

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/140

3:00 p.m., September 10, 1984

J. de Larosière, Chairman

Executive Directors

M. Finaish

G. Lovato

G. Salehkhoul

Zhang Z.

Alternate Executive Directors

A. Koné, Temporary
S. Kolb, Temporary
G. E. L. Nguyen, Temporary
M. A. Weitz, Temporary
D. C. Templeman, Temporary
T. Alhaimus
H. Kobayashi, Temporary
B. Goos
I. R. Panday, Temporary
D. I. S. Shaw, Temporary
H. A. Arias, Temporary

A. S. Jayawardena
J. E. Suraisry
A. Steinberg, Temporary
H.-S. Lee, Temporary
O. Kabbaj
M. Camara, Temporary
J. L. Feito
K. A. Hansen, Temporary
J. Bulloch, Temporary

L. Van Houtven, Secretary
S. J. Fennell, Assistant

1. Syrian Arab Republic - 1984 Article IV Consultation Page 3
2. Philippines - Technical Assistance Page 12

Also Present

Exchange and Trade Relations Department: S. Mookerjee, Deputy Director.
Legal Department: J. K. Oh. Middle Eastern Department: A. S. Shaalan,
Director; M. Arif, P. Chabrier, F. Drees, S. H. Hitti, B. A. Karamali,
A. Ouanes, M. Shadman, E. M. Taha, G. Tomasson. Personal Assistant to
the Managing Director: S. P. Collins. Advisors to Executive Directors:
S. R. Abiad, W. Moerke. Assistant to an Executive Director: M. B. Chatah.

1. SYRIAN ARAB REPUBLIC - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with the Syrian Arab Republic (SM/84/185, 7/31/84; and Sup. 1, 9/7/84). They also had before them a report on recent economic developments in the Syrian Arab Republic (SM/84/189, 8/7/84).

Mr. Finaish made the following statement:

Economic policy in Syria since the last Article IV consultation has continued to focus on, and balance between, two main considerations. The first is the implementation of the Fifth Development Plan (1981-85), which had been formulated in the light of long-term social and economic objectives. The second is to respond in a timely and effective manner to the increased financial strains brought about mainly by exogenous factors, including adverse weather conditions, a decline in international oil prices, and an unsettled situation in the region that has increased the pressures on the country's resources. In both areas a measure of success has been achieved.

The predominance of the public sector in Syria gives development planning particular importance in the overall functioning of the economy. The progress achieved in the two previous Plans (1971-80) was reflected in an impressive rate of growth averaging over 8 percent annually and a substantial improvement in the standard of living of the population. While the Fifth Plan was conceived as a continuation of the ongoing development process, particular emphasis has been placed on promoting agriculture and improving social services, particularly in rural areas, in order to limit further migration into urban centers. At the same time, the Plan has sought to achieve a more balanced regional distribution of public investment. Moreover, priority has been accorded to the completion of existing projects, to the upgrading of existing industries, and to the removal of major institutional and financial impediments to growth and diversification. While actual fixed investment during the first three years of the Plan equaled close to one half the total amount for the five-year period, public investment in 1983 was below the target. The shortfall was mainly due to difficulties in project implementation associated with shortages in skilled manpower, as well as to the limited availability of foreign exchange, particularly for the manufacturing sector. To deal with these problems, the authorities have initiated an industrial training program and introduced measures designed to allocate foreign exchange resources in a more efficient manner. On the other hand, and despite the slower than anticipated implementation, the important first phase of the land reclamation project--ground preparation--has by and large been completed. Phase two of this project which is designed almost to double the area of irrigated land is expected to proceed at a considerably

faster pace. The authorities consider that the long-term prospects for Syrian agriculture depend on success in expanding the irrigated area and minimizing the effects of adverse weather conditions, which in 1982-83 were a major factor explaining the slowdown in economic growth to about 3 percent annually from 10 percent in 1981 and the increased pressures on the country's finances.

In response to these pressures, fiscal policy during 1983 continued to be one of restraint. The authorities, in the preparation of the 1983 budget, had sought to hold the line on current expenditures and to exercise firm restraint on capital outlays. Furthermore, they continued their policy of not granting salary increases while largely limiting capital expenditures to ongoing projects. Emphasis was also laid on improving tax administration, particularly with respect to the collection of tax arrears. Further restraint in the implementation of the budget was reflected in actual expenditures for the year being kept at 17 percent below target. This reduction was mainly on account of capital expenditures which, representing a budget implementation rate of 70-80 percent, was broadly in line with recent experience. Moreover, current expenditures were lower by about 4 percent even though national security expenditures were about 6 percent above target. However, despite an increase of 11 percent over 1982, budget revenue fell short of the target by 13 percent, due largely to a lower than expected rate of growth in GDP. These developments resulted in an actual deficit, excluding external grants, which was 20 percent smaller than originally envisaged, and, as a ratio of GDP, about 1 percentage point lower than in 1982. In adjusting their fiscal policy to adverse external conditions, including a shortfall in external grants, the authorities have shown a good measure of responsiveness without which the outcome for 1983 would have been much less favorable.

The Syrian authorities are keenly aware, however, that more needs to be done to strengthen the fiscal position. In preparing the 1984 budget, they have endeavored to hold the line firmly on expenditures. In addition to maintaining public sector wages at their 1980 levels in nominal terms, and except for security outlays, there will be little or no change in expenditure levels. Tax revenue on the other hand is expected to increase markedly during the year as a result of improved tax administration, increased participation of public sector enterprises in the tax effort, and favorable effects of the planned unification of income taxes. While current projections for 1984 point to a further reduction in the deficit as a ratio of GDP, plans already exist to effect substantial cuts in expenditure if domestic revenue or external grants fall short of expectations.

The 1984 budget figures envisage that about three fourths of the deficit will be financed by domestic bank borrowing and the rest by external loans. The rate of increase in bank claims on the public sector, however, will be smaller than that registered in 1983. This, in addition to an expected slowdown in the expansion of private sector credit, is projected to result in a significant drop in the rate of domestic liquidity expansion in 1984 to about 14 percent, thereby contributing to a further dampening of inflationary pressures.

The balance of payments data for 1983 reflect two main developments: the reduced availability of foreign exchange receipts from exports and other inflows, and the authorities' policy of import restraint. The 5.4 percent decline in exports was attributable mainly to reduced oil export receipts as well as to some difficulties in the exportation of non-oil products to certain markets. Imports, on the other hand, were reduced by a somewhat larger amount, resulting in some improvement in the trade balance. At 9 percent of GDP, the current account deficit continued its downward trend for the third consecutive year. While the policy of import restraint is continuing, cereal imports to supplement poor crops are expected to result in an overall increase in imports in 1984. This, however, will be offset, to some extent, by a 6 percent increase in exports projected for the year. While little change in the current account is forecast, the overall deficit is expected to register a small decrease. The Syrian authorities recognize the need to strengthen the external payments position in the period ahead and to respond more effectively to the pressures on foreign exchange resources brought about, in part, by an unsettled regional situation and a shortfall in external assistance. The authorities are hopeful that in the period ahead economic and financial policies could be adjusted sufficiently so as to attract significant amounts of savings held by Syrians in the form of foreign exchange deposits outside the country. For this purpose, it was decided in March 1984 to permit Syrians working abroad to use up to \$300,000 of their own foreign exchange resources to finance imports of certain goods. Other means of attracting balances held abroad are currently under consideration.

The authorities' emphasis on attracting the savings of Syrian workers abroad is in line with their prudent policy on external borrowing. It should be noted that the outstanding foreign debt is owed mainly to friendly countries, Arab multilateral institutions as well as the World Bank. More important, all external debt outstanding, with the exception of the lines of credit extended to the Commercial Bank of Syria, is on concessionary basis.

With respect to the exchange system, the authorities consider that the present arrangement is a temporary one. It is in fact the Government's stated policy to move as circumstances permit toward the simplification of the system and eventual unification of the exchange rate at an appropriate level. The parallel and tourist rates were introduced in 1981 and 1982, respectively, as transitional arrangements. The latter, which had been designed to attract additional flows through the official market, underwent periodic depreciations in order to minimize the spread over the unofficial rate which has come under speculative pressures. While it is the authorities' belief that a major change in the exchange rate at the present time is difficult to undertake, particularly in view of the policy of wage restraint and the potential impact of a major exchange rate adjustment on consumer prices, the present exchange arrangement continues to be under review. In the meantime, additional steps will be taken to improve the working of the transitional arrangement by making all receipts from agricultural exports convertible at the parallel rate, thus reducing the extent of rate mixing between the official and parallel rates.

In conclusion, the Syrian economy has in recent years come under increased financial pressures owing to a variety of factors, most of which were exogenous. While the authorities have responded to those pressures prudently, additional efforts will be needed, particularly if the adverse exogenous environment continues. In formulating policy in the period ahead, the authorities will strive to improve the financial situation while proceeding with the development effort which, in the longer term, is essential for sustained economic growth under conditions of relative financial stability.

Mr. Salehkhoulou remarked that the economic and financial conditions of the Syrian Arab Republic had remained difficult in 1983 and that the prospects for a sustainable improvement in 1984 did not look promising. For the second consecutive year real GDP growth had been only 3 percent in 1983, compared with an average real economic growth of 9 percent a year in 1980-81. Although the authorities had been able to contain the deterioration of the domestic and external financial imbalances, the current account deficits of the public sector and the balance of payments remained high, and the strong decline in inflation had been achieved only through strict price controls. Such poor performance had been due to adverse exogenous factors, including the deteriorating political situation in the past two years and the unjust occupation of part of the country by external forces. The heavy defense budget necessitated by those disturbances had put significant pressure on the fiscal position, the balance of payments, and the banking system. Other adverse external factors included the continuation of unfavorable weather and weak prices in the world oil markets. He recognized that the lack of strong adjustment

policies had also been responsible for the unsatisfactory performance in 1983 and the poor prospects for 1984. However, the security situation and the reduced flow of assistance from friendly neighboring countries had forced the authorities to proceed prudently and adopt cautious policies aimed at meeting domestic needs.

The authorities had implemented a number of corrective measures, aimed at maintaining positive real growth, particularly in the agricultural and manufacturing sectors, that seemed more compatible with Syria's present economic and geopolitical circumstances than the staff recommendations, Mr. Salehkhoul considered. The periodic adjustment of agricultural producer prices and the intensification of efforts to expand irrigation were steps in the right direction, although their effects on agricultural output had been reduced by prolonged unfavorable weather conditions. The authorities were aiming to increase the utilization of manufacturing capacity and were addressing the problem of manpower shortage by introducing an industrial training program. In view of the reduced availability of financing, the objectives of the Five-Year Development Plan had been scaled down, and the authorities intended to concentrate their efforts on the consolidation of existing development projects.

On financial policies, efforts were directed toward maintaining the overall public sector deficit at the absolute level recorded in 1982/83, resulting in a further modest decline of the deficit as a ratio to GDP, Mr. Salehkhoul noted. Measures had been implemented or were planned to increase revenues, curtail development expenditure significantly, and freeze public sector salaries. Given the pressure of the public sector deficit on the expansion of domestic liquidity and the substantial domestic bank financing of the deficit projected for 1984, the authorities' intention to offset a possible shortage in external assistance by further cuts in expenditure was also welcome.

The authorities had made continuing efforts to expand exports and restrict total imports, while encouraging an increase in the flow of exchange through official channels, Mr. Salehkhoul observed. But any consequent improvement in the balance of payments position would be more than offset by security-related expenditure and the projected large increase in imports owing to the unfavorable weather conditions. Syria's balance of payments position would therefore remain a matter for concern in 1984.

Despite balance of payments difficulties and uncomfortably low international reserves, Syria's external debt situation was not particularly worrying owing to the cautious attitude of the authorities toward borrowing and the concessionality of most external loans outstanding, Mr. Salehkhoul stated. Finally, he could support the proposed decision and Syria's request for technical assistance by the Fund to strengthen and improve the recording of economic and financial data.

Mr. Suraisry indicated his general agreement with the staff appraisal and his support for the proposed decision. Syria had been faced with difficult economic and financial problems, caused primarily by factors

beyond the authorities' control. A weak international oil market and bad weather, among other things, had slowed economic activity since the beginning of the 1980s. Consequently, the overall fiscal deficit, balance of payments position, and level of gross reserves had deteriorated.

Corrective measures designed to put the economy back on track were necessary, Mr. Suraisry said. More specifically, given the importance of the agricultural sector in the economy--its value-added contribution to GDP had averaged about 18 percent a year in 1979-83--the emphasis on that sector in the Fifth Development Plan was appropriate. He welcomed particularly the completion of the first phase of the land reclamation project, an important step toward increasing agricultural production. But it was equally important to continue adjusting prices periodically to provide sufficient incentives to farmers. A more flexible pricing policy would also be beneficial for the industrial sector, and he was encouraged to note that the existing system of price controls was being applied flexibly. Industrial output, particularly in manufacturing, had been below expectations. The implementation of an industrial training program to build up local skills was welcome and should help the authorities to overcome one of the obstacles to higher growth, the shortage of skilled manpower. He agreed with the authorities and the staff that efforts should be concentrated on the completion of existing projects and utilization of existing capacity rather than on the introduction of new projects. The infrastructural projects underway seemed well designed to increase output in both the industrial and agricultural sectors over the medium term. Higher output was vital to ease the financial problems that were reflected in the large fiscal deficit and the heavy recourse to bank financing. He fully supported the authorities' efforts to reduce the deficit and eliminate borrowing from the banking system.

The new revenue-raising measures proposed for 1984 were a step in the right direction, Mr. Suraisry noted. He hoped that the authorities would soon be in a position to implement them, and he welcomed Mr. Finaish's statement that the authorities stood ready to implement new measures to reduce expenditure if the targets for domestic revenue and external grants were not met.

The external sector also faced deep-rooted structural problems, Mr. Suraisry remarked. Efforts to improve export performance had been made more difficult by the complex exchange rate system, and while the authorities recognized the need for structural reform of the system, they felt that the time was not yet right. He hoped that they would move steadily toward the goal of a unified exchange rate system, which would help to restructure the economy and to reduce the existing imbalances. Finally, he fully supported the authorities' request for technical assistance in collecting and recording statistics.

Mr. Templeman remarked that given the scarcity of detailed economic data on Syria, it was difficult to formulate an accurate picture of the economy. However, developments in the fiscal and external sectors

warranted a few comments. On the fiscal side, the authorities had continued to follow the measures introduced in 1981. While expenditure had increased by only 8 percent in 1983 and revenues had recorded an increase of 11 percent, the budget deficit after grants had still reached 9 percent of GDP in that year. Furthermore, the budget deficit for 1984 was projected to decline only marginally, if at all. Public wage constraint had been impressive but would become increasingly difficult to pursue in the future, even with the low inflation rate. As grants and the growth in revenues were expected to decline, fiscal policy should be directed toward expenditure reduction, perhaps in the parastatal sector, since development expenditure had already been reduced substantially.

The privatization of some of the parastatal enterprises was likely to lead to reduced government subsidies and to increased and more efficient production, Mr. Templeman stated. Those enterprises could then *become a source of the savings needed to promote economic development and reduce reliance on foreign grants.* As a first step, the authorities should adjust prices to reflect the costs of production, as they had done in the petroleum sector. The World Bank might make similar recommendations after its investigation of the natural gas sector later in 1984.

The disequilibrium in the domestic economy was reflected in the external accounts, Mr. Templeman observed. While there had been some improvement in the current account, the overall deficit had changed little in the past few years and was not expected to improve substantially in 1984, despite strict controls on imports. Efforts to increase the inflows of foreign currencies held abroad by Syrian nationals might help to improve the balance of payments, but those inflows were unlikely to be a continuing source of foreign exchange unless the interest and exchange rate policies were adjusted to provide the necessary assurances to foreign account holders that they could have continuing access to their repatriated foreign exchange. He urged the authorities to unify the exchange market as soon as possible so that exporters could earn--and importers would have to pay--world market prices, thus stimulating production of exports and import substitutes. The external debt situation should be of concern to the authorities. Civilian debt was already high, and military debt was presumably higher. By maintaining and providing the Fund with statistics on all foreign debt, the authorities would be able to prepare for future debt service payments that must be funded from foreign exchange earnings. Finally, he supported the authorities' request for technical assistance to improve their data base and economic policymaking capabilities.

The staff representative from the Middle Eastern Department stated that the staff was particularly concerned about the fiscal situation in the Syrian Arab Republic. The budget deficit of between 15 and 17 percent of GDP was high, although some improvement had been registered in 1983 and was targeted for 1984. The weakening rate of growth of revenues was the principal problem, and as development expenditure was expected to decrease substantially in 1984, there was little room for improving the fiscal situation from that side.

Mr. Finaish remarked that a number of exogenous factors had affected economic development in the Syrian Arab Republic. Agricultural output, which had increased by 40 percent in 1980, had not increased in the past two years owing to adverse weather conditions. Furthermore, the drop in international oil prices, decline of foreign assistance, and increase in cereal imports had had a negative impact on Syria's external position. Additionally, the unsettled regional situation and the continued occupation of Syrian territory had necessitated greater expenditure on security and had, to some extent, diverted the authorities' attention from the pursuit of economic development.

He recognized that there were structural imbalances in the economy that had to be corrected, Mr. Finaish commented. However, the Government was pursuing a pricing policy that would provide adequate incentives to producers, particularly in the agricultural sector, and subsidies had been reduced substantially as a proportion of current expenditure from about 12 percent in 1980 to 6 percent in 1983. The subsidies on essential products, including basic food items, were financed through a stabilization fund, the sources of which were derived from surcharges on less essential commodities produced domestically or imported by the public sector.

The authorities considered the existing exchange rate system to be transitory, Mr. Finaish noted. They intended to unify the rates at an appropriate time, but, in the interim, would apply a flexible exchange rate policy.

The Chairman made the following summing up:

Directors noted that the Syrian economy was experiencing financial and economic difficulties and a significant slowdown in growth caused partly by factors outside the control of the authorities. These included the effects of adverse weather conditions on agricultural output, substantial expenditures necessitated by security conditions, a decline in external grants, and decreasing oil sector earnings. Directors, however, also observed that the weakening performance, especially in the external sector, reflected to some degree inadequacies in domestic, economic, and financial policies. Efforts were made in 1983-84 to enhance domestic resource mobilization, but these efforts have been somewhat limited, and the exchange reform initiated more than three years ago has progressed slowly.

Directors welcomed the increased emphasis given by the Syrian authorities to the development of agriculture, including appropriate producer price policies, and noted the progress made in the land reclamation projects aimed at enlarging considerably the area of irrigated land. The priority given under the Fifth Development Plan to completing existing projects and to upgrading existing industry was also appropriate.

Directors welcomed the improvement made in 1983 in reducing the ratio of the fiscal deficit to GDP, and noted that the authorities were hopeful that further significant progress in that direction could be made during the current year. Public sector borrowing from the domestic banking system had been one of the main causes of high rates of credit creation, and the anticipated moderation in 1984 is predicated on a successful containment of such borrowing. In this context, Directors welcomed the willingness of the authorities to take additional steps that might be needed to achieve the intended improvement in public finances. Such steps would have to include measures to improve the financial position of the public sector enterprises. An enhanced domestic mobilization effort would facilitate expanding public development expenditure to stimulate future growth in the economy.

In the external sector, Directors noted that continuing balance of payments deficits had led to restrictions on imports, particularly those of the private sector, with adverse effects on output. Syria's exchange system has become increasingly complex, with widening spreads between the different official rates, and between those and the unofficial market rate. Directors believe that the Syrian economy would benefit from prompt moves to simplify the exchange system and unify the exchange rate at a realistic level. Such action would facilitate correcting Syria's weak balance of payments position and allow winding down of dependence on import restrictions.

Directors observed that considerable improvement was needed with respect both to the adequacy and currentness of economic statistics in Syria, so as to facilitate analysis and provide a sound base for policy formulation. A request from the Syrian authorities for technical assistance from the Fund in improving the collection and compilation of economic and financial data would certainly receive most favorable consideration.

The next Article IV consultation with the Syrian Arab Republic will be held on the standard 12-month cycle.

The Executive Board then took the following decision:

Decision Concluding 1984 Article XIV Consultation

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/84/189. 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 a Fund member and notes that the two remaining agreements with Fund members are inoperative and hopes that these agreements will be terminated as soon as possible.

Decision No. 7802-(84/140), adopted
September 10, 1984

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/84/139 (9/10/84) and EBM/84/140 (9/10/84).

2. PHILIPPINES - TECHNICAL ASSISTANCE

In response to a request from the Philippine authorities for technical assistance, the Executive Board approves the proposal set forth in EBD/84/239 (9/7/84).

Adopted September 10, 1984

APPROVED: June 27, 1985

LEO VAN HOUTVEN
Secretary