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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/98

10:00 a.m., July 6, 1983

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
	T. Ramtoolah, Temporary
	G. Ercel, Temporary
B. de Maulde	
	C. A. Salinas, Temporary
	T. A. Connors, Temporary
M. Finaish	T. Alhaimus
	Y. Okubo, Temporary
J. E. Ismael	Jaafar A.
	D. I. S. Shaw, Temporary
	C. Robalino
G. Laske	
	C. P. Caranicas
	C. J. Batliwalla, Temporary
	J. E. Suraisry
	K. Okma, Temporary
A. R. G. Prowse	
G. Salehkhou	O. Kabbaj
	S. M. Hassan, Temporary
	S. E. Conrado, Temporary
	A. Lindå
	C. Taylor
	Wang E.

L. Van Houtven, Secretary
J. C. Corr, Assistant

Also Present

Asian Department: L. H. De Wulf, W. G. L. Evers, S. Kimura, H. O. Roden, G. Szapary. Exchange and Trade Relations Department: S. Mookerjee, Deputy Director; D. K. Palmer, Associate Director; C. R. C. Saint-Etienne. Legal Department: J. K. Oh. Middle Eastern Department: A. S. Shaalan, Director; A. K. El Selehdar, Deputy Director; M. Arif, J. G. Borpujari, S. H. Hitti, H. E. Jakubiak, E. M. Taha, S. Thayanithy. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. El-Khouri, P. D. Péroz. Assistants to Executive Directors: L. Barbone, R. Bernardo, J. Bulloch, M. B. Chatah, I. Fridriksson, M. Hull, P. Leeahtam, V. K. S. Nair, G. W. K. Pickering, J. Reddy, P. S. Tjokronegoro, M. Toro.

1. VIET NAM - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with Viet Nam (SM/83/123, 6/13/83). They also had before them a report on recent economic developments in Viet Nam (SM/83/138, 6/22/83, and Cor. 1, 7/5/83).

The staff representative from the Asian Department stated that Viet Nam had settled the SDR 50,000 of overdue payments to the Fund referred to on page 1 of SM/83/123.

Mr. Ismael made the following statement:

On behalf of my Vietnamese authorities, I would like to thank the staff for their clear and concise reports on a country which has just emerged from a difficult period. The staff has done commendable work on estimating data on various key variables and in putting together data on national income accounts based on the SNA concept which is significantly different from the MPS concept used in Viet Nam.

In spite of the many adversities that have confronted the Vietnamese economy, several recent developments have given cause for optimism about the future. The Third Five-Year Plan has correctly placed emphasis on raising agricultural productivity to make the country self-sufficient in food. The measures introduced include improvements in producer prices; investment in rural infrastructure, including irrigation facilities; and increased availability of agricultural inputs. These policies are already beginning to pay dividends: agricultural output increased by 8.1 percent and food grain imports declined from 1,568,000 metric tons in 1979 to 500,000 metric tons in 1982. It is noteworthy that these gains have come largely from productivity increases rather than from increases in acreage under cultivation.

With regards to industrialization, there has been a shift in policy based on pragmatic considerations. In line with Viet Nam's comparative advantages, the authorities have moved away from heavy, capital intensive industries to lighter industries that yield quick results. In addition there is a greater focus now on improving capacity utilization in existing industries rather than investing in new facilities. This policy, however, has not impeded investment in several priority projects, such as electricity generation, cement, and coal mining, which are considered vital for economic development. However, non-priority projects have been curtailed owing to a shortage of financial resources.

After several years of stagnation, the growth performance of the economy improved in 1983 and 1982 as a result of improved incentives for production, improved supplies of agriculture and

industrial inputs, public investment in infrastructure, and a shift toward decentralized decision making. The introduction of flexible planning and pricing policies has also helped in accelerating economic growth to 5 percent in 1981 and 8 percent in 1982, compared with negative growth of 0.5 percent in 1979 and 3.7 percent in 1980. As a result of the policies pursued by the authorities, gross industrial production increased by 12.5 percent in 1981 and 14 percent in 1982. Agricultural production, which was aided by favorable weather, increased by 3.2 percent in 1981 and 8.1 percent in 1982.

Fiscal developments in 1982 were characterized by rapid expenditure growth (particularly for social benefits), while revenues remained at about the same level as in the previous year. As a result, the fiscal deficit increased from D 5 billion (9.8 percent of GDP) to D 19.5 billion (19.7 percent of GDP) in 1982. As indicated in the staff report, the Vietnamese authorities have already taken measures to improve the fiscal situation in 1983. The extension of the commercial license tax and profit tax to enterprises previously not covered, the increase in the turnover tax, and the introduction of new excise taxes on oil products, beer, cigarettes, and 12 other consumer products are expected to contribute toward raising revenues to the equivalent of 30 percent of GDP in 1983. Meanwhile, expenditure growth in 1983 will be limited to 13 percent. As a result, the fiscal deficit is expected to decline to about 14.6 percent of GDP in 1983, compared with 19.7 percent in 1982. The authorities intend to reduce the deficit further by introducing import duties and raising the yield of the agricultural tax. In a centrally planned economy where most of the investment, production, and distribution activities are in the hands of the Government, the 1983 projected fiscal deficit of 14.6 percent of GDP is considered to be modest.

Monetary developments in 1981 and 1982 indicate a somewhat larger growth in credit and liquidity than was justified by changes in official prices. As a consequence, the consumer price increases were in excess of official price increases. It is the intention of the authorities to curtail credit expansion in 1983 without affecting the availability of credit to priority sectors. This would be achieved through greater selectivity in the allocation of credit. Regarding the question of resource mobilization, the primary instrument for achieving this objective remains taxation policies and public sector pricing policies. Interest rate policy has a somewhat lesser role in mobilizing domestic savings. Nonetheless, the authorities increased the interest rates on deposits toward the end of 1982, a factor that is expected to have a positive impact on private saving.

In 1982 the balance of payments showed little improvement. Indeed, the overall position continued to be very precarious. Exports increased from 4.8 percent of GDP in 1981 to 5.6 percent of GDP in 1982 and there was a sharp increase in private and

official transfers. The improvement in current account receipts was partly offset by a higher level of imports of raw materials, but the current account deficit in 1982 declined to 7.5 percent of GDP, compared with 10.1 percent in 1981. The overall balance of payments deficit declined from 2.5 percent of GDP in 1981 to 1.7 percent in 1982. Official holdings of foreign exchange were at a very low level of $16 million, and, as noted by the staff, the entire deficit in 1982 was financed by accumulating arrears on foreign debt service payments to the convertible area. The Vietnamese authorities find the present inability to service their debt obligations regrettable and they hope that the world economic recovery and expanded markets for their products in the convertible currency area in 1983 and beyond will allow them to service their debts. Meanwhile, the understanding and cooperation of the creditor countries will be necessary to reschedule a major part of the debt.

Finally, we would like to express our reservations on the staff's view that an exchange rate adjustment is urgently needed to improve the balance of payments situation of Viet Nam. In a country where producer prices, consumer prices, imports, and exports are centrally controlled, the scope for exchange rate policy in bringing about adjustment to the balance of payments is limited. It is our view that the cause of the current balance of payments difficulties lies more in deficiencies in the planning of foreign exchange resources (i.e., sources and uses) rather than in the inappropriateness of the exchange rate.

Mr. Connors said that he agreed with the broad thrust of the staff appraisal and that he supported the proposed decision. The staff had made a strong case for action to strengthen the balance of payments. Viet Nam's weak payments position was constraining growth and development in addition to causing an accumulation of external arrears. The authorities should make the needed adjustment in the exchange rate with a full passthrough to domestic prices of the effects of the exchange rate change. Further decentralization, increased incentives, and greater private sector investment should also help to increase production and to reallocate it to the external sector. The steps taken by the authorities to reduce the severe fiscal imbalance were welcome. The reduction in the fiscal imbalance would be made easier by raising the prices of imported goods. Such an approach could be undertaken, at least in part, by adjusting the exchange rate and by letting domestic prices change to reflect the new depreciated rate. Finally, Viet Nam's statistical base was weak. He joined the staff in urging the authorities to work to improve the statistical base so that economic policy could be formulated with more timely and complete economic and financial data. The authorities should also provide data for inclusion in International Financial Statistics (IFS).

Mr. Prowse commented that he also agreed with the staff appraisal and that major adjustments in macroeconomic policies were required in the fiscal sector, the exchange rate, interest rates, and the credit

allocation system. He endorsed the staff's recommendations to expand the revenue base and to increase the profitability of state enterprises so that they could generate resources for investment. In particular, there was a need to increase incentives via the price system.

Were the authorities considering the question of rescheduling, Mr. Prowse inquired. Furthermore, were they considering an arrangement with the Fund? The staff had made an interesting comment on page 14 of SM/83/123 to the effect that budgetary performance had deteriorated sharply in 1982 and that government borrowing from the banking system had been an important factor in the expansion of monetary aggregates and in the continued pressure on prices in the free market. He invited the staff to comment further on the nature of the banking system within Viet Nam's economy. He also invited the staff to elaborate on the statement that "the adoption of more selective credit policies is welcome."

Reservations had been expressed by Mr. Ismael concerning the staff's view on an exchange rate adjustment, Mr. Prowse noted. The staff correctly stated that an adjustment was urgently needed. However, Mr. Ismael had made the interesting comment that "in a country where producer prices, imports, and exports are centrally controlled, the scope for exchange rate policy in bringing about adjustment to the balance of payments is limited." Similar views had been expressed with regard to other countries, but Mr. Ismael's following statement was more difficult to accept, namely: "It is our view that the cause of the current balance of payments difficulties lies more in deficiencies in the planning of foreign exchange resources (i.e., sources and uses) than in the inappropriateness of the exchange rate." He invited Mr. Ismael to elaborate on the reasoning behind those remarks.

Mr. Taylor observed that it was evident that the Vietnamese economy was suffering from serious structural problems. He agreed with the comments made by Mr. Connors and Mr. Prowse, particularly with Mr. Prowse's question regarding the role of exchange rate policy.

The external current account deficit remained large, Mr. Taylor commented, well beyond the ability of the economy to finance it through normal capital and aid inflows, and the prospects for an improvement in the debt position did not seem good. The debt service ratio was high, 72 percent overall and about 120 percent for the convertible currency area. Given the near exhaustion of foreign exchange reserves and the level of external arrears, Viet Nam would have little immediate prospect of recourse to the private capital market. The only reliable source of external finance would appear to be overseas aid. The building-up of external arrears was most unsatisfactory; it represented an undependable and counterproductive means of financing the balance of payments. He welcomed the recognition of that point in Mr. Ismael's statement.

Without a major adjustment effort accompanied by further restructuring of debt repayments, it was difficult to see how the authorities could begin to make progress in reducing their arrears, Mr. Taylor added.

Nevertheless, they would have to attempt to do so if they were to maintain trading relations with neighboring countries, and particularly if they were to have some prospect of access to the international capital markets in the future. There had been some progress with regard to debt rescheduling negotiations, but such negotiations were costly and only bought time. In the meantime, the addition of another multiple currency practice, namely, the preferential exchange rate for salary remittances from the nonconvertible currency area, was not an adequate response to the problem.

Inflation was approaching very high levels, Mr. Taylor remarked. By conventional measures, the exchange rate was seriously out of line, and it was not surprising that the staff remarked that "many exports incurred losses of up to 30 percent...." While it was true that exchange rate policy was likely to have a more limited role in a centrally planned economy, no economy could avoid developing serious structural imbalances if the exchange rate became seriously out of line with its production costs.

Commenting on fiscal policy, Mr. Taylor considered that the fiscal imbalances reflected in part the imbalances in the external accounts--the need for subsidies for domestic enterprises reflected to some extent the lack of proper adjustment in the tradables sector. In the long term, progress on the external front would go hand in hand with progress in the fiscal area. However, there remained a need to address the fiscal problem directly by, for example, increasing the prices of the products of some of the parastatal enterprises and by making better efforts to control expenditures. Further progress with the parastatal enterprises would depend on improving the quality of management and organization, but it would be helped by an exchange rate adjustment, which could provide the right kind of incentives and the appropriate shadow prices to guide the authorities in setting priorities in the production area.

He agreed with Mr. Connors' remarks concerning the economic data base, Mr. Taylor went on. Viet Nam had been a member of the Fund for a long time, but it was among the few countries that did not contribute to International Financial Statistics. The authorities should be encouraged to do so. Finally, the Article IV consultations with Viet Nam were important, and they should be maintained on the 12-month cycle. He noted with satisfaction that Viet Nam had settled its overdue obligations to the Fund, and he hoped that further arrears to the Fund could be avoided in the future. He supported the proposed decision.

Miss Batliwalla remarked that the staff's painstaking effort in the face of the inadequate data base was welcome. Over the previous two years the Vietnamese economy had shown a reasonable growth rate, and she agreed with Mr. Ismael that recent developments gave cause for a measure of optimism. Favorable weather, greater availability of fertilizers, wider application of incentives, and improved irrigation facilities appeared to have borne fruit; the increase in agricultural output was encouraging. The emphasis placed by the authorities in the Third Five-Year Plan on agricultural productivity in order to achieve self-efficiency in food

grains was also welcome. The reordering of plan priorities in favor of the agricultural sector was the right strategy in an economy in which per capita availability of food grains remained below adequate nutritional requirements.

In the industrial sector, Miss Batliwalla continued, the pragmatic policies followed by the authorities had helped to improve industrial output, which had shown marked gains of 12.5 percent in 1981 and 14 percent in 1982. In the face of financial constraints, the focus on improving capacity utilization in existing industries--rather than creating new investments--and on curtailing nonpriority projects appeared to be sensible. The improved performance of exports in 1982, reversing the earlier declining trend, was encouraging, and she agreed with the staff that efforts to improve exports should continue if the debt situation was to be eased.

The staff indicated that fiscal developments in 1981 and 1982 had been dominated by the effects of price and salary adjustments and higher consumer subsidies, Miss Batliwalla noted. It was a cause for concern that, despite the recovery, inflation had remained high and prices had risen by 90 percent in 1981 and by another 80 percent in 1982. The authorities appeared to be aware of the need to curb price increases and they were undertaking policy initiatives in the right direction. In particular, they were determined to pursue a policy of domestic demand restraint and to make more efficient use of financial resources by curtailing credit expansion and being more selective in the allocation of credit, while avoiding the starvation of priority sectors. However, an improvement in budgetary performance was critical to deal with inflation. The authorities were also grappling with the problem of rapid expenditure growth and they were making efforts to widen the revenue base; she wished them success in their endeavors.

The balance of payments position remained tenuous, Miss Batliwalla commented, despite the sharp increase in exports, particularly to the convertible currency area, and despite some improvement in the current account deficit, which had declined from 10.1 percent of GDP in 1981 to 7.5 percent in 1982. The low level of reserves, limited access to capital markets, and diminished aid prospects from the convertible currency area were all factors that had made the task of the Vietnamese authorities exceedingly difficult. Debt servicing had become an unsustainable burden on Viet Nam's economy, which was passing through a painful adjustment. The authorities were taking remedial actions on many fronts; she hoped that donors would show the needed understanding by increasing assistance to Viet Nam, and that the hoped-for economic recovery would enable higher penetration of Vietnamese products into the convertible currency area. She sympathized with the views expressed by Mr. Ismael with regard to the exchange rate question; the efficacy of the exchange rate as an instrument for promoting exports in a centrally planned economy remained open to debate. She looked forward to Mr. Ismael's comments on Mr. Prowse's question.

The staff representative from the Asian Department remarked that, to the extent possible, the authorities were attempting to reschedule their debts with their more established creditors. They had been successful with a certain number of creditors on a bilateral basis. The authorities would prefer a multilateral rescheduling, and in that regard, they had made an approach to the Paris Club in 1982, but the staff had no information on the outcome. The authorities had also requested a stand-by arrangement with the Fund, and exploratory discussions on the subject had taken place. However, the present imbalances in the economy were so severe that they required drastic policy actions far beyond those that the authorities were presently contemplating. It was true that there had been an impressive recovery in exports in 1982, but it had been from a very low base, and it had been accounted for mainly by one product--the export of shrimp undertaken with the help of Japanese private investment. A more forceful trend in the recovery of exports was required.

About 25 percent of total credit expansion had been accounted for by the need to finance the budget deficit, the staff representative continued. That factor had been an element in the excessive growth in the monetary aggregates, which had contributed to inflation. Other factors had also played a part, such as the expansion of credit to the state enterprises in excess of their requirements. The latter development could possibly be attributed to the fact that, until recently, credit control had been undertaken primarily by the State Planning Commission, which had provided credit to the enterprises on the basis of the Plan. At present, however, the Bank of Viet Nam had a more independent role, and it had been empowered to recall credit if it was granted for excessive inventory building or for projects that did not materialize. The staff had endorsed that change, and it had strongly urged the authorities to continue pursuing those more selective credit policies.

With regard to the exchange rate, the staff representative from the Asian Department noted, the Vietnamese authorities were in broad agreement that the rate was overvalued at present. On the question of the economic data base, Viet Nam had recently requested Fund technical assistance in supplying statistics for IFS, and a staff representative from the Bureau of Statistics would shortly be undertaking a mission to assist the authorities in that regard.

Mr. Ismael, commenting on the question of the exchange rate raised by Mr. Prowse, remarked that in Viet Nam exports and imports were undertaken on the basis of the national plan. As the staff noted on page 42 of SM/83/138, an import plan and an export plan were drawn up annually in accordance with the overall annual plan and with the quotas agreed upon under bilateral trade arrangements. In principle, import and export transactions were carried out by about 20 central import-export corporations and 12 local corporations. As noted on page 14 of the same report, producer prices were centrally determined and they had been increased by between 400 percent and 600 percent in 1981; there was no direct relationship between the exchange rate and producer prices. In such circumstances, it was doubtful whether an exchange rate action would produce the desired results. A more useful approach might be for the authorities to address possible deficiencies in the import and export plans.

The Acting Chairman then made the following summing up:

Executive Directors noted that the lack of viability of the balance of payments, the high inflation rate, and the high debt burden dictated prompt and substantial corrective measures on all policy fronts. Directors welcomed present policies for further decentralization of economic management and greater flexibility in the determination of prices and wages.

Directors observed that despite the recent introduction of higher taxes there had been a sharp deterioration in the budgetary position in 1982 which had contributed to the continuation of a high rate of inflation. A substantial reduction in the budget deficit was urgent, through better control of the growth of current expenditures, including consumer subsidies, and a further mobilization of resoures. Additional fiscal measures should comprise more flexible pricing policies, including the introduction of scarcity prices for imported commodities. More selective credit policies and further increases in interest rates could contribute to the abatement of inflationary pressures and to a more efficient allocation of scarce capital resources.

Directors commented that, with the introduction of greater flexibility in the determination of domestic prices, the expansion of export- and import-competing sectors crucially depended on adequate incentives to producers and on the removal of bottlenecks in foreign trade. In view of the urgent need to improve the balance of payments, most Directors urged that the dong should be set at a more realistic level, and that in the future the exchange rate should be determined in the light of domestic and foreign price developments. The importance of the early elimination of payments arrears in order to restore confidence was stressed.

Directors also urged the Vietnamese authorities to improve the statistical base for the formulation and implementation of economic policy.

It is expected that the next Article IV consultation with Viet Nam will be held on the standard 12-month cycle.

The Executive Directors then took the following decision:

Decision Concluding 1983 Article XIV Consultation

1. The Fund takes this decision relating to the Socialist Republic of Viet Nam's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1983 Article XIV consultation tion with the Socialist Republic of Viet Nam, in the light of the 1983 Article IV consultation with the Socialist Republic of Viet Nam conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Viet Nam maintains restrictions on payments and transfers for current international transactions and multiple currency practices as described in SM/83/123 and SM/83/138. The Fund encourages Viet Nam to undertake measures to strengthen the balance of payments and thereby permit the restrictions and multiple currency practices, including the bilateral payments arrangements with Fund members, to be eliminated as soon as possible.

Decision No. 7459-(83/98), adopted
July 6, 1983

2. OMAN - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with Oman (SM/83/122, 6/9/83). They also had before them a report on recent economic developments in Oman (SM/83/132, 6/21/83).

The staff representative from the Middle Eastern Department stated that the staff had been informed by the authorities that the budget measures equivalent to 2 percent of GDP, referred to on page 6 of SM/83/122, had been approved. The staff had also requested the authorities to provide information on the timing of the implementation of the measures.

Mr. Finaish made the following statement:

The Omani authorities are in broad agreement with the staff's assessment of the performance of the Omani economy in 1982 and the prospects for 1983.

Despite adverse conditions in the international oil market in 1982, economic activity in Oman continued to expand at a brisk pace manifested by about 15 percent growth rate in real non-oil GDP. At the same time, however, liquidity expansion slowed down considerably and inflation is estimated to have dropped to well under 5 percent from a level of 10-15 percent in 1981. Moreover, the balance of payments continued to show a surplus, though it was smaller than those recorded in the previous two years.

Prior to 1982, the rapid increase in oil revenue permitted an accelerated growth rate in public expenditures which averaged 30 percent annually between 1979 and 1981. Despite the rapid increase in public spending, relatively large surpluses were recorded. Most of these surpluses were assigned to a State Reserve Fund that was established in 1980 to finance budget deficits that might emerge in the future, while maintaining development spending at planned levels. The annual allocations to the Reserve Fund were targeted at 15 percent of oil receipts.

The drop in oil revenue in 1982 had, by and large, been anticipated by the authorities and the actual revenues and outlays were closely similar to those estimated in the 1982 budget. On the revenue side, a 6 percent drop in oil receipts was coupled with a significant decrease in grants. On the expenditure side, current outlays increased by 13 percent compared to 26 percent in 1981, while capital outlays maintained a growth rate of about 25 percent. A deficit amounting to about 9 percent of GDP was recorded. This deficit, which was somewhat lower than anticipated in the budget, was largely financed by drawing on government foreign reserves. It should be noted, however, that if receipts assigned to the Reserve Fund were included in the calculation, the total budget balance would yield a surplus equal to 1.3 percent of GDP.

After the issuance of the 1983 budget, in which revenues were estimated on the basis of an average daily crude oil production of 360,000 barrels and a per barrel price of $34, the situation had to be reviewed further due to subsequent developments in the international oil market. Since the policy of the Government has been to try to maintain budget outlays and, in particular, capital expenditures, at the planned levels, a number of measures have recently been approved by the authorities. These include: (a) raising oil output to 380,000 barrels per day from the original target of 360,000 barrels per day; (b) increasing non-oil domestic revenue from carefully selected sources so as to ensure that lower income groups were not adversely affected; and (c) reducing expenditures by delaying the implementation of certain low-priority projects as well as introducing stricter cotrols to ensure that ministries and government agencies adhered to budgeted allocations. These measures are expected to keep the total budget deficit at less than 5 percent of GDP in 1983. The authorities intend to finance that deficit mainly through foreign borrowing and an early utilization of Reserve Fund resources. It is also worth noting that Oman has no consumer subsidies on items such as water and petroleum products. The domestic prices of these products, including gasoline, have been maintained at levels comparable to international prices.

Oman is currently at the midpoint of its Second Five-Year Plan whose main objectives include diversification of the economy's base, further improvements in physical and social infrastructure, and expansion of the role of the private sector. Total investments under the Plan are estimated at $9.6 billion of which 65 percent is to be undertaken by the public sector. In order to promote the participation of the private sector in the development process the authorities have offered various incentives including low-interest loans and some grants. However, these capital subsidies, which are generally meant for small investors, are viewed by the authorities as transitory in nature and might be eliminated after the current Plan. More importantly,

the pace of realization of the financial and physical targets of the Plan in 1982 has been quite satisfactory and no major bottlenecks have been experienced. This was helped by a liberal policy toward expatriate workers who constituted close to 65 percent of the labor force in 1982. At the same time, progress continued to be made in upgrading the skills of Omani workers through educational and training programs which constitute an integral part of the Development Plan. As for the impact of recent oil market developments, it is the view of the authorities that those developments do not require any basic readjustments of Plan priorities and that the fiscal measures referred to earlier will facilitate the implementation of the Plan during 1983-85. The authorities are aware, however, that policy decisions, particularly over the medium term, should be approached cautiously and that adjustments may need to be made as circumstances require.

In the monetary area, the Central Bank's policy in 1982 continued to be one of promoting sound commercial banking practices. A previous guideline limiting foreign currency exposure for each bank to 40 percent of its capital and reserves was made mandatory. Furthermore, the minimum paid-in capital that banks were required to maintain was doubled and specialized banks were requested to report on their activities on a regular basis. Interest rate policy in 1982 continued to be implemented on the basis of ceilings on lending and deposit rates of 11.5 percent and 9.5 percent, respectively. It is the view of the authorities that these ceilings have served a useful purpose in providing credit at a reasonable cost in order to encourage private sector participation in the development process. However, with the decline in international interest rates, that policy has come under review and serious consideration is being given to the removal of those ceilings. This would also be in line with the general policy toward subsidies that the Omani authorities have implemented for some time.

In the external sector, oil market developments and the slowdown in government spending in 1982 were clearly reflected in the balance of payments. Oil exports fell by 8 percent, while the rate of growth of imports dropped to 16 percent, which was half of the rate in 1981. Although the current account remained in surplus, the size of that surplus dropped from 18 percent of GDP in 1981 to 4 percent in 1982. The reduction in the overall surplus was less sharp due mainly to private capital inflows. Projections for 1983 indicate a significant current account deficit and a small overall surplus.

Oman continues to adhere to a liberal exchange and trade system. The exchange regime and the rate of the Omani rial are kept under periodic review by the authorities in light of Oman's external position and developments in international exchange rates.

Mr. Suraisry remarked that he was in general agreement with the staff appraisal. It was clear that the economy had adjusted well to the recent weakness in the oil market. The authorities had taken timely and appropriate action to minimize the impact of that development, and he complimented them on the results that they had achieved.

In response to the absolute decline in government revenues and external grants in 1982, Mr. Suraisry continued, the authorities had taken certain measures to contain the growth of total outlays. The staff had suggested that the authorities might find it necessary to increase domestic outlays over their 1983 target level in order to maintain growth at 1982 levels. While there might be scope for increasing government spending, there were good reasons for supporting the authorities' cautious approach, particularly since the economy was oil based, and since the picture for the oil markets remained unclear. Capital outlays for 1983 had not been cut back. Therefore, the effects of the reduction in the growth rate of current outlays on economic activity might not be as great as they would appear, and they should be short term.

The oil sector had been strengthened by two important projects, Mr. Suraisry observed, namely, the establishment of the country's first oil refinery and a program to use associated gas to maintain oil field pressure. Those projects would not only strengthen the sector; they would increase its efficiency, and the benefits would work through to the rest of the economy. As the authorities recognized, there was also good potential for developing the fisheries sector. Recent actions, including the establishment of a bank for agriculture and fisheries, would increase the contribution of that sector to GDP and they would help the process of diversification. The authorities should also be congratulated for following a liberal trade system. Finally, given the record of sound management and the size of Oman's economy, it might be more appropriate to hold the next Article IV consultation with Oman on an 18-month cycle, rather than the standard 12-month cycle.

Mr. Prowse said that he agreed with the staff and with Mr. Finaish that the Omani authorities' policy response to the lower level of oil revenues had been broadly appropriate. Indeed, policy responses over the medium term, both with regard to the increase in oil income and its subsequent decline, had been appropriate. In particular, the authorities should be congratulated for having consistently sought to limit explicit and implicit subsidization in the economy.

The example of Oman raised an interesting issue, relevant to other oil producers and to commodity producers relying heavily on a single, limited exported base, Mr. Prowse commented. The staff stated on page 9 of SM/83/122:

> Although no large recovery in oil revenue is now anticipated ...the authorities intend to maintain essentially unchanged their growth and development objectives. The rate of increase in investment expenditures is to be broadly sustained, while the growth of

> current spending is to be further reduced in order to contain the budget deficit. The staff agrees with the authorities' assessment that the financing of a budget deficit this year and the projected further weakening in the external position are not of immediate concern....

The staff was being somewhat ambiguous about the central issue of what the Omani authorities should have done in the face of declining revenues. The authorities had responded by maintaining investment expenditures in order to diversify the productive base and exports, but they had also allowed the budget deficit to increase to 5 percent of GDP, and they had proposed to finance it by running down their reserves and by undertaking external borrowing for the first time.

Such an approach appeared appropriate, Mr. Prowse considered, but it was unclear whether the staff was suggesting that the deficit ought to be larger and that the external borrowing ought to be higher. In its appraisal, the staff went on to say:

> The authorities, therefore, need to consider whether to undertake budget and financing measures which are compatible with the growth target for this year or to accept a somewhat lower level of economic activity. Whether an expansionary budget policy over the medium term is sustainable will need to be reviewed...Reserve Fund resources will be utilized, but the possibility of foreign commercial borrowing, if the need arises, has not been ruled out.

On page 6 of the same paper, the staff stated:

> ...The authorities might need to consider the relative importance of a reasonable increase in net domestic expenditures over the budgeted level to help maintain economic growth against the risk of a lower growth rate. Although the former might entail a somewhat larger budget deficit and greater use of external resources, there was scope for increasing domestic outlays without endangering financial stability. The authorities are aware that pursuing such a policy mix over the medium term would need to be approached cautiously.

If the staff was suggesting that the budget could be more expansionary and that it could be financed to a greater extent by commercial borrowing in external markets, greater evidence was needed for such a proposition. A budget deficit of 5 percent of GDP was sufficiently expansionary for the short term, and commercial borrowing should only be urged on a country with great caution. Finally, he agreed with Mr. Suraisry that Oman could appropriately be placed on an 18-month cycle for the next Article IV consultation.

Mr. Shaw stated that he agreed with Mr. Suraisry's suggestion for the consultation cycle.

Mr. Lindå said that he also agreed with the suggestion.

The staff representative from the Middle Eastern Department commented that the Omani authorities were committed to maintaining the pace of both development and growth of the economy. In that regard, they intended to maintain the growth of development expenditures in 1983, but they had cut back current expenditures. The staff had undertaken a financial programing exercise in cooperation with the authorities to assess the implications of the policy being pursued. The outcome of that exercise had suggested that the level of net domestic expenditures being envisioned might not be sufficiently high to maintain the growth rate that the authorities hoped to achieve in 1983. Net domestic expenditure by the Government was the primary stimulating force for the private sector in Oman. The staff had, therefore, pointed out to the authorities that they might need to increase net domestic expenditures or, alternatively, to accept a lower growth rate. The external loan arranged by the authorities should be regarded as a precautionary line of credit.

Mr. Finaish remarked that the point raised by Mr. Prowse was also relevant to other oil countries, given the recent changes in the oil situation. The staff had stated that there was scope for increased expenditure without endangering financial stability, and it did not seem convinced that the projected level of government spending in 1983 would be sufficient to maintain the rate of economic growth. To some extent, it was a question of judgment. The authorities were aware that there was a risk of lower growth, but at the same time they wished to proceed with caution in the face of possibly larger budget deficits and the greater use of external resources. Beyond 1983, caution was warranted in light of the uncertainty in the oil situation and the implications of that factor for the balance of payments and the budget. The authorities intended to keep all those questions under review.

The Omani authorities had established a Reserve Fund, Mr. Finaish noted, to accumulate reserves so that the development effort could be maintained for future generations. The regulations governing the Reserve Fund's use meant that it was not readily available and that it should only be used in cases of particular need. The commercial borrowing that Oman was undertaking was relatively small; one purpose of such borrowing was perhaps to establish a rating in the private market at a time when Oman's debt service ratio was low.

Commenting on the question of the frequency of the Article IV consultations, Mr. Finaish said that he acknowledged the point made by Directors that a 12-month cycle of consultations might not be necessary for small countries that had no pressing economic problems and that were not users of Fund resources.

The Acting Chairman then made the following summing up:

Executive Directors agreed with the staff appraisal and commended the Omani authorities on their policy response to the weakening of the international oil market. They noted that, despite the slower growth of oil revenues, the authorities intended to implement the planned increases in capital outlays in order to sustain the pace of development, economic diversification and growth.

To reconcile that objective with petroleum revenue developments, the authorities had taken measures to curtail sharply the growth of current spending and increase domestic tax revenue. Directors observed that the firm budgetary and demand management stance had resulted in a marked slowing in the growth of domestic liquidity, and that the rate of inflation had dropped to a low level. They agreed with the authorities' assessment that the emergence of the anticipated budget deficit in 1983 and a weakening of the balance of payments were not causes for immediate concern, given the strong reserve position. They observed, however, that the authorities would need to be cautious in implementing expansionary policies over the medium term. Directors welcomed the authorities' careful approach to subsidization in the economy, the continuation of liberal external policies, and the prudent approach to external borrowing.

Directors suggested that the next Article IV consultation with Oman be held on an 18-month cycle.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/97 (7/1/83) and EBM/83/98 (7/6/83).

3. SALARY OF DEPUTY MANAGING DIRECTOR

The proposal regarding the salary of the Deputy Managing Director set forth in EBAP/83/170, 6/29/83 is approved.

Adopted July 1, 1983

4. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 83/19 and 83/20 are approved. (EBD/83/179, 6/27/83)

Adopted July 1, 1983

5. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/83/172 (7/1/83) is approved.

6. STAFF TRAVEL

Travel by the Managing Director as set forth in EBAP/83/175 (7/5/83) is approved.

APPROVED: December 7, 1983

LEO VAN HOUTVEN
Secretary