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July 31, 1984

To: Members of the Executive Board

From: The Acting Secretary

Subject: Syrian Arab Republic - Staff Report for the
1984 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with the Syrian Arab Republic. A draft decision appears on page 15.

It is proposed to bring this subject to the agenda for discussion on Monday, September 10, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Tomasson (ext. 73392) or Mr. Ouanes (ext. 77421).

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INTERNATIONAL MONETARY FUND

SYRIAN ARAB REPUBLIC

Staff Report for the 1984 Article IV Consultation

Prepared by the Staff Representatives for the
1984 Consultation with the Syrian Arab Republic

Approved by Said H. Hitti and Subimal Mookerjee

July 27, 1984

I. Introduction

The 1984 Article IV consultation discussions with the Syrian Arab Republic were held in Damascus during May 24-30, 1984. The Syrian representatives included the Minister of Economy and Foreign Trade, the Minister and Deputy Minister of Finance, the Acting Governor of the Central Bank, and other senior officials. The staff team consisted of Messrs. S.H. Hitti (Head), A. Ouanes, M. Shadman, and G. Tomasson (all of MED), and Ms. N. Blanchet (Secretary--ADM).

The Syrian Arab Republic continues to avail itself of the transitional arrangements of Article XIV.

II. Recent Developments

After averaging about 9 percent annually in 1980-81, real GDP growth slowed down to an average of 3.3 percent in 1982-83 (Table 1) due mainly to poor crop yields caused by adverse weather conditions. Industrial output was also adversely affected by the reduced availability of agricultural inputs as well as underutilization of existing capacity, due in part to shortages of skilled manpower and of foreign exchange. Crude oil production, which had declined from 9 million tons in 1978 to 8.2 million tons in 1982, increased in 1983 by 3.7 percent to 8.5 million tons.

Syria has a comprehensive system of price controls. The Government has frequently adjusted procurement prices for major crops to maintain appropriate incentives for farmers. It has also adjusted retail prices for petroleum products to keep them in line with international prices and to promote energy conservation. Prices of industrial products are determined by a committee consisting of representatives of different ministries as well as concerned public bodies. The available indices show a substantial moderation in price increases in 1983 reflecting mainly fewer changes in administered prices. Consumer prices rose by about 6 percent in 1983 compared with 14 percent in 1982. The available price indices are based on outdated consumer baskets, limited in coverage, and reflect technical problems in the compilation of data.

The authorities are reviewing these indices with a view to improving their quality. With regard to wages, the last overall wage increase for public employees was granted in 1980.

Table 1. Syrian Arab Republic: Selected Economic Indicators, 1979-83

	1979	1980	1981	1982	1983
<u>(In percent)</u>					
Rate of change of selected indicators					
GDP at constant 1980 market prices	3	8	10	3	3
Consumer price index <u>1/</u>	4	19	18	14	6
Government revenues	26	50	20	16	11
Government expenditures	15	63	9	15	8
Money and quasi-money	17	34	16	20	26
Net domestic assets	11	53	20	25	27
Exports	55	28	6	-9	-5
Imports	39	31	21	-23	-6
<u>(Ratios to GDP)</u>					
Overall fiscal surplus or deficit (-)					
Excluding grants	-15	-21	-16	-17	-16
Including grants	1	-10	-6	-9	-9
Balance of payments					
Current account deficit (-)	-15	-16	-14	-10	-9
Overall surplus or deficit (-)	2	-5	-2	-1	-2
Gross reserves <u>2/</u> ratio to imports (in weeks)					
	(10)	(4)	(3)	(3)	(1)

Source: Data provided by the Syrian authorities.

1/ Average annual rate of change in the Damascus Retail Price Index.

2/ Excludes bilateral balances and gold holdings (833,000 ounces)

During 1981-83, the first three years of the Fifth Five-Year Plan (1981-85), fixed domestic investment in constant 1980 prices was equivalent to about 45 percent of the total projected for the Plan period as a whole. While shortfalls in actual development expenditures relative to budget allocations occur regularly, other contributing factors included difficulties in project implementation and delays caused by the limited availability of foreign exchange. The development of the agricultural sector continues to be a central element of the Fifth Plan and the first phase of the land reclamation project has by and large been completed. In the industrial sector, while no new major projects have been initiated, several important plants producing cement, sugar, fertilizer, and textiles have either been completed or are close to completion. Furthermore, other major infrastructural projects relating to irrigation, power supply, road construction, and expansion of the railroad network are underway. Emphasis is also being placed on the development of social services.

A heavy defense burden has strained Syria's public finances and, while these expenditures have continued to mount, financial assistance from neighboring countries, intended to defray part of this burden, declined to an average of about LS 5.5 billion in 1982-83 compared with an average of LS 6.3 billion in 1979-81. In the recent period, the public finances have also been adversely affected by the decline in international oil prices and by the absence of major changes in administered prices. The growth rate of government revenues has been on a decreasing trend, reflecting mainly slower growth in the economy and falling import levels.

At the time of the last consultation discussions in October 1982, the authorities indicated an expectation of a substantial improvement in fiscal performance, with the overall deficit (excluding grants) decreasing to LS 6.9 billion from the 1981 level of LS 10.5 billion. However, the actual results showed the deficit reached LS 12 billion. The disparity between the actual results for fiscal 1982 and the October 1982 estimates reflected partly differences in coverage of the budgetary accounts. Specifically, external and internal transactions of the Public Debt Fund, which had not been included in the October 1982 estimates, were incorporated in the actual results for 1982 on both the expenditure and revenue sides. Taking the wider coverage into consideration, the Syrian representatives explained that the difference between the actual results for 1982 and earlier estimates was mainly due to higher current expenditure (mostly for defense) and capital expenditure, but revenues had also been somewhat lower than estimated.

Apart from strengthening procedures for the collection of tax arrears, the 1983 budget did not include any change in taxation. Overall, the authorities' intention was to improve fiscal performance in 1983 principally through exercising strict expenditure restraints. Public sector wages continued to be frozen at their 1980 level while capital expenditures were once again limited basically to ongoing projects. Compared with the 1982 outcome, revenues increased by 11 percent

in 1983. With capital expenditure virtually unchanged between the two years, the increase of 8 percent in total expenditure in 1983 was attributable to a 12 percent rise in current expenditure. While the absolute amount of the overall deficit (excluding grants) increased marginally to LS 12.4 billion, its ratio to GDP declined by one percentage point (to 16 percent) compared with 1982. With the amount of foreign grants increasing from LS 5.4 billion to LS 5.8 billion between 1982 and 1983, the budget deficit (including grants), at LS 6.7 billion, was approximately unchanged from the 1982 level. Gross external loan receipts showed little change between 1982 and 1983. The Ministry of Finance data show net government recourse to the banking system to have declined to LS 5 billion in 1983, while the monetary accounts indicate net claims on Government by the banking system to have increased by LS 6.3 billion. 1/

Despite substantial balance of payments deficits, the rate of domestic liquidity creation in Syria remained high (averaging over 20 percent annually) during the three years 1981-83. The principal factor accounting for the substantial rise in net domestic assets of the banking system was borrowing by the public sector. 2/ Monetary developments in 1983 were marked by an acceleration in the rate of domestic liquidity expansion to 26 percent compared with 20 percent in the preceding year due to an increase of LS 10 billion in the net domestic assets of the banking system in 1983 compared with LS 6.6 billion in 1982, while the change in net foreign asset holdings of the banking system was only LS 0.4 billion more contractionary in 1983 than in 1982. Although the banking system's claims on the Government and the state enterprises increased by a smaller amount in 1983 than in 1982 (LS 8 billion versus LS 9 billion), this was more than offset by the virtual cessation of the growth in import deposits, a considerable acceleration in private credit expansion, and a turnaround from contraction to expansion in the unclassified liabilities of the banking system. The increase in credit to the private sector in 1983 was due in part to the expansion of trade and construction financing by the banking system, while the stagnation of import deposits reflected severe restrictions on imports during the year.

The official balance of payments data show that Syria incurred in the period 1980-83 cumulative overall deficits totaling LS 6.5 billion (US\$1.6 billion at the official exchange rate). Between 1981 and 1983, the current account deficit was reduced by LS 2 billion basically through severe cuts in recorded imports (mainly private imports), effected

1/ Fiscal data for 1983 are provisional and the revenue total for the year includes estimates for December.

2/ Since on occasions the "excess" liquid assets of state enterprises are siphoned off into the Treasury while, on other occasions, the Treasury has taken over large chunks of public enterprise indebtedness to the banking system, it might be useful to lump together, for the purpose of monetary analysis, the changes in the public sector's financial transactions with the banking system.

through administrative measures, which more than offset a considerable fall in export receipts. The reduction in the current deficit was matched by an approximately commensurate fall in aid receipts, leaving the overall annual deficit in the range of LS 1.0-1.5 billion.

Syria has three official exchange rates, two of which are effectively pegged to the U.S. dollar: (i) the official market rate has been LS 3.90/3.95 per US\$1 since April 1976; (ii) the parallel market rate, which was established in April 1981 and now stands at LS 5.40/5.45 per US\$1, has not been changed since August 1981; and (iii) the tourist market rate, which was introduced in May 1982, now stands at LS 6.50/6.60 per US\$1. There is also an unofficial exchange market. While there are no estimates of its size, it is believed to be substantial and expanding. The unofficial market is fed mainly by workers' remittances and private capital flows and it finances transactions denied exchange in the official markets. With respect to the relative weight of exchange transactions at the three different exchange rates (official, parallel, and tourist), the Syrian authorities estimate that some 70-80 percent of all exchange transactions is effected at the official rate. The share of the public sector in total imports is also estimated at about 80 percent.

The authorities made significant efforts to supply the mission with data and information. It should be mentioned, however, that the data base for all sectors needs to be improved considerably with respect to both currentness and adequacy in order to facilitate analysis and provide a sound basis for policy formulation. There are irreconcilable discrepancies between various accounts. The mission indicated that a request from the Syrian authorities to the Fund for assistance in improving the collection and compilation of economic and financial data would receive favorable consideration.

III. Prospects and Policies for 1984

1. Production developments and policies

Considering the general indicators currently available (especially the weak performance in agriculture), it appeared that overall economic growth in 1984 would approximate the 1982-83 average of a little over 3 percent. The Syrian representatives explained that agricultural output continued to depend on rainfed crops and was thus subject to fluctuations due to changes in weather conditions. While the Government had intensified its efforts to expand the irrigated area, bringing an additional 20,000 hectares under irrigation in the Euphrates basin, land reclamation was a time-consuming process. During 1982-84, unfavorable weather had seriously hampered agricultural production in general and that of wheat and barley in particular, with the result that in 1983 the Government had to import both items and further substantial cereals imports would be needed in 1984. The Syrian representatives stated that while agricultural producer prices were controlled, they were adjusted periodically so as to provide appropriate incentives for farmers. For cotton, an

export item, procurement prices were by and large at levels comparable to those in neighboring countries and there are indications that the favorable incentives are stimulating expansion in cotton output. In addition to pricing policies, other measures to enhance production in the agricultural sector include purchasing wheat and barley at the farmgate, improving the availability of essential inputs and better seeds, and encouraging the use of fertilizers and insecticides.

In order to expand domestic oil production, the Syrian representatives stated that exploration activities had been intensified but they believed that, in the absence of major new discoveries, the current annual production level of 8.5 million tons was not likely to be exceeded in the foreseeable future. In the interest of energy conservation, the Government has adopted a policy of keeping domestic consumer prices of refined products in line with international prices and, after the adjustment of producer prices in 1982, refinery operations became profitable and subsidies were eliminated. Regarding the development of natural gas resources, the Syrian representatives stated that the completion of several major ongoing projects was expected to result in a significant increase in production later in 1984. Natural gas is considered an essential consumer item and, despite a 50 percent increase in 1982-83, consumer prices of natural gas are only about half the international price. 1/

The Syrian representatives explained that data on manufacturing was provisional and might underestimate actual performance in the sector. However, they noted that in general the growth of industrial output had been below expectations because of shortages of foreign-made inputs, reduced supply of domestically produced agricultural inputs, and a growing shortage of skilled manpower and managerial capability. In the face of these difficulties, the authorities introduced measures to rationalize the use of scarce foreign exchange resources and embarked on an ambitious industrial training program. Industrial investments were being concentrated on the completion of ongoing projects and the improvement of capacity utilization of existing plants.

A staff mission from the World Bank is tentatively scheduled to visit Syria later this year in order to update the last Bank report on the Syrian economy which was issued in 1982. In the view of the Bank staff, the shift in emphasis in the present five-year Plan (1981-85) toward consolidation of development projects initiated in earlier years was appropriate, considering both serious bottlenecks which had been encountered in project implementation during the preceding plan period and the continuing shortage of financial resources available for investment in the domestic economy. In the period ahead, the Bank staff regards the problem of resource mobilization to be of primary concern, given the present high degree of Syria's dependence on external grants for financing public sector expenditures.

1/ The World Bank will be sending an energy assessment mission to Syria later this year which will, inter alia, look into the medium-term prospects for the oil and gas sector.

2. Financial policies

The staff representatives commented that while the 1983 budgetary outcome reflected an improvement, the overall deficit had remained very high relative to GDP and net government borrowing from the banking system had been the principal source of rapid monetary expansion during the year. In light of this, the staff representatives inquired what steps the authorities had taken in the 1984 budget to moderate the size of the overall deficit and of the Government's recourse to the banking system. The Syrian representatives stated that in preparing the 1984 budget, the authorities had endeavored to hold the line firmly on expenditure, as evidenced for example by the fact that the freeze on public sector wages was maintained. In addition, except for an estimated LS 2.1 billion increase in national security outlays, all other expenditure items received negligible additional allocations. Concerning the 1984 budget estimates, it was noted that they were not strictly comparable with the actual data for 1983 for three reasons: (i) the budget estimates excluded debt servicing payments which were included in the 1983 actuals; (ii) the estimates for development expenditure were somewhat overstated in line with the usual practice to budget in excess of expected implementation; and (iii) grants were estimated in the budget on the basis of commitments made in the 1978 Baghdad agreement as well as expected grant receipts from the Islamic Republic of Iran. As approved, the 1984 budget estimates projected total expenditure at LS 41.3 billion and total revenue at LS 25.1 billion, implying an overall deficit, excluding grants, of LS 16.1 billion (Table 2). The budget forecasts that the deficit would be financed by LS 8.8 billion in foreign grants, LS 5.6 billion in bank borrowing, and by external loans of LS 1.7 billion.

A sizable increase in revenue in 1984 is projected in the budget resulting from the planned implementation of the proposed consolidated income tax law (which is expected to become effective in the second half of 1984), increased collection of taxes on public enterprises, and continued emphasis on improved tax administration. The Syrian representatives, however, stated that since approval of the new income tax law had been delayed, there might be some revenue shortfall. On the expenditure side, strict restraints are being exercised and although almost LS 18 billion has been allocated for development expenditure in 1984, due to the five-month delay in the approval of the 1984 budget and the deferral of infrastructure project implementation, the actual outlays are likely to be no more than LS 10 billion for the year. After taking into account the operations of the Public Debt Fund, which will be reflected in the actuals for 1984 on a basis similar to that in 1981-83, the absolute level of the overall deficit in 1984 is anticipated roughly to approximate its average level in 1982-83 while its ratio to GDP would decrease for the second successive year. If the overall deficit is held to this level, external grant receipts approximate last year's level, and drawings on external loans are in line with the budget forecast, recourse to the banking system will be about LS 5 billion in 1984. The authorities stated that the Government

was determined to effect an improvement in fiscal performance in 1984 and would review the situation in midyear and, if it then appeared necessary, would instruct spending agencies to cut expenditures by 10-15 percent from their present budget allocations.

Table 2. Syrian Arab Republic: Summary of Financial Accounts, 1982-84
(In billions of Syrian pounds)

	1982	1983	Proj. 1984	Budget 1984
I. Government finances				
Overall deficit	-12.0	-12.4	-12.0	-16.1
Grants	5.4	5.8	5.5	8.8
Deficit (including grants)	-6.7	-6.6	-6.5	-7.3
II. Factors affecting changes in domestic liquidity				
Money and quasi-money	5.7	8.7	5.8	
Net domestic assets	6.6	10.1	7.0	
Net foreign assets	-1.0	-1.3	-1.2	
III. Balance of payments				
Exports, f.o.b.	8.0	7.5	8.0	
Imports, f.o.b.	-14.5	-13.6	-15.0	
Current account balance	-7.4	-7.2	-7.7	
Overall surplus or deficit (-)	-1.0	-1.3	-1.2	

Sources: Data provided by the Syrian authorities and staff estimates.

Monetary projections for 1984, the Syrian representatives stated, indicated a marked deceleration in the rate of domestic liquidity expansion to 14 percent from 26 percent in 1983. The banking system's claims on the Government (net) and public enterprises were projected to increase in 1984 by LS 5 billion and LS 1.5 billion, respectively; the combined total increase of LS 6.5 billion was substantially below that of 1983. Credit to the private sector was expected to rise by LS 0.6 billion in 1984, import deposits were expected to remain largely unchanged, and the net foreign asset position of the banking system was projected to decline by LS 1.2 billion.

3. Balance of payments

There are major gaps in Syria's official balance of payments statistics. The estimates exclude transactions relating to military imports, and their financing and debt servicing. Moreover, the official data do not include estimates of transactions passing through the unofficial exchange market, which are believed to be substantial and growing, especially as regards inward workers' remittances and some private sector imports. The staff mission noted that comprehensive and reliable data were needed as a basis for developing a meaningful medium-term framework for assessing Syria's balance of payments prospects.

A fifth successive balance of payments deficit falling approximately in the range experienced in the past four years is forecast by the authorities for 1984. An expected modest improvement in export performance in 1984, the first since 1981, would be more than offset by a projected large increase in imports, mainly of cereals, to supplement domestic supplies in the wake of a third poor crop. Thus, holding the overall deficit to the level forecast by the authorities is predicated on reducing the deficit on the invisible account as well as increasing remittances and external borrowing.

The Syrian representatives stated that serious efforts were being made to strengthen the external payments position. However, some of the factors involved were effectively beyond the control of the authorities, such as the continuing instability in Lebanon, which was costly in terms of foreign exchange, and the inadequate level of assistance provided by neighboring Arab countries. In the period ahead, however, the Syrian representatives were hopeful that economic and financial policies could be adjusted sufficiently so as to attract significant amounts of savings held by Syrian nationals in the form of foreign exchange deposits outside the country. Fundamentally, the Syrian authorities believe that the problem of overall balance in the economy needs to be tackled from the supply as well as the demand side. In their view, while significant progress had been made in the production sector, further improvement needed to be made in adapting the pattern of consumption to domestic supply availabilities. With respect to the balance of payments, there have been continuing efforts to expand exports and limit total imports without jeopardizing domestic growth. The policy of severe restraint on imports, which has been in effect in the last 2-3 years, will continue to be applied in 1984 (except to allow cereals imports to supplement the poor crops). The authorities recognized that exchange rate policy could be used as an instrument to strengthen external sector performance and it remained the intention of the Government to unify the exchange rate structure at a realistic level at an opportune time. Meanwhile, the authorities have been taking steps aimed at encouraging an increase in the flow of exchange through official channels. The authorities asserted that policy continued to stress self-reliance as the means for improving economic performance. External aid represented a transitory phenomenon necessitated by Syria's exceptional circumstances.

4. External debt

The Syrian representatives stated that Syria's policy on external borrowing remained highly cautious. The principal suppliers of external resources were friendly countries as well as the Arab Fund for Social and Economic Development and the IBRD. Apart from lines of credit negotiated by the Commercial Bank of Syria, all external debt outstanding was on concessionary terms. The increase in the banking system's external liabilities reflected drawing on foreign lines of credit and the authorities stated that the banking system had been meeting all external obligations on time. There were, however, delays by a few enterprises in discharging their obligations to suppliers abroad and, in the opinion of the Syrian authorities, this had been used as an excuse to curtail sharply certain foreign lines of credit to the Commercial Bank of Syria. It appeared to the Syrian authorities that political considerations had played a role in these decisions.

The staff representatives stated that the Ministry of Finance had provided certain data relating to the civilian debt outstanding at the end of 1983 and to debt service obligations through 1987. Comprehensive data on Syria's external debt situation were needed in view of the growing concern in the international community over the question of external indebtedness of many countries, and in order to enable the Fund to make adequate assessments of members' medium-term balance of payments prospects. The data supplied to the mission by the Ministry of Finance were not comprehensive in coverage. The Syrian representatives confirmed that the amount of disbursed debt outstanding at the end of December 1983 (LS 8.8 billion) represented only civilian medium- and long-term external debt. This total did not include about US\$1 billion ^{1/} (LS 4 billion at the official rate) owed to the Islamic Republic of Iran on account of oil imports and LS 8 billion in foreign liabilities of the banking system. These three components of external debt, which show an incomplete picture, add up to approximately 27 percent of the 1983 GDP. Assuming only 10 percent interest on the banking system's external liabilities, the civilian debt service ratio in 1984 is about 30 percent of exports. No information on Syria's military debt (which is handled solely by the defense authorities) and its servicing was available. The staff representatives emphasized that every effort should be made to improve the recording of Syria's external debt on a comprehensive basis in order that unpleasant surprises may be avoided in the management of the external sector.

5. Exchange and trade policies

The Syrian representatives explained that the establishment of the tourist exchange market in 1982 had been aimed at facilitating increased transfers of inward workers' remittances through official

^{1/} Under an agreement which had just been concluded between the two countries, the oil import debt was to be repaid interest-free over a five-year period, with a grace period of two years.

channels; in support of this objective, periodic adjustments in the tourist exchange rate, including two so far in 1984, had been made in order to minimize the spread between that rate and the one prevailing in the unofficial market.

The staff team noted that Syria's exchange rate pattern is complex. The Syrian pound's peg to the dollar in combination with rising domestic costs had caused the official rate (LS 3.95 = US\$1) to be overvalued substantially. Similarly, the parallel market rate (LS 5.45 = US\$1), which initially was introduced in April 1981 in recognition of the overvaluation of the official rate, had been overtaken by the introduction in May 1982 of a third rate, the tourist rate, which subsequently had been depreciated to its present level of LS 6.5 = US\$1. The spreads between the three official rates had been widening and the pound has continued to depreciate in the unofficial market. ^{1/} The complexity of the exchange system was further compounded by the application of various mixing of rates for export proceeds sold in the official and parallel markets.

Recent measures in the exchange system, such as depreciation of the tourist rate and the specification of mandatory sales through official channels, ^{2/} represented attempts to capture a larger slice of the exchange flow from the unofficial market. While exchange rate flexibility as regards the tourist rate was helpful, it was likely that the augmented demand in the unofficial market caused by the import restrictions would result in a continued pressure on the exchange rate in that market. Therefore, a meaningful reform of the exchange system called for basic restructuring and simplification of exchange markets and moves toward exchange rate unification through depreciation of the official rate as well as reduction, if not the elimination, of the spread between the tourist and parallel rates.

The Syrian representatives stated that it remained the policy of the authorities to bring about the eventual unification of the three official exchange markets, while seeking in the interim to simplify and make more effective the existing exchange rate structure. An important step in this direction, the Syrian representatives noted, had been the application in March 1984 of the parallel exchange rate to a large part (and in some cases to all) of most export proceeds other than oil and cotton. With external assistance from Arab countries as well as cotton and oil export proceeds being channeled through the official market, approximate balance generally prevailed between demand and supply of foreign exchange at the official exchange rate, although some net

^{1/} The Syrian pound has depreciated in the unofficial market to LS 7.35 = US\$1 (representing a depreciation of about 22 percent over the year ended in May 1984) probably reflecting an increase in the unsatisfied demand for exchange in the official markets.

^{2/} For details, see Recent Economic Developments report, to be issued shortly.

increase in the foreign liabilities of the banking system had taken place from time to time in the recent past, especially when aid receipts had fallen short of expectations. Exchange surpluses in the tourist market were being used to supplement the supply of exchange in the parallel market.

The authorities stated that any change in exchange arrangements would have to be carefully studied before it was implemented because of the wide-reaching impact thereof on domestic prices, the continued stability of which was important for maintenance of government wages and salaries at present levels. In the opinion of the authorities, the present circumstances did not permit exchange rate adjustments which would increase substantially consumer prices. The recent series of regulations in the exchange markets were designed to contain the adverse impact of the operations in the unofficial market. The authorities' view was that the unofficial market was currently subject to speculative pressures leading to excessive depreciation of the Syrian pound in that market. Syria's exchange arrangements remained under review. The authorities would move when they believed that such a step would be successful and the domestic situation was favorable, as well as when the necessary accompanying measures (such as a limited wage adjustment) were put in place. Meanwhile, they noted that action would soon be taken to reduce the extent of rate mixing between the official and the parallel market rates by making the proceeds of all agricultural exports convertible at the parallel market rate.

Developments in the exchange and trade system since the last consultation discussions in October 1982 are detailed in the Recent Economic Developments report (to be issued shortly). The bilateral payments agreement with the U.S.S.R. is the only active agreement in force. The banking arrangement with the Islamic Republic of Iran involves restrictions subject to Article VIII. Since the last consultation discussions, the bilateral payments agreements with the People's Republic of China and the Democratic People's Republic of Korea have been terminated, while no transactions have been made under the agreements with Sri Lanka and Viet Nam.

IV. Staff Appraisal

Syria is experiencing serious economic and financial difficulties, partly for reasons beyond the control of the authorities. Economic growth has slowed down considerably in large measure due to adverse weather conditions affecting agricultural output. Poor weather has persisted in 1984 and production levels are not expected to improve. A heavy defense burden has strained Syria's public finances and financial assistance from neighboring countries intended to defray part of this burden has decreased. The public finances and the export sector have been affected by the fall in international oil prices which reduced budget revenues and export receipts.

While it may be tempting to perceive Syria's present financial difficulties as stemming from external factors, an increased aid flow would merely conceal, for a time, the structural weaknesses in the economy. Only by implementing self-reliance measures can the performance of the Syrian economy be enhanced in a fundamental way. Apart from strengthening administrative procedures and proposing, but not yet enacting, a new consolidated income tax law, no major tax measures or price adjustments were introduced in 1983-84. The limited domestic policy response to the adverse external factors has resulted in continuing weaknesses of Syria's fiscal position. The authorities point to some progress in reducing the fiscal deficit ratio in 1983 and are hopeful that further progress would be made in 1984, leading to a significant deceleration in the growth rate of the monetary aggregates in the current year. The staff welcomes this determination to improve the fiscal performance, but notes that strong efforts will be needed to realize the authorities' objectives for 1984. Specifically, it is to be hoped that the authorities will not authorize additional allocations and indeed will find it possible to cut back expenditures if external aid and/or revenues appear to be falling significantly short of expectations. Moreover, expenditure restraints in recent years have resulted in the effective freezing of development expenditures in nominal terms and sooner or later these expenditures will have to rise if the future growth prospects of the economy are not to be compromised.

In the external sector, Syria incurred a fourth successive overall balance of payments deficit in 1983 and another deficit is in prospect for 1984. The weakening external position prompted the authorities to place severe restrictions on imports (in particular those of the private sector), to implement measures regarding surrender of foreign exchange through official channels, to induce the private sector to repatriate its savings held abroad, to exercise some flexibility in the tourist exchange market, and to allow a greater proportion of certain export receipts to be converted at the parallel market rate. While some of these measures have been helpful, the effect of restricting import financing in the official markets has been to augment the demand in the unofficial exchange market, leading to considerable depreciation of the pound in that market, thereby attracting exchange that might have flowed through official channels. Moreover, the recent changes in Syria's exchange arrangements have further fragmented the markets and increased the complexity of the system. In view of the fact that the authorities do not have specific plans for simplifying the system and unifying the exchange markets at an early date, the staff is not recommending approval of Syria's exchange system.

The staff is of the view that in Syria's present condition of severe foreign exchange stringency, inappropriate pricing of scarce foreign exchange resources should be corrected without delay. A one-step reform establishing a unitary rate for the pound at a realistic level is needed but if this is considered to be difficult in present circumstances, the authorities should proceed with a phased reform of the country's exchange arrangements with the aim of establishing such a

unitary rate in the not too distant future. To reap the benefits of an adequate exchange rate adjustment, demand management policies will need to be strengthened in support of the reform effort. While the budget would stand to benefit from an effective exchange reform, additional steps to strengthen the fiscal stance would be desirable. The public sector enterprises, which are currently the prime beneficiaries of the policy of cheap foreign exchange, will have to adjust to more economic pricing thereof and will need to be allowed more flexible pricing of their products to absorb the higher costs. If necessary, a few sensitive items in the consumption basket of the people may be subsidized for a limited period to cushion the impact of the adjustment.

The authorities recognize the desirability of establishing a unitary realistic exchange rate for the Syrian pound. Their concerns center on the possible repercussions of substantial price increases, especially as no general increase in wages has been granted since 1980. They stated that the exchange rate issue was a major topic of review within the Government. However, they expressed the belief that in the present situation, it would not be feasible to take major steps.

It is recommended that the next Article IV consultation with the Syrian Arab Republic be held on the standard 12-month cycle.

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V. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision relating to the Syrian Arab Republic's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1984 Article XIV consultation with the Syrian Arab Republic in the light of the 1984 Article IV consultation with the Syrian Arab Republic conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Syria's present exchange regime involves multiple currency practices and exchange restrictions subject to Article VIII, as described in SM/84/____. The Fund notes the complexity of Syria's exchange system and hopes that in the near future the authorities will take steps toward the establishment of a unified exchange system and the liberalization of exchange restrictions. The Fund welcomes the termination of the bilateral payments agreements with two Fund members and notes that the two remaining agreements with Fund members are inoperative and hopes that these agreements will be terminated as soon as possible.

Syrian Arab Republic - Fund Relations

(As of May 31, 1984)

I. Membership Status

Date of membership: April 1947
Status: Article XIV

A. Financial Relations

II. General Department (General Resources Account)

Quota: SDR 139.1 million
Total Fund holdings of SDR 139.1 million, equivalent
Syrian pounds: to 100 percent of quota

III. SDR Department

Net cumulative allocation: SDR 36.56 million
Holdings: SDR 8.0 million and 21.9 per-
cent of net cumulative
allocation

IV. Use of Fund Resources

The Syrian Arab Republic made frequent use of Fund resources under stand-by arrangements and the compensatory financing facility during the early 1970s but has not made any purchases in recent years.

B. Nonfinancial Relations

V. Exchange Rate Arrangement

The Syrian pound (LS) is pegged to the U.S. dollar (the intervention currency) at the rates of LS 3.90, buying and LS 3.95, selling per US\$1. These rates have been unchanged since April 1976. The representative rate applicable to Fund transactions is LS 3.925 per US\$1. As of April 1981 an official parallel market was established which handles all imports and trade-related services transactions of the private sector and covers certain commodities exported by the private and public sectors. Since August 1981 the rate in the parallel market has been set at LS 5.40, buying and LS 5.45, selling per US\$1. From May 1982 a third rate--a "tourist" rate--has been applied to tourism receipts, remittances, and the provision of foreign exchange for travel abroad; since March 1984 this rate has been LS 6.50, buying and LS 6.55, selling per US\$1. Syria's exchange system contains multiple currency practices and exchange restrictions subject to Article VIII, as described in the report on Recent Economic Developments.

VI. Last Article IV Consultation

Discussions were held in October 1982. The Staff Report (SM/82/235) was discussed by the Executive Board on January 21, 1983.

The Executive Board's decision (Decision No. 7309-(83/16)), adopted January 21, 1983, was as follows:

1. The Fund takes this decision relating to the Syrian Arab Republic's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1982 Article XIV consultation with the Syrian Arab Republic in the light of the 1982 Article IV consultation with the Syrian Arab Republic conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Syria's present exchange regime involves multiple currency practices and an exchange restriction subject to Article VIII, as described in SM/82/235. The Fund hopes that in the near future the authorities will take steps toward the establishment of a unified exchange system and the liberalization of exchange restrictions. The Fund welcomes the intention of the Syrian authorities to terminate the bilateral payments agreements with three Fund members and hopes that all such agreements with member countries will be terminated as soon as possible.

VII. Technical Assistance

A fiscal technical assistance mission visited Damascus in April 1977 to survey the tax system and recommend improvements, and its report was submitted to the authorities in August 1977. A mission visited in November/December 1978 to advise on measures to stimulate domestic savings and the flow of expatriate remittances, and its report was submitted in February 1979. A staff member from the Bureau of Statistics visited in March 1981 to advise on balance of payments statistics; another staff member visited Damascus in October 1982 to advise on government finance statistics.

Syrian Arab Republic: Basic Data

Population (1982 estimate)	9.7 million
Area	185,170 square kilometers
Currency	Syrian pound (LS)
Official exchange rate (since April 1976)	LS 3.925 = US\$1
Parallel market rate (since August 1981)	LS 5.425 = US\$1
Tourist market rate (since March 1984)	LS 6.550 = US\$1
GDP at current market prices (1983)	LS 77,240 million
GDP per capita (1983)	LS 7,700

	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>Budget</u> ^{1/} <u>1984</u>
<u>(In millions of Syrian pounds)</u>				
Government finances				
Revenues	16,555	19,202	21,291	25,147
Tax	(6,588)	(8,490)	(8,745)	(11,867)
Nontax	(9,967)	(10,712)	(12,546)	(13,280)
Expenditures	27,038	31,218	33,648	41,289
Current, of which:	(17,175)	(19,166)	(21,571)	(23,439)
Public debt amortization	[1,678]	[1,620]	[2,086]	[...]
Capital	(9,863)	(12,052)	(12,077)	(17,850)
Deficit (excluding grants)	-10,483	-12,016	-12,357	-16,142
External grants	6,358	5,354	5,762	8,828
Deficit or surplus (including grants)	-4,125	-6,662	-6,595	-7,314
				<u>Proj.</u> <u>1984</u>
Money and credit (changes during period)				
Foreign assets (net)	-1,487	-966	-1,336	-1,200
Net domestic assets	5,298	6,636	10,070	7,006
Claims on Government (net)	(1,806)	(9,735)	^{2/} (6,275)	(5,000)
Claims on other public sector	(7,493)	(-872)	^{2/} (1,666)	(1,490)
Claims on private sector	(545)	(983)	(1,466)	(575)
Import deposits	(-2,657)	(-2,621)	(-104)	(-13)
Other items (net)	(-1,889)	(-589)	(767)	(-46)
Money and quasi-money	3,811	5,670	8,734	5,806

^{1/} The budget estimates for 1984 do not allow for transactions of the Public Debt Fund during the year, but such transactions are incorporated in the budget actuals for 1981-83.

^{2/} The rise in claims on Government (net) in 1982 is overstated and the rise in claims on public sector enterprises understated because of the assumption by the Government of LS 3.7 billion bank credits of these enterprises during the year.

Syrian Arab Republic: Basic Data (Concluded)

	1981	1982	1983	Proj. 1984
<u>(In millions of Syrian pounds)</u>				
Balance of payments				
Exports, f.o.b., of which:	8,752	7,975	7,547	8,000
Petroleum	(6,582)	(6,057)	(5,340)	(...)
Imports, f.o.b.	-19,010	-14,535	-13,620	-15,000
Services and private transfers	1,202	-796	-1,089	-700
Current account balance	-9,056	-7,356	-7,161	-7,700
Official transfers (net)	7,138	5,413	5,015	5,000
Capital movements (net)	536	921	1,136	1,500
Errors and omissions	-63	56	-326	--
Overall surplus or deficit (-)	-1,445	-966	-1,336	-1,200
<u>(In millions of SDRs)</u>				
External reserves (end of period)				
Gross official holdings <u>1/</u>	254	181	92	
Net foreign assets	-686	-948	-1,326	
<u>(Ratios to GDP)</u>				
Overall fiscal surplus or deficit (-)				
Excluding grants	-16	-17	-16	
Including grants	-6	-9	-9	
Balance of payments				
Current account deficit (-)	-14	-10	-9	
Overall surplus or deficit (-)	-2	-1	-2	
<u>(In percent)</u>				
Rate of change of selected indicators				
GDP at current prices	28	8	8	
GDP at constant prices	10	3	3	
Consumer price index <u>2/</u>	18	14	6	
Government revenues	20	16	11	
Government expenditures	9	15	8	
Money	14	19	26	
Money and quasi-money	16	20	26	
Net domestic assets	20	25	27	
Credit to Government (net) and public enterprises	33	24	17	
Exports	6	-9	-5	
Imports	21	-23	-6	

1/ Excludes bilateral balances and gold holdings (833,000 ounces).

2/ Average annual rate of change in the Damascus Retail Price Index.

Syrian Arab Republic - Statistical Issues

1. Coverage, Currentness, and Reporting of Data in International Financial Statistics

		<u>Latest Data in June 1984 IFS</u>
Real Sector	- National Accounts	1982
	- Prices	June 1983
	- Production	1982
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	n.a.
	- Financing	n.a.
	- Debt	n.a.
Monetary Accounts	- Central Bank	Feb. 1983
	- Deposit Money Banks	Feb. 1983
	- Other Financial Institutions	n.a.
External Sector	- Merchandise Trade: Values	June 1983
	- Merchandise Trade: Prices	1982
	- Balance of Payments	1982
	- International Reserves	June 1983
	- Exchange Rates	April 1984

During the past year, the reporting of data for inclusion in IFS has been inadequate, both for data supplied through report forms and those supplied by cable.

2. Outstanding Statistical Issues

Real Sector: Data on prices are not current and indices of industrial production are available only on an annual basis. Major efforts are needed to improve the data base in this area.

Government Finance: The latest data in the Government Finance Statistics Yearbook relate to 1981. At present, there are no government finance data for Syria in IFS.

Monetary Accounts: The principal problem with respect to the money and banking data is currentness; the most recent data in IFS relate to February 1983, and these were received in February 1984. Data for commercial banks cover the five institutions described as Specialized Banks in the Central Bank of Syria's Quarterly Bulletin--Commercial Bank of Syria, Industrial Bank, Agricultural Cooperative Bank, Real Estate Bank, and Popular Credit Bank. While there are some differences in presentation between IFS and the Quarterly Bulletin, these can be easily reconciled.

The Post Office Saving Fund (POSF) appears to have substantial transactions, but outstanding deposit balances are not available.

International Banking Statistics: There are substantial discrepancies between data in the cross-border interbank liabilities reported by Syria and those obtained from IBS correspondents.

External Sector - Balance of Payments: Data were last submitted to the Bureau of Statistics in September 1983 and relate to 1982.