

FOR
AGENDA

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INFORMATION

June 17, 1982

To: Members of the Executive Board

From: The Secretary

Subject: Yemen Arab Republic - Staff Report for the 1982 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1982 Article IV consultation with the Yemen Arab Republic. A draft decision appears on page 12.

This subject will be brought to the agenda for discussion on a date to be announced.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

YEMEN ARAB REPUBLIC

Staff Report for the 1982 Article IV Consultation

Prepared by the Staff Representatives for the
1982 Consultation with the Yemen Arab Republic

Approved by A K El Selehdar and Subimal Mookerjee

June 16, 1982

I Introduction

The 1982 Article IV consultation discussions with the Yemen Arab Republic (Y A R) were held in Sana'a during the period May 2-6, 1982. The Y A R representatives included the Deputy Prime Minister for Economic Affairs, the Ministers of Finance, Development, Economy and Industry, Agriculture, and Electricity and Water, and the Governor of the Central Bank, as well as other senior officials. The staff mission comprised Messrs G T Abed (Head), R K Basanti, J E Blalock, S Geadah, A Salman, and Mrs A L Yates (Secretary), all of MED. The discussions were also attended by the four experts assigned to the Y A R under the technical assistance programs of the Fiscal Affairs and Central Banking Departments. The Y A R continues to avail itself of the transitional arrangements of Article XIV of the Articles of Agreement.

II Background

The year 1981 marked the completion of the Y A R 's First Five-Year Development Plan (FFYP) ^{1/}. This Plan continued a process of modernization of the economy that was begun in the early 1970s. During this period, the Y A R 's domestic resources were augmented by very substantial inflows of workers' remittances and foreign aid from bilateral and multilateral sources. The availability of these external resources permitted consumption and investment to grow rapidly and, at the same time, allowed for an increase in official reserves. Starting from a very underdeveloped state, basic services and infrastructure were established, social and economic institutions were set up, and the economy was diversified from a narrow agricultural base. These structural changes were carried out within the framework of a free and open economy.

During the FFYP period real economic growth averaged almost 6 per cent per annum. The growth of the dominant agricultural sector was sluggish, averaging only 1 per cent per annum, mainly because of the

^{1/} The Plan was originally intended to cover the period 1976/77-1980/81 (fiscal year ended June 30), it was later extended to the end of calendar 1981.

emigration of farm labor to urban centers and neighboring countries, unfavorable weather conditions, and the expansion of the area planted to qat. ^{1/} On the other hand, the manufacturing, electricity and water, construction, financial, and government services sectors all achieved growth rates in excess of 10 per cent per annum. Gross fixed investment rose from 17 per cent of GDP in 1975/76 to 43 per cent in 1980/81, and consumption expenditure also increased as a proportion of GDP. Reflecting the growing reliance on foreign resources, by the end of the Plan period total spending exceeded GDP by some two thirds. In the last 18 months of the FFYP the overall growth rate declined to 3-4 per cent per annum. This slowdown appears to have resulted mainly from a falloff in remittances, which particularly affected the construction, trade, and other services sectors.

The Y A R 's balance of payments showed considerable strength in the early part of the FFYP period, largely reflecting the rapid growth in remittances from Yemenis working abroad (principally in Saudi Arabia). A current account surplus was recorded until 1978/79, and an overall surplus until 1979/80. However, as remittance inflows ebbed the balance of payments swung into deficit. The leveling off and subsequent decline in remittances were the result mainly of a reduction in Yemeni emigration caused by narrow wage differentials and by increased competition for jobs in the oil producing countries. ^{2/} Imports, on the other hand, rose sharply during the first part of the Plan period and remained at a high level. In 1981 the current account deficit was US\$664 million (23 per cent of GDP) and the overall deficit was US\$331 million (11 per cent of GDP). Reserves, which had reached a peak of US\$1,613 million in March 1979, declined to US\$804 million in November 1981 before rising, mainly as a result of external assistance, to US\$967 million at the end of the year (equivalent to about seven months of imports at the 1981 level). Although the external debt servicing burden remained moderate by international standards, by 1981 debt service payments required 5 per cent of current account receipts, compared with less than 1 per cent at the beginning of the FFYP period.

As regards the public finances, government expenditures rose sharply during the FFYP period, as institutional and supply bottlenecks which had constrained spending in the early part of the 1970s were relieved. Capital expenditures relative to GDP in 1981 were four times their level in 1975/76, and there was also a doubling of current outlays relative to GDP. Government revenues increased rapidly in the first two years of the Plan, as import growth boosted the collection of import duties (the most important source of tax receipts), and in 1978/79 sizable external grants were received. Nonetheless, after a number of years of surpluses a small

^{1/} Qat is a plant widely consumed in the Y A R whose leaves act as a mild stimulant when chewed, its cultivation is not adequately accounted for in the agricultural production statistics.

^{2/} Recorded remittances have also been affected by the increasing tendency for workers to remit their earnings through money changers or in the form of imports brought overland (in both cases the inflows may not be caught in the balance of payments).

overall deficit emerged in 1977/78. This deficit expanded considerably in subsequent years, reflecting a slowdown in revenue growth in face of the continued increase in expenditures, and was held to YRls 2.3 billion (17 per cent of GDP) in 1981 mainly as a result of the receipt of large grants from abroad. 1/ The Government was able to improve its position with the banking system through 1977/78, but in view of the size of the overall deficit, external financing was not sufficient to prevent the bank-financed deficit from rising to YRls 2.0 billion (16 per cent of GDP) in 1981.

Monetary developments during the FFYP period mirrored the evolving fiscal and balance of payments positions discussed above. The sharp increases in net foreign assets were the primary impetus to domestic liquidity expansion in 1976/77 and 1977/78, as the Government added to its net deposits with the banking system. Beginning in 1978/79, however, the impact of external transactions became less expansionary and in 1979/80 it turned contractionary for the first time in a number of years. At the same time, the Government's role shifted from being a net depositor to being a substantial net borrower from the banking system. Mainly because of the countervailing effects of the external and government sectors there was a steady decline in the growth rate of domestic liquidity (money and quasi-money) from 74 per cent in 1976/77 to 8 per cent in 1981. The rate of inflation, as measured by the retail price index, also decreased from 26 per cent in 1976/77 to about 5 per cent per annum in 1980 and 1981. The easing of inflationary pressures in the latter part of the Plan period was also affected by the slowdown in economic activity, the improved balance between supply and demand for labor, and the appreciation of the Yemen rial.

The Y.A.R. continues to pursue liberal trade policies and does not maintain any restrictions on the making of payments or transfers for current or capital international transactions. Since February 1973 the Yemen rial has been pegged to the U.S. dollar at the rate of US\$1 = YRls 4.50. In the period from December 1980 to March 1982 the import-weighted exchange rate of the rial appreciated by 15 per cent.

III Report on the Discussions

The consultation discussions were held immediately following the Yemen Second International Development Conference which was convened by the authorities to elicit international input and support for the Y.A.R.'s Second Five-Year Development Plan (SFYP). 2/ The discussions focused on

1/ The large statistical adjustment item in 1981 (and also in some earlier years, see "Basic Data," Appendix II) means that the overall deficit may actually have been much larger. The authorities are currently reviewing the fiscal data in an attempt to improve their classification and reduce the size of the statistical discrepancy.

2/ The SFYP covers the period 1982-86, but was intentionally left in draft form in order to incorporate the views of Conference participants and foreign donor countries and organizations. The Plan is now being finalized.

the macroeconomic aspects of the SFYP, and in particular on its financial and monetary implications. In a broader context, the discussions dealt with the causes of the recent weakening in the fiscal and balance of payments positions and sought to identify the critical areas in which policy actions would be required to create a stable financial environment in which development objectives could be pursued in 1982 and beyond.

1. Output and investment policies

The SFYP aims at a real growth rate of 7 per cent per annum. The commodity-producing sectors are projected to enlarge their overall share of GDP, with annual growth rates of 4.8 per cent in agriculture, 14.5 per cent in manufacturing, and 25.0 per cent in the electricity and water sector. Total investment is set at YRLs 29.3 billion, ^{1/} which is 45 per cent more than was invested during the FFYP, and a substantially larger proportion is allocated to the commodity-producing sectors (40 per cent compared with 24 per cent under the First Plan). The Second Plan calls for a reduction in the ratio of consumption to GDP, from 120 per cent in 1982 to 110 per cent in 1986, as well as for substantial increases in government and private sector savings. Reliance on foreign resources is expected to remain high, but will decline relative to GDP from 61 per cent in 1982 to 44 per cent in 1986.

As regards the agricultural sector, the projected growth rate of 4.8 per cent per annum contrasts sharply with the 1 per cent growth rate achieved during the FFYP. The area under agricultural production has decreased significantly in recent years, in particular the area planted to cereals and cotton, and the growth rate of output has fallen well below the population growth rate. As a result, the Y A R has become increasingly dependent on food imports, during the decade of the 1970s such imports expanded in value terms by no less than 45 per cent per annum. Putting these developments into perspective, the Y A R representatives noted that historically there had been an oversupply of labor in the rural areas so that in spite of the recent substantial emigration there was no real shortage of agricultural labor. However, rural wages had risen causing marginal lands to be withdrawn from production and inducing a shift in the composition of output toward more remunerative products such as fruits and vegetables. The Y A R representatives stated that while the area planted to qat had increased, this was not a major factor behind the slow growth in the output of other crops.

The Y A R representatives recognized that the agricultural production target in the SFYP was ambitious, but regarded it as feasible in light of the strong recovery of output in the last two years. They emphasized that a greater share of investment would be directed toward agriculture than under the FFYP, and that priority would be given to improving the productivity of existing farmland. In addition, farmers would be encouraged to adopt modern production techniques through upgrading agricultural

^{1/} This figure is in constant 1981 prices, in current prices both the amount of investment and the increase over the FFYP would be higher.

research and extension services and through expanding the availability of low-cost production credit. Apart from providing farmers with low-cost credit and improved seed varieties, and distributing fertilizer on a cost-plus basis, the Government would maintain its policy of nonintervention in the pricing of agricultural inputs and outputs.

The industrial sector achieved a growth rate of almost 12 per cent per annum during the FFYP, and by 1981 it accounted for 6 per cent of GDP. In the SFYP period this sector is projected to expand by 14.5 per cent per annum. A noteworthy development has been the increase in private sector investment in industry, encouraged by, inter alia, Public Investment Law No. 18 of 1975 which provides for exemptions from import duties on capital goods and some raw materials, income tax holidays, and complete freedom of profit repatriation. This law has stimulated foreign as well as domestic investment in the Y.A.R., especially from neighboring oil producing countries.

Despite the progress that has been made, a number of problems continue to hamper the Y.A.R.'s industrial development. Labor costs have risen sharply in recent years, rendering local production less competitive with imports, and at the same time the exchange rate has remained unchanged (more recently, the rial has appreciated against the currencies of most trading partners). Moreover, the extensive smuggling denies many domestic industries the benefit of tariff protection. The relatively small size of the local market is another constraint, as is the shortage of entrepreneurial and professional skills. The Y.A.R. representatives indicated that they were mindful of these difficulties and that policies were under consideration for dealing with them.

In the Second Plan period, the intention is to expand into some heavier industries such as cement, iron bars, marble quarrying, and building materials. However, even in these more basic industries, the Y.A.R. representatives stressed, the involvement of the private sector would be encouraged and no subsidies would be granted. As regards specific projects included in the SFYP, the Y.A.R. representatives indicated that project selection criteria emphasized (1) the utilization of existing productive capacity, (2) import substitution, (3) exploiting national resource endowments, and (4) attracting foreign and private sector investors. Recent measures taken to promote industrial development included (i) strengthening the Industrial Bank of Yemen, (ii) establishing industrial estates in the three main cities of Sana'a, Taiz, and Hodeidah, and (iii) entering into several bilateral and regional agreements guaranteeing foreign investments against arbitrary action.

Concerning other sectors of the economy, the Y.A.R. representatives said that the recession that had characterized most of the preceding two years appeared to have ended about the beginning of 1982, and that activity had been picking up since then as evidenced by the recent growth in imports and in credit to the private sector. They anticipated that this upturn would continue for the remainder of 1982, providing a strong start for the SFYP.

2 Fiscal policies

Concerning the fiscal aspects of the SFYP, no major tax initiatives are assumed, but the authorities expect government current revenues to rise in real terms by 10.5 per cent per annum, reaching 32 per cent of GDP in 1986 (compared with 25 per cent of GDP in 1981). Current expenditures, on the other hand, are estimated to increase by 7.5 per cent per annum in real terms. Even if these favorable assumptions were to be realized, however, the overall deficit would still be substantial and would require markedly higher levels of foreign financing and/or excessive recourse to domestic bank borrowing. The Y.A.R. representatives and the mission agreed that in view of the deterioration in the public finances that had occurred during the latter half of the FFYP, and of the current less satisfactory level of international reserves, high priority needed to be given to the mobilization of domestic resources for the SFYP by noninflationary means. Two other potential problems were that the availability of foreign financing, in the current international economic environment, might be less than hoped for, and that even if ample foreign financing were to be forthcoming, shortages of counterpart domestic resources might lead to the emergence of inflationary strains. The authorities assured the mission that they intended to implement the investment program flexibly, amending it as necessary to ensure that stable financial conditions are maintained.

In any event, the SFYP commences at a time when fiscal performance has shown a distinctly weakening trend. In the 18 months from 1979/80 to 1981 total revenues grew by 19 per cent, while total expenditures increased by 41 per cent. The Y.A.R. representatives explained that the rapid rise in government expenditures in recent years had been necessitated by political considerations and by the need to provide basic facilities and services, especially in the rural areas connected by the expanding transportation and communication networks. At the same time, problems of exercising effective administrative control over outlying regions had tended to hold down revenue growth. With the more extensive infrastructure and improved administrative capacity, the authorities hoped to achieve a significant improvement in fiscal performance during the SFYP. In order to reduce the need for borrowing from the Central Bank, the authorities are considering a scheme to sell government bonds to the commercial banks to absorb their excess reserves. In addition to providing finance for the development, this scheme would have the advantage of contributing to the development of the domestic financial market.

Tentative projections of the likely fiscal outturn for 1982 indicated a 42 per cent increase in the overall deficit to YRLs 3.2 billion (22 per cent of estimated GDP) and stabilization of the domestic bank-financed deficit at about YRLs 2.0 billion (14 per cent of estimated GDP). Although the bank-financed deficit would decline relative to GDP, it remains too large in both absolute and relative terms. Moreover, these estimates are at variance with the more optimistic assumptions of the SFYP, thus indicating the need for prompt policy adjustment in the direction of improving fiscal performance or revising the Plan investment targets, if potentially destabilizing pressures on resources are to be avoided.

Revenues and grants were estimated to increase by 11 per cent to YRls 5.35 billion (37 per cent of projected GDP, equivalent to 1981), with the expected rise in revenues mainly a result of various changes in collection methods. A simplified income tax collection procedure introduced early in 1981, the regularization of tax payments by the Yemen Oil and Mineral Resources Corporation, improvements in procedures for collecting the annual fee for deferment of military service, and the extension of the income tax to salaries of members of the armed forces. Certain changes in the real estate transfer tax resulted in a more than doubling of receipts in the first quarter of 1982, compared with the same period of the preceding year, although this is unlikely to have a significant effect on the overall fiscal outcome. Other measures under consideration for implementation in 1982 are a revision of wage and salary tax rates, reform of the stamp tax and the motor vehicle tax, and reorganization of the Tax Department of the Ministry of Finance. The mission suggested that should excise tax collections on qat from the recently established urban central markets prove disappointing, consideration be given to the possibility of a land-based tax on qat cultivation. External grants were assumed to remain at the relatively high level of YRls 1.5 billion received in 1981.

Total expenditures were forecast to increase by 21 per cent to YRls 8.55 billion (59 per cent of estimated GDP, compared with 55 per cent in 1981), of which investment spending would be YRls 4.45 billion. Current outlays were expected to rise by 26 per cent partly as the result of a 15-20 per cent wage and salary adjustment. The mission noted the continued rapid growth in current expenditures and the high level of total outlays relative to GDP. The authorities indicated that they were aware of these trends, and that they would be taken into consideration in formulating expenditure policy in the coming period.

3 Monetary policies

Monetary developments in the past three years have been determined by the largely offsetting effects of expansionary fiscal policies and a widening balance of payments deficit. A substantial reduction has occurred in the rate of monetary growth, although there was some acceleration in the first quarter of 1982. The domestic inflation rate has also subsided. The Y.A.R. representatives stated that it was their intention during the SFYP to maintain the growth rate of domestic liquidity at a level which is consistent with domestic and external financial stability.

There was almost no growth in credit to the private sector in 1981, which the Y.A.R. representatives said was the result of several factors including a reduction in private sector imports caused by the less buoyant economic conditions in the Y.A.R. and abroad, more restrained lending practices on the part of foreign branch banks, the increasing proportion of imports (mainly those transported over land routes) financed outside the banking system, and the high level of interest rates. In the first quarter of 1982, on the other hand, private sector credit rebounded sharply reflecting the lowering of interest rates in December 1981, optimism engendered by the initiation of the SFYP, and the increased level of private sector imports.

In the current international economic environment the Y A R authorities have opted for a flexible interest rate policy, and a number of interest rate adjustments have been made in the last two years. The most recent change took effect on December 1, 1981 and entailed decreases in both lending and deposit rates of 1-2 percentage points. The maximum lending rate for commercial banks is now 15 per cent, and minimum deposit rates range from 9½-12 per cent. In another recent policy move, time deposits with a maturity of nine months or more were exempted from the cash reserve requirement and those with a maturity of one year or more were exempted from both the cash and the statutory reserve requirements. The Y A R representatives explained that these policy initiatives had been undertaken in light of the decline in Eurocurrency interest rates, in order to encourage private sector activity and to remove the anomaly in the interest rate/reserve requirement structure whereby banks had been discouraged from accepting longer-term deposits. In recent months the commercial banks have built up excess liquidity, and the authorities are considering selling government bonds to the banks and/or paying interest on the banks' deposits with the Central Bank. The mission noted that the bond proposal had several advantages in addition to providing an interest-earning asset for the banks, and agreed that the payment of interest on the banks' deposits with the Central Bank might also be appropriate as a temporary measure.

Concerning the growth of the informal money and credit market, the mission pointed out that this made it more difficult to manage the monetary and financial system. The Y A R representatives agreed, and said that a commission had recently been set up to make a preliminary study of the operations of the money changers and remittance agents, and to propose appropriate regulations to bring these operations under the supervision of the Central Bank. At present, the only requirement is that money changers and remittance agents be licensed by the Central Bank. The intention of the authorities is not to interfere with the financial operations of these individuals, but rather simply to ensure that these operations are consistent with existing banking legislation and policies.

External sector policies

While the deterioration in the balance of payments that occurred during the FYYP period partly reflected the country's improved capacity to import imports and the utilization of foreign financial assets to create domestic real assets and raise living standards, it also resulted from a slowdown in external receipts. Given the current less satisfactory level of reserves, payments developments will have to be monitored more closely under the Second Plan. The situation is complicated by the uncertainties associated with some of the major sources of external receipts and by the very large foreign component of the development effort.

The balance of payments assumptions of the SFYR appear optimistic. Imports are estimated to increase by only 1 per cent per annum in real terms, while the surplus on services and transfers account is projected to rise from US\$975 million in 1982 to about US\$1,200 million in 1986.

As a result, the current account deficit will decline steadily and with the anticipated sustained net inflow of foreign capital, this improvement will carry through to the overall balance where surpluses are envisaged beginning in 1985. The import projection, which may be the most difficult of achievement, is predicated on a restructuring of the composition of imports. The share of consumption goods, which was 50 per cent in 1981, is expected to fall to 40 per cent by 1986, whereas the share of intermediate and investment goods is forecast to rise from 50 per cent to 60 per cent over the same period. The mission noted that substantial increases in import duties on consumption goods would probably be required in order to bring about such a restructuring.

Tentative balance of payments projections for 1982 give an indication of the extent of the policy adjustments required for the achievement of the targets set out in the Plan. In these projections, imports are conservatively forecast to increase by 3 per cent to US\$1,800 million, and the surplus on services and transfers account is estimated at US\$1,070 million. Nonetheless, with the surplus on capital account expected to be US\$320 million, there remains an overall deficit of about US\$400 million (compared with the Plan estimate of US\$110 million). A financing requirement of US\$400 million would leave the Central Bank with only about US\$520 million of usable reserves at the end of the year, equivalent to approximately 3 months of imports at the projected 1982 level. The Y A R representatives considered that such a balance of payments outcome would be manageable, but felt that the resulting reserve level would be uncomfortably low and that appropriate policy actions needed to be taken. The mission suggested that these should take the form of measures to improve the fiscal balance, as the main impetus to the high level of private sector import demand was the continued injection of liquidity into the economy through the government budget, supplemented by measures to increase the international competitiveness of local production.

As regards the exchange rate, the Y A R representatives felt that the present peg to the U.S. dollar at the rate of US\$1 = YR1s 4.5 continued to serve their needs adequately, although in light of the recent effective appreciation of the rial, exchange rate policy would remain under active review. Concerning the management of their international reserves, they noted that their principal concerns were the preservation of capital value and the minimization of risk, with due consideration also being given to concerns of yield and liquidity. Their policy was to refrain from altering the composition of the existing portfolio in response to short-term interest rate or exchange rate factors, diversification was generally accomplished by means of new placements or net withdrawals of funds which were made on the basis of, inter alia, an assessment of the prospects for various currencies.

On the external debt, the mission noted that while the debt service ratio remained low compared with other developing countries, as the Y A R had been fortunate in obtaining relatively large amounts of concessional aid, it had risen sharply in the last year and needed careful watching especially given the substantial foreign borrowing assumed in the 3PYP.

The Y A R representatives said that a special debt control unit had been established in the Central Planning Organization to monitor the situation. They further reported that all of the external debt had been contracted for development purposes and was on concessional terms. It was essential for the country to continue to incur such debt, but they would refrain from contracting medium- or long-term debt on a commercial basis. They indicated that it might be possible to reschedule some repayments of outstanding debt if that became necessary in order to hold the debt service ratio to a manageable level.

IV Staff Appraisal

In the past decade the economy of the Y A R has recorded some impressive achievements. Supported by substantial inflows of workers' remittances and bilateral and multilateral aid, both consumption and investment have expanded rapidly. Efforts have been directed toward developing basic services and infrastructure, establishing social and economic institutions, and diversifying the economy from its traditional agricultural base. Progress in these areas accelerated during the FFYP, which terminated in 1981.

Among the successes of the FFYP was an average growth rate of real GDP of nearly 6 per cent per annum. Nonetheless, in the latter years of the Plan problems began to emerge which were of considerable concern to the authorities. In particular, as institutional and supply bottlenecks were relieved the growth rate of government expenditures outstripped that of revenues and external grants, and the fiscal position shifted from one of surplus to one of rising deficits. The financing of these deficits through borrowing from the Central Bank led to continuous injections of liquidity into the economy, which supported a high level of private sector import demand even as external receipts leveled off and then declined. As a result, the balance of payments also moved from a position of surplus to deficit, and the substantial reserves that had been built up in earlier years began to be depleted. Although the use of accumulated reserves to finance the Y A R's development is not necessarily to be objected to, the rate at which reserves have been drawn down is clearly unsustainable.

These adverse trends are particularly worrisome as they could pose a threat to the successful implementation of the SFYP (1982-86). The Plan's growth and investment targets can be achieved only if considerably greater efforts are made to mobilize domestic resources and to improve fiscal and balance of payments performance. Although the authorities recognize the importance of improved financial performance for the success of the Plan, there is an urgent need to formulate and implement the specific policy measures needed to bring about this result.

Economic reform measures must, first and foremost, focus on the fiscal structure and be of a type to help the authorities gain better control over expenditures and improve the administration of existing taxes. Collections of several important taxes, such as import duties, have recently failed to keep pace with the growth in their respective bases. In some cases, the elasticity of tax receipts could be increased by converting rates from a specific to an ad valorem basis. On the expenditure side, the importance of current expenditures to support and maintain the infrastructure and basic services that have been established in recent years should not be overlooked, and thus capital expenditures may need to be constrained if the growth of total expenditures is to be kept within appropriate limits. In any event, the size of the budget deficit in relation to GDP remains comparatively high and substantial measures, on the expenditure as well as revenue side, are required to reduce this ratio to a sustainable level. As regards the investment program, the authorities should remain flexible in its implementation. While an improvement in the fiscal outturn should help considerably in alleviating the pressure on the balance of payments, direct measures to reduce the payments imbalance may also be needed. The authorities indicated their intention to keep the payments situation under close review, in particular, the appropriateness of the present exchange rate arrangement.

The staff believes that policy measures of the type described above are the best way of achieving the stable domestic and external financial conditions needed to provide a foundation for the successful implementation of the SFYP. The staff agrees with the authorities' view that the imposition of quantitative restrictions or other restraints on current international payments or transfers would not solve the underlying balance of payments problem and could jeopardize the benefits that have accrued to the economy from the liberal exchange and trade system.

V. Proposed Decision

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

1 The Fund takes this decision in concluding the 1982 Article XIV consultation with the Yemen Arab Republic, in the light of the 1982 Article IV consultation with the Yemen Arab Republic conducted under Decision No 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies)

2 The Fund notes with satisfaction that the Yemen Arab Republic continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions

Yemen Arab Republic: Relations with the Fund

Date of membership	May 22, 1970
Status	Article XIV.
Quota	SDR 19.5 million.
Fund holdings of Yemen rials	As of May 31, 1982, Fund holdings of Yemen rials were SDR 19 50 million (100 per cent of quota).
SDR position	As of May 31, 1982, the Y.A.R.'s holdings were SDR 14.09 million (228.72 per cent of the net cumulative allocation of SDR 6 16 million)
Trust Fund	The Y A.R. was on the list of eligible countries, but did not satisfy the requirement of need
Direct distribution of profits from gold sales	SDR 1 58 million
Gold distribution	8,557 999 fine ounces
Exchange system	The Yemen rial is pegged to the U S dollar which is the intervention currency. In February 1973 the Central Bank rate was set at YRls 4 5 = US\$1, which has since been maintained. The representative rate established under the Fund's Rule 0-2 is US\$1 = YRls 4 5625, the average of the Central Bank's buying and selling rates
Technical assistance	Since 1970 the Fund has provided technical assistance through central banking and fiscal experts stationed in the Y A R. At present, the Central Bank of Yemen and the Ministry of Finance each have two experts assigned by the Fund. In addition, Fund staff participated in technical assistance missions on domestic resource mobilization (with the World Bank) in 1981 and on the macroeconomic impact of alternative fiscal policies in 1982

Last Article IV consultation

Discussions were held by the staff in Sana'a during June 6-10, 1981. The staff report (SM/81/165) was discussed by the Executive Board on September 9, 1981.

The Executive Board's decision (Decision No. 6947-(81/121)), adopted September 9, 1981 was as follows

1. The Fund takes this decision relating to the Yemen Arab Republic's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1981 Article XIV consultation with the Yemen Arab Republic, in the light of the 1981 Article IV consultation with the Yemen Arab Republic conducted under Decision No 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2 The Fund notes with satisfaction that the Yemen Arab Republic continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions.

Yemen Arab Republic: Basic Data

Area and population

Area	195,000 square kilometers
Resident population	6.6 million
Per capita GDP (1981)	YRls 2,025 (US\$450)

	<u>1978/79</u> <u>1/</u>	<u>1979/80</u> <u>1/</u>	<u>1981</u>	<u>Proj.</u> <u>1982</u>
	<u>(In millions of Yemen rials)</u>			
Production and prices				
GDP in current prices	10,166	11,919	12,949	
GDP in constant 1975/76 prices	5,988	6,318	6,635	
Percentage growth of real GDP	(6 6)	(5 5)	(5 0)	()
Percentage change in Sana'a retail price index	(21 8)	(10 6)	(4.9)	()
Public finances				
Total revenues and grants	3,525	3,214	4,799	5,350
Revenues	(2,175)	(2,763)	(3,283)	(3,850)
Grants	(1,351)	(451)	(1,516)	(1,500)
Total expenditures	4,465	5,024	7,061	8,550
Current expenditures	(1,847)	(2,531)	(3,253)	(4,100)
Capital expenditures	(2,618)	(2,492)	(3,807)	(4,450)
Overall deficit (-)	-940	-1,810	-2,262	-3,200
External financing	554	525	921	1,200
Domestic bank financing	381	1,808	2,023	2,000
Statistical adjustment	5	-523	-681	--
Deficit as a percentage of GDP	(9 2)	(15 2)	(17 5)	()
Money and credit (change during period)				
Money	1,192	1,077	303	
Domestic liquidity (money and quasi-money)	1,378	1,240	726	
Net foreign assets	574	-127	-1,326	-1,800
Net claims on Government	381	1,808	2,023	2,000
Claims on nongovernment sector	645	630	294	
Public and mixed enterprises	(188)	(316)	(264)	()
Private sector	(456)	(315)	(30)	()
Percentage change in domestic liquidity	(22)	(16)	(8)	()
Ratios of				
GDP to money <u>2/</u>	(1 79)	(1 75)	(1 68)	()
GDP to domestic liquidity <u>2/</u>	(1 47)	(1 45)	(1 36)	()

1/ Year ended June 30.

2/ Denominators are beginning and end of period averages

Yemen Arab Republic Basic Data (concluded)

	<u>1978/79</u> 1/	<u>1979/80</u> 1/	<u>1981</u>	<u>Proj.</u> <u>1982</u>
	<u>(In millions of U.S. dollars)</u> 2/			
Balance of payments				
Exports, f.o.b.	3	7	10	10
Imports, f.o.b.	-1,250	-1,546	-1,748	-1,800
Trade balance	-1,247	-1,539	-1,738	-1,790
Services (net)	-36	--	-51	-60
Private transfers (net)	833	1,099	788	800
Official transfers (net)	312	112	337	330
Current account	-138	-329	-664	-720
Nonmonetary capital	116	158	230	320
Commercial banks (net)	33	-119	1	--
Errors and omissions (net)	150	143	102	--
Overall balance	160	-148	-331	-400
Current deficit as percentage of GDP	(6.1)	(12.4)	(23.1)	()
Total reserves (end of period)	1,551	1,430	967	
In months of imports	(15)	(11)	(7)	()
Disbursed external debt outstanding (end of period)	543	592	1,101	
Percentages of				
External debt to GDP	(24)	(22)	(38)	()
External debt service to GDP	(0.6)	(0.4)	(2.4)	()
External debt service to current account receipts	(0.9)	(0.7)	(5.0)	()

1/ Year ended June 30

2/ Converted at US\$1 = YRls 4.5