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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/16

3:00 p.m., January 21, 1983

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	J. K. Orleans-Lindsay, Temporary
	E. M. Ainley, Temporary
	H. G. Schneider
	A. Le Lorier
	E. A. Salinas, Temporary
	C. Dallara
M. Finaish	T. Alhaimus
	I. R. Panday, Temporary
	T. Yamashita
	D. I. S. Shaw, Temporary
	H. Arias, Temporary
	G. Grosche
	C. P. Caranicas
	C. J. Batliwalla, Temporary
	J. E. Suraisry
	T. de Vries
	A. Halevi, Temporary
	K. G. Morrell
G. Salehkhou	O. Kabbaj
	M. Camara, Temporary
	E. Portas, Temporary
J. Tvedt	
	Wang E.

L. Van Houtven, Secretary
K. S. Friedman, Assistant

Also Present

Exchange and Trade Relations Department: S. Mookerjee, Deputy Director. Legal Department: J. K. Oh. Middle Eastern Department: A. S. Shaalan, Director; A. K. El-Selehdar, Deputy Director; M. Arif, J. R. Dodsworth, F. Drees, S. H. Hitti, Z. Iqbal, B. A. Karamali, D. B. Noursi. Personal Assistant to the Managing Director: N. Carter. Advisor to Executive Directors: S. R. Abiad, S. El-Khouri, M. A. Janjua. Assistants to Executive Directors: H. Alaoui-Abdallaoui, G. Ercel, V. K. S. Nair, Y. Okubo, J. G. Pedersen, J. C. Williams, Zhang X.

1. SYRIAN ARAB REPUBLIC - 1982 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1982 Article IV consultation with the Syrian Arab Republic (SM/82/235, 12/17/82). They also had before them a report on recent economic developments in Syria (SM/82/236, 12/21/82; Cor. 1, 12/27/82; and Cor. 2, 12/30/82).

The Deputy Director of the Middle Eastern Department said that there had been small appreciations of the tourist market exchange rate on December 29, 1982 and January 8, 1983. Changes in the tourist market rate were based on developments in the unofficial market in Syria and in the Syrian pound/U.S. dollar crossrates in neighboring countries, particularly the Amman and Beirut markets. In addition, the authorities had provided revised monetary survey data for May 1982 that showed a faster rate of growth in the net domestic assets of the banking system in the first five months of 1982 than had been indicated in the provisional data provided in the staff report. The revised figures indicated an increase in liquidity of 5 per cent in the first five months of 1982, compared with an increase of 6 per cent in the same period in 1981.

Mr. Finaish made the following statement:

> I wish to thank the staff for two useful documents on the economy of the Syrian Arab Republic (SM/82/235 and SM/82/236).
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> Economic policy in Syria has been geared toward making an effective utilization of domestic and external resources available to the country to develop the productive base with a view to promoting economic growth under conditions of relative financial stability. In the context of an institutional framework characterized by a predominant public sector, reliance was placed on development planning. The implementation of a series of development plans, which have required substantial amounts of investments that have been in part financed by Arab financial assistance, has yielded impressive results, particularly if one takes into account the heavy burden of security associated with the unsettled situation in the region.
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> Considerable progress toward the aforementioned objectives was made in various sectors of the economy, and the average annual rate of real economic growth was about 11 per cent under the Third Development Plan (1971-75). This performance was accompanied, however, by the emergence of physical and financial strains. These were important factors contributing to the deceleration in the average annual rate of real growth to about 6 per cent under the Fourth Plan (1976-80). The recently launched Fifth Plan (1981-85) which has been formulated with a perspective stretching toward the year 2000, seeks to achieve an average annual real rate of growth of GDP of 7.7 per cent and aims mainly at consolidating gains made under the previous Plan, completing projects already initiated, and eliminating existing bottlenecks.

The Plan places renewed emphasis on agriculture and agro-related industries as well as rural development projects and expansion of social services as part of the efforts aimed at stemming the rural-urban drift and achieving a more balanced regional economic growth. The bulk of the Plan's total investments of LS 101.5 billion is expected to be financed from domestic resources, with the private and cooperative sectors contributing about one fifth of that amount. Reflecting the authorities' greater flexibility in their approach, the Plan refrains from lisiting pre-set annual investment programs. This increased planning flexibility has been made necessary by financial developments particularly in 1980, and the authorities' efforts to achieve a higher degree of financial stability by restricting the growth of demand beginning with 1981.

Mainly as a result of the accelerated development effort in the last year of the Fourth Plan (1976-80), an increase in defense expenditures, and an adjustment in salaries of government employees, the substantial improvement of the fiscal position that was achieved in 1979 was reversed in 1980 with the overall fiscal deficit (excluding grants) widening from the equivalent of 15 per cent of GDP to about 21 per cent. In order to contain the resulting inflationary pressures, the authorities tightened the stance of fiscal policy in late 1980 and during 1981 and to that effect took several corrective actions. On the revenue side, the steps that had been adopted included new tax measures aimed at improving the basis for taxation of income and profits and accelerating the collection of tax arrears. On the expenditure side, efforts were made to severely restrain the growth of current spending through stricter control of administrative expenditures, increased prices of some subsidized products, and reduction in certain fringe benefits. The growth of capital expenditures was considerably slowed down as the development budget focused mainly on the completion of ongoing projects with particular emphasis being placed on more effective utilization of existing capacity. These measures met with some success as evidenced by a decline in the overall fiscal deficit (excluding grants) and a moderation in the underlying inflationary pressures in 1981.

A further decline in the fiscal deficit was expected to be achieved in 1982, reflecting the continuation of fiscal restraint. Budgetary payments for subsidies of a number of consumer goods and petroleum products were further reduced. This, together with only a moderate growth in development expenditures and continued tightening of controls on current expenditure, is expected to limit total expenditure to the level of 1981. At the same time, budget revenues were projected to increase significantly, reflecting the full impact of tax measures adopted in the previous year, the effect of the March 1982 law subjecting public enterprises to taxes applicable to private enterprises, the sizable increase in customs duties, in particular on cars the imports of which have been liberalized, and the larger profit transfers from public oil and banking enterprises. On this basis, the overall budget deficit (excluding grants) would be reduced to less than LS 7 billion compared with about LS 10.5 billion in 1981.

The rate of growth of total domestic liquidity, which reached 34 per cent in 1980, decelerated sharply to about 16 per cent in 1981. This outcome was the result of several factors. These included a substantial reduction in bank financing of the budget, some deceleration in the rate of expansion of credit to the private sector, due in part to the upward adjustment in interest rates, and the contractionary monetary impact of the advance import deposit scheme that was introduced at the time of establishment of the parallel market in April 1981. These factors more than offset the expansionary impact of the increase in credit to a few public sector enterprises, largely to finance the working capital needs and fixed investment of the Banias oil refinery. Available data for the first five months of 1982 point to the likelihood of a further decline in the rate of domestic liquidity growth during the year.

During 1980, the external current account deficit recorded a sizable increase reflecting the Government's effort to step up development expenditures in the last year of the Fourth Plan as well as the impact of the liberalized import policies pursued during that period. On account of this and a slight fall in official unrequited transfers, the overall balance of payments position turned into a substantial deficit. The current account weakened further in 1981, due to a further growth of imports and in spite of a considerable increase in private transfers reflecting in part the effect of the parallel exchange market. Nevertheless, because of a sizable increase in official transfers the overall deficit declined substantially. In 1982 a significant improvement in the current account and the overall payments position is expected, reflecting mainly a projected decline in imports. The latter reflects in part the tight demand management policies and in part the lagged effect of the advance import deposit scheme.

In view of the weakening of external accounts in 1981 and the resulting movements in the unofficial exchange rate of the pound, the authorities effected some adjustments in the exchange system. A "tourist" exchange market was introduced in May 1982. This measure aims at allowing the conversion of tourist receipts and transfers at a rate that would be managed flexibly in light of rate movements in the unofficial market. It is hoped that this would contribute to attracting in 1983 a larger inflow of remittances and tourist receipts than in 1982. With regard to the operation of the parallel exchange market, a number of official circulars authorizing the exchange of certain percentages of specified export receipts at the parallel rate were issued. As a result, the schedule of foreign transactions that could be converted at the official rate was reduced somewhat. On the general policy, the authorities have reiterated their objective to move toward a new unitary rate. However, the unsettled conditions in the region since the introduction of the parallel market have not been conducive to a more rapid pace of reform. The authorities will consider additional steps in that direction as circumstances permit.

To recapitulate, in the last two years the authorities have followed financial policies that have reduced excess demand pressure while continuing to emphasize the growth of the economy. In 1983, they are intent on reducing further the budgetary deficit and the rate of growth of domestic liquidity in order to bring about a continued deceleration in the rate of inflation and an improvement in the external position. In addition, greater emphasis is to be accorded in investment strategy to making a more effective use of existing productive capacity.

Mr. Salehkhou remarked that the continued large domestic and external imbalances in 1982 should be a matter of concern to the authorities, despite their commendable achievements and the general improvement in the economy since the previous consultation with Syria. The good growth performance and the significant narrowing of the fiscal and current account deficits were clearly traceable to the authorities' prudent policies and were remarkable in that they had been achieved despite the difficult political situation and the occupation of an important part of the country. The political situation in the region was an important factor in Syria's economy; it had a direct bearing on the main economic imbalances, as the authorities had to maintain a large security budget that placed significant pressure on the fiscal balance, the balance of payments, and the banking system.

The growth performance of Syria in 1981 and 1982 was satisfactory, Mr. Salehkhou said, even though the weather had been unfavorable and capital expenditure had been significantly reduced. Economic activity had been encouraged by the substantial increase in support prices for agriculture and by the measures introduced in 1981 to increase the availability of machinery and to improve productivity. In addition, several new development projects had come on stream.

The flexibility evident in the new five-year development plan was welcome, Mr. Salehkhou stated. The plan provided for a significant increase in investment, but it did not include annual phasing, and actual spending was to be determined in the light of the availability of resources. Moreover, the plan concentrated on the completion of ongoing projects and was aimed at improving agricultural production through the provision of better extension services and further mechanization, increasing capacity utilization in the industrial sector, and curbing the migration to urban areas and neighboring countries that had resulted in serious shortages of skilled manpower.

The recent fiscal and monetary developments were satisfactory, Mr. Salehkhou commented, mainly because the restrained policy stance had helped to reduce significantly the large budget deficit and the underlying inflationary pressures. Action on both the expenditure and revenue sides had contributed to the reduction of the budget deficit from the equivalent of 21 per cent of GDP in 1980 to 17 per cent in 1981 and an estimated 11 per cent in 1982. A significant reduction in overall subsidies--and the virtual elimination of subsidies on petroleum products--the introduction of several tax measures, including improved income tax assessment and collection, and strict control of administrative outlays had resulted in a large increase in revenues and in the containment of expenditure growth. The decline in the budget deficit helped to explain the deceleration in the rate of growth of the net domestic assets of the banking system.

The authorities had stated their intention of maintaining their restrictive policies in general, and of further tightening the fiscal stance in particular, Mr. Salehkhou noted. Government revenue should benefit considerably from the measures introduced in 1981. It would be useful to have a further comment on the 1982 law that made public enterprises subject to the same taxes as private enterprises. What effect would the law have on public enterprise profits and transfers to the government budget?

The current account deficit, Mr. Salehkhou observed, was projected to decline from the equivalent of 15 per cent of GDP in 1981 to 12 per cent in 1982, and the authorities' intention of continuing the restrained demand management stance in order to reduce further the deficit was certainly encouraging. Unfortunately, the reduction in the deficit had been accompanied by an extension of multiple currency practices and by an increase in external debt. Those developments were a cause for concern, but the exchange system should be appraised in the light of Syria's economic difficulties and of the authorities' belief that the present multiple exchange rate system was temporary. They had stated their intention of eventually moving to a unitary rate, and the system seemed to be moving in that direction, as the scope of the parallel market was expanding. In the circumstances, he disagreed with the staff that the Executive Board should not approve the existing multiple currency practices. Finally, it was important to note that a substantial portion of the external debt was in the form of concessional loans and stable deposits by friendly countries.

Mr. Suraisry commented that economic conditions in Syria were difficult. The authorities had to deal with a number of serious problems, including significant pressure on the balance of payments and the pound, a large budget deficit, and bad weather. Experience showed that authorities would need courage, determination, and a great deal of luck to solve the problems facing the economy.

The authorities had already taken commendable steps to deal with the problems, Mr. Suraisry continued. They had improved productivity, increased capacity utilization, and tightened fiscal policy, all fundamental parts of the effort to revive the health of the economy, thus reducing the fiscal deficit and the rate of inflation. Nevertheless, largely because of the long-term nature of the problems, there were still certain weaknesses in the economy. The authorities would have to continue to make adjustments to solve the present problems and to be in a position to eliminate the existing temporary restrictions.

Mr. Ainley stated that he accepted the proposed decision and basically agreed with the staff appraisal. The economy had been going through a difficult period in recent years; the authorities' recognition of the need for adjustment in the short and medium run and for more cautious development planning in the longer run was encouraging. The realistic approach evident in the Fifth Development Plan was particularly welcome. The greater emphasis on increasing capacity utilization, improving agricultural services, and exploiting the large reserves of natural gas should provide a framework for renewed growth in the future.

The measures adopted since late 1980 to reduce the budget deficit were welcome, Mr. Ainley said, and he fully agreed with the authorities' objective of further limiting the deficit in 1983. The important initiatives that the authorities had taken to strengthen the financial position of the public enterprises should help the enterprises to meet their budgetary objective. Were further reductions in subsidies and price controls planned? He agreed with the staff that, given the weakness of oil receipts and the limited scope for further improving tax administration and reducing arrears, efforts to boost revenues might be needed.

The reduction in the fiscal deficit in 1981/82 had helped to reduce the inflationary pressures, Mr. Ainley remarked, but the financing of the budget deficit was still uncomfortably dependent on foreign grants and on borrowing from the domestic banking system. He wondered whether such financing could be sustained in the medium term, and whether the authorities could not make an additional effort to stimulate domestic savings in general, and private savings in particular. Such an effort was particularly important in the light of the target under the Fifth Development Plan of an annual average growth rate in domestic savings of nearly 11 per cent; and roughly 90 per cent of total investment under the Plan was to be financed from domestic sources. The ratio of domestic savings to GDP had fallen sharply in the four years to 1980, and it would be useful to know whether the ratio had increased since then. The public sector played a dominant role in generating savings in a planned economy with a nationalized banking system, but the staff report said surprisingly little about interest rates, which, despite the decline in inflation, remained negative in real terms. Further upward adjustments in interest rates could be one way of encouraging private savings, which were to account for one fifth of the financing under the Fifth Development Plan.

The authorities should be encouraged to compile more comprehensive data on official external debt as a matter of priority, Mr. Ainley considered. Given the present international lending climate, that task should be given a high priority. The technical assistance that the Central Bank had requested in the area of computerization should help the authorities in their effort to improve the data base.

He agreed with most of the staff's conclusions concerning the level of the exchange rate and the structure of the exchange system, Mr. Ainley said. The external position had been weak, and was likely to remain so for some time. Non-oil exports had declined steadily, and oil revenues had fallen as well, but the official exchange rate, which still applied to 85 per cent of exchange transactions, had appreciated considerably on a nominal trade-weighted basis since April 1981. The urgent need for a change in the exchange rate was underscored by the tightening in the foreign exchange situation during 1982, the delays in granting letters of credit, and the low level of official reserves. An adjustment of the official exchange rate would be desirable, possibly in conjunction with a substantial shift in transactions from the official rate to a flexibly managed parallel rate. The shift could be a useful first step in the establishment of a realistic unitary system, in line with the authorities' stated objective. It would be useful to know whether the staff and the authorities had discussed the possibility of moving in the longer run to a peg to something other than the U.S. dollar. He hoped that the authorities would succeed in their continuing adjustment efforts, and that they would soon be able to phase out and remove the existing multiple currency practices.

Commenting on the Fund's policy on multiple exchange rates and exchange restrictions, Mr. Ainley noted that the staff had traditionally, and appropriately, argued that a one-step devaluation to a single realistic exchange rate was a more effective means of external adjustment than recourse to a transitory system of multiple rates. However, it was his impression from recent Executive Board discussions that an increasing number of members appeared to be resorting to multiple rates as a means of gradually depreciating their currencies in circumstances in which a one-step adjustment was thought to be unworkable. In some cases, the Executive Board had reluctantly supported such moves while urging that the multiple systems be removed as soon as possible.

The staff could usefully explore more fully the recent experience of members with multiple systems to see what could be learned about their usefulness and about the ways in which such systems could be successfully managed, Mr. Ainley remarked. There might well be cases in which legitimizing an unofficial market, although thereby creating a multiple system under Article VIII, might help to provide the banking system with much-needed foreign exchange. There might also be cases in which it would be difficult to phase out the unofficial rate if, for instance, the official parallel rate was supported by administrative restrictions in the form of import deposits or import licences. The staff could usefully explore those matters, together with the factors that determined the appropriate level of the parallel rate and the circumstances in which two or more official rates might be warranted.

It was important to underscore the importance of close Fund surveillance over multiple exchange rate systems, Mr. Ainley said, particularly as the systems could remain in force for longer than their originators had intended. Such systems were of course covered by Fund programs; a country's letter of intent often included a timetable for reducing or eliminating the systems. It was equally important to cover fully the multiple exchange rate systems in regular Article IV consultations. While it might not always be possible during such consultations to arrive at a timetable for moving toward a unified exchange rate system, the staff should discuss with the authorities the economic conditions under which progress could be made toward that goal and the prospects for so doing.

Mr. Schneider said that basically he agreed with the staff appraisal. Despite the unsettled conditions that had prevailed in the region for some time, the Syrian authorities had introduced restrictive fiscal and monetary policies in 1981 and 1982. That shift was particularly welcome in view of the rapid worsening of the Government's financial situation in 1980, the strong inflationary pressures, and the sharp deterioration in the balance of payments. As a result of the policy restraint, the overall budget deficit had declined markedly in 1981, and a further reduction to the equivalent of about 11 per cent of GDP was estimated to have occurred in 1982. Although that percentage was the lowest in many years, it would still seem advisable for the authorities to attune their budgets to the amount of external grants from friendly countries that could realistically be expected to be available to cover at least the major part of the budget deficits. Such an approach would certainly contribute to the desirable deceleration in monetary growth and to a further decline in the underlying rate of inflation.

The fiscal and credit plans for 1983 had not yet been finalized, but the intention of the authorities to maintain their cautious demand management was welcome, Mr. Schneider said. The financial situation of Syria was still difficult, and it would therefore seem prudent for the authorities to keep the restrictive policy stance even at the cost of a somewhat lower rate of growth of GDP.

The targets under the recently published five-year plan (1981-85) were rather ambitious, Mr. Schneider commented. In the light of the uncertainties about the economy, it seemed advisable to maintain the flexible approach to determining actual spending. In principle, the new plan was designed to achieve two goals. The first was an increase both in crude oil production--through special efforts to discover new fields--and in the exploitation of the large reserves of natural gas; the receipts were to be used to broaden the industrial base. In that connection, the elimination of subsidies through increases in product prices was a welcome step, as it would help to contain domestic consumption and to improve the fiscal position. The second goal, to improve the agricultural sector, also merited special emphasis. The efforts to provide social, cultural, and educational services in rural areas--to curb the flow of migrants to cities and the emergence of urban slums--were particularly important.

The staff report contained no information on the employment situation in Syria, Mr. Schneider noted. It would also be useful to know more about the development of per capita GDP, which had been estimated at LS 5,922 in 1980.

He agreed with the staff, Mr. Schneider said, that the exchange rate system was complex, and that simplification would help the authorities in implementing their exchange rate policy. The official system of pegging the Syrian pound to the U.S. dollar had remained unchanged since April 1976 and probably was no longer appropriate. In 1981, for instance, some 66 per cent of Syria's exports had gone to EC and other European countries, excluding those of Eastern Europe, while only 3.7 per cent of exports had been directed toward the United States and Canada. The pattern on the import side was similar. It was of course true that in 1981 approximately 80 per cent of exports on an f.o.b. basis had been of petroleum, and that the international petroleum markets operated on a dollar basis, but pegging the Syrian pound to the U.S. dollar had resulted in an appreciation of the Syrian pound vis-à-vis Syria's trading partners since 1981, a trend not warranted by the developments in Syria's balance of payments. Early action was needed to simplify the complex exchange rate system and make it more responsive to developments abroad. Serious consideration should be given to moving to a basket of currencies suited to Syria's needs. It was likely that, after the reform of the exchange system, the present requirement that virtually all exports be settled by letter of credit could eventually be abolished.

Mr. Dallara stated that he broadly agreed with the staff appraisal and accepted the proposed decision. The authorities had somewhat tightened fiscal policy in 1981 and had apparently maintained the restraint in 1982. Their commendable efforts to contain expenditures and to increase revenues had been reflected in the improvement in external accounts. The measures introduced thus far were clearly desirable, particularly in the light of the continued relatively large fiscal deficit and the tight foreign exchange situation. Given the continued uncertainty with respect to the availability of foreign exchange, the authorities should be encouraged to strengthen their effort to maintain fiscal restraint.

He agreed with the staff, Mr. Dallara said, that the authorities should simplify the exchange system by unifying the exchange rate at a realistic level. In determining the appropriate level of the rate, the authorities should take into account the recent appreciation of the Syrian pound. He hoped that they would be able to take that action in the near future and, in the absence of a clear timetable, he agreed with the staff that the Executive Board should not be asked to approve the multiple currency practice. Mr. Ainley's suggestion for a staff study on the desirability and efficacy of transitory multiple currency practices was useful.

The authorities should be encouraged to improve the collection of data, Mr. Dallara considered. The lack of timely data was a hindrance to the analysis of recent economic developments in Syria. Only five months of 1982 data on the net domestic assets of the banking system were available. Such data gaps could hamper the effective implementation of monetary policy, and Fund technical assistance in the effort to provide more timely monetary data would be welcome.

Mr. Camara said that he broadly agreed with the staff appraisal and accepted the proposed decision. Under the previous five-year plan, which had ended in 1980, growth in real output, averaging approximately 6 per cent per year and peaking at 10.7 per cent in 1980, had been satisfactory. The rapid growth had been made possible by increases in agricultural, mining, and manufacturing output, and by the high level of development spending, but inflation continued to be a problem, despite the dampening effect of price controls. The increase in the consumer price index for Damascus had accelerated to 19 per cent in 1980 and, although inflationary pressures had abated somewhat in 1981, the rate of inflation had remained relatively high at 18 per cent. The authorities' cautious approach under the current five-year plan should help to reduce the pressure on domestic prices.

The pace of economic activity in Syria seemed to be slowing, Mr. Camara commented, as the rise in real GDP of 6 per cent in 1981 represented a decline of about four percentage points from 1980. Syria's growth performance was satisfactory by current international standards, but a further decline in the growth rate was estimated to have occurred in 1982 as a result of bad weather and continued restraint on development spending.

The emphasis that the authorities were placing on agriculture seemed to be a step in the right direction, Mr. Camara remarked. Total production of barley had been falling in recent years, despite the increase in acreage and the hike in the price paid to farmers. It would be useful to know whether the authorities had taken any other steps specifically to improve productivity.

On the fiscal front, Mr. Camara said, the authorities, in maintaining a more restrained policy stance, had been limiting the growth of both recurrent and capital expenditure while raising additional revenues. As a result, significant fiscal adjustment had occurred in 1981: the overall budget deficit as a proportion of GDP had been reduced to 7 per cent, compared with 10 per cent in 1980. That the authorities had been able to increase capital expenditure under the 1982 budget while attempting to achieve further adjustment in the overall fiscal deficit was certainly welcome, but, in the light of the bottlenecks mentioned by the staff, including the lack of managerial experience and skilled labor in various sectors of the economy, he wondered whether the planned expansion of development spending was not somewhat excessive. The authorities had attempted to deal with the bottlenecks under the previous five-year plan but had not been fully successful, and the same bottlenecks would probably be a factor in the implementation of the present development plan. Did the staff have current information on the level of actual capital expenditure in 1982?

Credit policy in recent years had been aimed at containing inflationary pressures while supporting the effort to achieve a viable balance of payments position, Mr. Camara noted. The authorities had stated their intention of restraining the expansion of credit to state enterprises while limiting the growth of private sector credit to between 10 per cent and 15 per cent.

The balance of payments position in recent years had been worrying, Mr. Camara said, as relatively large overall deficits had emerged, partly because of shortfalls in export receipts and in both private and official transfers. While continuing to implement their demand management policies, the authorities should seek to improve the performance of exports, including non-oil exports.

The Deputy Director of the Middle Eastern Department remarked that the public sector enterprises, which were subject to income and certain other taxes, had been exempt on an ad hoc basis from various specific taxes. In 1982 the authorities had decided that, as part of the effort to improve the performance of public sector enterprises, they should be required to pay taxes like any producer in the private sector. At the same time, public sector enterprises were given the flexibility to adjust their prices to compensate for most or all of the additional tax burden and to achieve a reasonable rate of return.

One of the authorities' basic policy objectives, the Deputy Director continued, was to reduce subsidies to the extent that it was feasible to do so. The increases in the price of petroleum products in 1981 and 1982 had brought domestic prices in line with international ones.

The authorities had increased interest rates in 1981, the Deputy Director explained, and they felt that, given the fall in the rate of inflation in Syria and the decline in international interest rates, the structure of interest rates was reasonable. They were continuing to monitor interest rates and to adjust their policy as necessary.

Data for 1982 on foreign debt, GDP, public sector investment and the labor market had not yet become available, the Deputy Director explained. Moreover, the data on the savings ratio and expenditure on GDP for 1981 were not of good quality. The staff had concluded that, in the light of the substantial decline in agricultural output--particularly of cereals--the rate of increase in GDP in 1982 was considerably lower than the rate in 1981. The only available data for the budget for 1981 were still provisional, and there were no data on actual budgetary expenditures and receipts in 1982.

The peg to the U.S. dollar was a long-established practice in Syria, the Deputy Director said, and traders found it easiest to deal in terms of dollars. A shift to a basket of currencies based on the SDR or another combination of currencies might involve daily rates for the U.S. dollar, something that might complicate the operation of the exchange system. Still, the issue of the peg was not the most important one in the exchange rate area; the practice of maintaining the peg would have to be re-examined when the authorities were willing to make a major change in the exchange system. For the moment, the main issue in the exchange rate area was the need to move at an early date to a more realistic exchange rate that took into account the appreciation in the past of the Syrian pound against into currencies of the country's major trading partners. Even more important, the authorities should maintain a flexible approach in managing the rate in the parallel exchange market.

Finally, the Deputy Director of the Middle Eastern Department explained, the considerable fluctuation in the output of barley had been caused by fluctuations in crop yields due to changing weather conditions.

The Deputy Director of the Exchange and Trade Relations Department remarked that the present multiple currency system in Syria had been introduced about three years previously and had been noted in the decision on Syria adopted by the Executive Board in 1980. At that time, the Executive Board had not approved the multiple currency system, which had become increasingly complex in 1981 and had been noted again in the consultation decision in that year, when the Executive Board had again refrained from approving the system. Since then, the system had become even more complex, and the staff had not recommended its approval in the proposed decision because it did not meet the established criterion, namely, that the Fund should be satisfied that the practice was temporary. The authorities had no concrete plans for an early elimination of the system. In that connection, Executive Directors should recall that the Fund had traditionally taken a strict attitude toward complex multiple currency systems. As early as 1957 the Fund had adopted a decision covering complex multiple systems, stating in part that "the Fund will not approve such systems unless the countries maintaining them are making reasonable progress toward simplification and ultimate elimination of such systems."

He agreed with Mr. Ainley, the Deputy Director of the Exchange and Trade Relations Department continued, that surveillance over multiple currency practices should be strengthened through Article IV consultations, and the staff was attempting to do so. Moreover, the staff was already considering a possible study on the temporary use of dual market systems, and the staff would pay particular attention to the suggestions that Mr. Ainley had made. A number of countries had introduced dual rate systems in recent years and, in many cases, it was too soon to know whether the objective of moving toward a unitary rate would be achieved in the foreseeable future. In some cases, such as those of Egypt and Sudan, the authorities had requested technical assistance from the staff in their effort to make further progress in reforming the exchange system. The study of dual market systems could not be completed until additional experience with the working of such systems had been gained.

Mr. Finaish said that the Syrian authorities viewed the present multiple currency system as a temporary one. Their intention was to move to a unitary rate, and, in that connection, the question of timing was crucial; such an important change in the exchange system had to be considered in light, inter alia, of developments in other sectors of the economy and the general conditions outside the country. In particular, a major reform of the exchange system would involve a decision regarding the determination of an equilibrium exchange rate, which, in turn, would affect the budget and the price level. The authorities had established the parallel market in April 1981 and had recently enlarged its scope by adding certain exports to its coverage. In May 1982, they had introduced a market with a more depreciated exchange rate for tourist receipts and remittances. As a result, the coverage of the official market had decreased in the previous two years. Nevertheless, the intention of the authorities was to move to a unitary rate when circumstances permitted.

The difficulties in the area of data collection in Syria were similar to those facing many developing countries, Mr. Finaish remarked. There were some delays in data collection, partly because of shortages of qualified staff, reflecting the emigration of technicians to neighboring countries. However, the authorities were well aware of the problem and were making serious efforts to improve the situation. In that connection, they had already requested the technical assistance of the Fund in part to computerize the functions of the Central Bank.

The authorities intended to maintain restraint in fiscal and monetary policies, and the new development plan was realistic, Mr. Finaish commented. The present policy stance reflected the financial constraints, the desire to control inflation, and the experience gained under the previous development plans, under which a number of industries had been established without sufficient preliminary examination. The emphasis on agriculture was greater under the new development plan than under previous ones. Agriculture was the mainstay of the economy and the authorities hoped to increase non-oil exports, reduce Syria's reliance on imports, achieve more balanced growth in the country, and slow the movement of labor from the rural areas to the urban centers.

The policy options available to the authorities, Mr. Finaish noted, were limited, in part by the conditions in the region. Some of the country was occupied, and there were border problems that required the authorities to make large expenditures on defense. In addition, there were uncertainties with respect to the flow of aid. The conditions in the region also had important implications for tourism in Syria and for the movement of labor between Syria and neighboring countries. Another exogenous problem was that, while Syria was heavily dependent on agricultural output, that sector was often hard hit by adverse weather conditions. There was of course room for improvement in the setting of domestic policy, but the important external constraints that he had mentioned should be kept in mind.

The Fund had traditionally taken a strong stand on multiple currency practices, Mr. Finaish noted. Such practices were important for small countries, although their implications for the rest of the world were rather limited. It seemed unnecessary to state the staff's reasons for not approving the multiple currency practice both in the staff report and in the appraisal. The staff's position on Syria's exchange system was clearly expressed in the staff report, and the portion of the second sentence of paragraph 2 of the proposed decision on the complexity of the exchange system could be eliminated. In that connection, it was unclear whether it was the practice to state in every case the reasons for the Fund's approval or disapproval of multiple exchange rates.

Mr. Suraisry remarked that he, too, felt that the statement in paragraph 2 of the proposed decision on the complexity of Syria's exchange system was excessively strong. The words in question could be eliminated or replaced by more appropriate language.

The Deputy Director of the Exchange and Trade Relations Department said that the term "complex" had been used in a number of previous decisions and accurately stated the facts of the present case.

Mr. Ainley stated that he preferred the proposed text as it stood. However, he was fully willing to accept Mr. Finaish's proposed amendment.

The Executive Board agreed that the words "notes the complexity of Syria's exchange system and" in the second sentence of paragraph 2 should be eliminated.

The Chairman made the following summing up:

> In their discussion of the staff report on the 1982 Article IV consultation with the Syrian Arab Republic, Executive Directors expressed broad agreement with the staff appraisal.
>
> They noted that, in an effort to sustain growth despite the financial constraints, the investment strategy embodied in the Fifth Five-Year Development Plan gave priority to completing ongoing projects, with emphasis on agriculture and rural development, and on more fully using the existing capital stock rather than on embarking on major new projects. This policy contributed to holding down development spending in the first two years of the plan. In addition, the rise in current outlays was strictly contained during 1981-82, in part by limiting the budgetary cost of subsidies. Furthermore, budget revenues were projected to increase as a result of tax measures adopted last year, and of the fact that public enterprises have recently been subjected to taxes applicable to private enterprises. As a consequence, the Government's recourse to domestic bank financing, which in 1980 had been the main inflationary factor, has been substantially reduced, and inflationary pressures have abated somewhat during the past two years.
>
> Directors welcomed the Syrian authorities' resolve to continue cautious demand management policies in 1983. Directors noted that, despite the restraining influence of fiscal policy on import demand, the foreign exchange position has become very tight, mainly because of delays in the receipt of external aid. As a consequence, the Syrian authorities are holding down the level of imports by delaying the opening of letters of credit. Some Directors expressed the hope that this measure could be lifted as soon as the foreign exchange position improved.

Directors noted that the Syrian Arab Republic maintained a complex multiple exchange rate system, but that it was the intention of the Syrian authorities to eventually move to a new unitary rate. Directors expressed the hope that such a move would not be unduly delayed, that in the meantime, serious consideration would be given to a substantial expansion of the scope of the parallel market and that management of the rates in that market would be flexible. Some Directors questioned the appropriateness of the continued peg of the Syrian pound to the U.S. dollar and asked whether a basket related to the structure of Syria's foreign trade would not be a more adequate solution.

A number of Directors referred to the question of the degree of adequacy of available economic, financial, and monetary data, in relation both to coverage and currentness. They noted that the authorities intend to press for improvements in this area, which is essential to economic analysis and for formulation of policies. The Fund would be pleased to provide technical assistance, if it were considered useful by the Syrian authorities.

The Executive Board approved the proposed decision, as amended.

The decision was:

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.

Decision No. 7309-(83/16), adopted
January 21, 1983

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/83/15 (1/21/83) and EBM/83/16 (1/21/83).

2. SYRIAN ARAB REPUBLIC - TECHNICAL ASSISTANCE

In response to a request by the Central Bank of Syria for technical assistance, the Executive Board approves the proposal set forth in EBD/83/17 (1/17/83).

Adopted January 21, 1983

APPROVED: June 24, 1983

LEO VAN HOUTVEN
Secretary