the 1960s when Yugoslav attempts to achieve more rapid growth helped cause growing inflationary pressures and balance of payments difficulties. The Fund granted Yugoslavia relatively small standby credits in 1965 and in 1971, worth under \$100 million each. These credits were modest compared to Yugoslavia's quota, and Belgrade was required only to demonstrate that it had a balance of payments need and was making "reasonable efforts" to solve its problem.

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Yugoslavia also derived what could be considered "nonpecuniary" benefits from the Fund. Technical advice accompanying the financial support in 1965 aided Yugoslavia in its drive to implement market-oriented reforms. In the early 1970s, IMF financial support made it easier for Yugoslavia to adopt a series of constitutional amendments that further decentralized economic decision-making. In both instances, however, the driving force for reform was local demands for more autonomy from Belgrade.

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The onset of the second oil price shock and Western recession in the late 1970s exacerbated Yugoslavia's persistent balance of payments problems and forced Belgrade to seek IMF standby programs every year since 1979. In addition, Yugoslavia has drawn over \$1 billion from the Fund's special Oil and Compensatory Financing Facilities. Few conditions are imposed under these facilities since the credits are granted to help overcome external shocks or other factors beyond the borrower's control. The policy measures outlined in standby programs in 1979 (\$90 million), 1980 (\$260 million) and the first two years of the 1981-83 agreement (\$1.8 billion) largely aimed at controlling the growth of domestic demand.

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Since the final year of the 1981-83 standby credit there appears to be some toughening of IMF conditionality. This reflects the failure of the Yugoslavs (and, implicitly, earlier Fund programs) to improve significantly their hard currency accounts, as well as the tougher conditions associated with purchases in the higher credit tranches. The criteria for the last year of the 1981-83 standby, for example, included monthly devaluations of the dinar. This year's IMF program--a one-year standby worth nearly \$400 million--is a significant departure from previous programs. Performance criteria were expanded considerably. Along with the usual criteria found in most programs, this agreement also includes:

- a deadline for the lifting of a price freeze,
- minimum prices for items under federal control such as railroad services and electricity, oil and gas prices,

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- continued monthly adjustments in nominal exchange rates,
- quarterly increases in interest rates on bank deposits,
- and
- limits on payments to ailing enterprises.

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The Fund has become very insistent about Yugoslav adherence to this new agreement. In mid-May, Yugoslavia's first disbursement was delayed until Belgrade demonstrated it was complying with the program's call for liberalizing price controls.

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Belgrade has been far cooler to these recent IMF dictates than in the past. Debates with the Fund over the 1984 standby credit, for example, were prolonged and--at times--hostile. At several points during the negotiations, Yugoslav officials went so far as to announce they were considering a "black option," an economic program under which Yugoslavia would "go it alone" without Western financial assistance. The differences were eventually resolved because Belgrade recognized that the economy would suffer without Fund help and that continued squabbling with the IMF could delay negotiations over debt relief. Belgrade may yet seek to soften some of the IMF demands in its future negotiations, especially if it perceives favored treatment for some Latin American debtors. Yugoslav differences with the IMF have centered not so much on what the Fund wishes to accomplish, as on the pace of the adjustment effort. Most Yugoslav leaders agree that the features of the IMF program fall well within the bounds of Yugoslavia's own long-term stabilization program. They share the apprehension of many LDCs, however, that the IMF wishes

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to do too much, too quickly, especially in light of domestic political and social conditions. [REDACTED]

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Romania. Bucharest's experience with the Fund parallels that of Yugoslavia. Romania has made extensive use of the Compensatory Financing Facility, citing floods, an earthquake, and a chemical refinery explosion as unforeseen events that contributed to worsening trade performances. Two standby credits were drawn in 1975 and 1977, but few strings were attached. The IMF noted shortcomings in the Romanian economy--particularly, price, interest rate and exchange rate distortions--but failed to press Bucharest into undertaking significant changes. [REDACTED]

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Romania's financial position began to deteriorate sharply in 1980-81, largely due to rising oil-import bills. The Fund helped by granting Bucharest a \$1.3 billion standby arrangement for 1981-84. Yet the Fund underestimated the severity of Romania's financial problems and the harsh banker reaction to Romania's plight, which led to a sharp pullout of most short-term credits in 1981. No sooner had the ink dried on the 1981 agreement than the IMF was forced to suspend drawings under the standby as arrears accumulated. The standby arrangement was amended in 1982 to include a clause specifically detailing how arrears were to be handled. IMF pressure was critical in persuading Ceaucesau to agree to debt rescheduling, and IMF advice was useful in negotiating the terms of rescheduling. [REDACTED]

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The IMF also began pushing harder for Bucharest to correct deficiencies that the Fund had long wanted redressed. The Fund successfully prodded Bucharest during 1982-83 to boost prices,

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especially those in the energy sector, and to eliminate most multiple exchange rates. Finally the IMF program in 1983 requested that Romania undertake four studies outlining further changes in prices, interest rates, exchange rates, and the cost of capital. [redacted]

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Bucharest eventually balked at the IMF program. In the fall of 1983 it informed a visiting IMF team that it would not complete the studies nor raise energy prices. The Fund withheld further disbursements until a settlement could be reached. The IMF subsequently agreed that Romania could draw the remaining credits for 1983, but, with Romanian agreement, canceled the rest of the standby accord. This prevented Romania from drawing previously scheduled credits in the first half of 1984. [redacted]

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Bucharest's most recent dealings with the IMF provide an interesting contrast to those of Yugoslavia. On the one hand, the IMF pushed Bucharest to do far less than Belgrade was asked to do. For example, Romania raised most prices as suggested by the Fund, but still retained administrative controls. This contrasts sharply with Fund dictates that Belgrade "free" entirely a number of goods from federal control. On the other hand, even the limited pressures applied to Romania apparently went too far for those commanding this more "orthodox" centrally planned economy. Bucharest--in part because of its more secure financial position--opted to shun further IMF help. [redacted]

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Hungary. Budapest's experience might seem to be more relevant as a case study to help understand the issues involved in membership for Poland since its economy is centrally planned

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and it just joined the IMF in 1982. But Hungary's debt problems do not approach Poland's and it has already started to implement a comprehensive reform program. [redacted]

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Budapest's application for IMF membership came in late 1981 at a time when its payments position was weakening due to poor export performance and high interest charges on its outstanding debt. Hungarian officials told the US Embassy that they announced their intentions to Moscow but did not seek advice, believing Moscow would go along because of Eastern Europe's deteriorating financial position. Moreover, Budapest wanted to get ahead of Poland, which the Hungarians felt would run into difficulties and thus delay their own bid. By the time Hungary was admitted in May 1982, it had survived--with help from Western central banks and the Bank for International Settlements--a severe liquidity crisis, brought on by the sudden withdrawal of over \$1 billion in short-term credits by Western, CEMA, and OPEC banks. [redacted]

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Still in need of new credits to meet its borrowing requirements, Hungary immediately sought IMF assistance. It was granted its first 13-month stand-by arrangement for \$500 million on 8 December 1982. While the IMF team praised Hungary's ambitious structural reform program, the Fund's overriding priority in the 1983 program was to help Hungary overcome its liquidity crisis. For this reason, the terms of the agreement called largely for increased administrative controls on demand, including stricter government regulation of prices and wages. Budapest performed reasonably well during the period, although it

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fell short of fulfilling several of the key program targets. Sympathetic to Hungary's plight, the IMF noted that continued excess demand was caused largely by the government's attempts to free up the economy--an example of the difficulties in moving from a centralized system of micro-controls to a decentralized system of macro-controls.

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Hungary currently is at the mid-point of its second 12-month standby agreement totalling \$440 million. The objectives of this year's program remain are similar to the the first program. But now that Hungary's financial crisis has eased, the Fund is advising a faster pace for reform. Moreover, the Fund has left open the possibility of replacing the present 12-month arrangement with an 18 month program if Hungary demonstrates that meaningful new reform measures will be taken by 1985.

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- A VII -

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