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AGENDA**

EBS/82/104

CONFIDENTIAL

June 15, 1982

To: Members of the Executive Board

From: The Secretary

Subject: People's Democratic Republic of Yemen - Use of Fund  
Resources

Attached for consideration by the Executive Directors is a paper on a request from the People's Democratic Republic of Yemen for a purchase equivalent to SDR 15.375 million. A draft decision appears on page 4.

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

Att: (1)



INTERNATIONAL MONETARY FUND

PEOPLE'S DEMOCRATIC REPUBLIC OF YEMEN

Use of Fund Resources

Prepared by the Middle Eastern Department

(In consultation with the Exchange and Trade Relations,  
Legal, Research, and Treasurer's Departments)

Approved by A. S. Ray and Subimal Mookerjee

June 15, 1982

I. Introduction

At the request of the authorities of the P.D.R. of Yemen a staff member visited Aden during the period May 8-11, 1982 to assess the economic impact of the disastrous floods that had struck large areas of the country during March 29-April 1, 1982, and to discuss with the authorities possible use of Fund resources under the Fund's emergency assistance related to natural disasters. In a letter to the Managing Director <sup>1/</sup> (Attachment I) the authorities requested a purchase equivalent to SDR 15.375 million, which is 25 per cent of quota, under the Fund's tranche policies to assist the country in meeting urgent import needs. The letter and attachment also stated the intention of the authorities to collaborate with the Fund to find a solution to the balance of payments problem and to formulate an appropriate adjustment program as soon as circumstances permit.

II. The Economic Problem

During the period March 29-April 1, 1982 large areas of the P.D.R. of Yemen were subjected to severe flooding as a result of unusually heavy rainfall. Although damage was sustained on a relatively wide scale, the worst hit areas were concentrated in the agricultural governorates of Abyan, Shabwa, and Lahaj, to the east and northeast of the capital city of Aden. As explained in the attachment to the Minister's letter, the damage to agricultural infrastructure and crops was extensive. Thousands of houses were destroyed as were several diversion weirs and dikes, miles of highways, and irrigation canals, as well as highway bridges, and irrigation wells. The damage to livestock is estimated at nearly 50,000. Estimates of the overall economic losses due to the physical destruction

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<sup>1/</sup> The letter and attachment were agreed, ad referendum, in Aden on May 10, 1982. In a subsequent communication from the Minister of Finance, dated May 23, 1982, the authorities requested that the letter and attachment be submitted to Fund management.

may reach several hundred million dollars and the tasks of repair and reconstruction, although already begun, are expected to take some time. Additional imports of machinery and equipment as well as of building materials have already been undertaken. The immediate tasks of emergency repairs and some reconstruction have begun with assistance from international organizations and bilateral aid donors.

The damage to agricultural crops was also considerable. A substantial portion of the seasonal crops of cotton, cereals, and vegetables was destroyed and prospects for resumption of agricultural production in the affected areas during the coming fall season have been greatly reduced. Although the export crops of cotton and certain vegetables were severely affected, the greater cost in the immediate period arises from the need to import substantial amounts of vegetables, grains, and dairy products to replace lost domestic output. As indicated in Attachment I, the additional balance of payments burden caused by the floods during 1982 is tentatively estimated at between US\$55-60 million. The impact on the 1982 budget is also expected to be substantial, and could exceed YD 20 million, about US\$58 million, or 10 per cent of total expenditures. <sup>1/</sup> The overall budget deficit is expected to increase to more than 35 per cent of GDP. Beyond 1982, prospects for recovery in agricultural production will depend on the speed with which certain infrastructural facilities in the affected areas (mainly diversion weirs, canals, and dikes) can be repaired or reconstructed to protect the agricultural areas from possible damage in the fall rainy season.

The P.D.R. of Yemen has already received some emergency assistance from UN agencies and from the neighboring Arab countries (both cash and in kind), and from European countries (mainly technical assistance). Three missions from the World Bank have visited the P.D.R. of Yemen since the floods and World Bank management has approved a supplemental allocation of up to US\$8 million for road reconstruction projects in the affected areas.

### III. Recent Developments

Overall growth rates in the P.D.R. of Yemen in recent years have been maintained at a relatively high level, averaging more than 8 per cent in real terms since 1975 and 10 per cent in 1981. <sup>2/</sup> The main sectors accounting for this growth in 1981 were agriculture, government services, construction, and transport. The overall budget deficit in 1981 is estimated to have widened somewhat in absolute terms, primarily as a result of the acceleration of development spending, but the ratio to

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<sup>1/</sup> YD 1 = US\$2.89524.

<sup>2/</sup> The staff report for the 1981 Article IV consultation with the P.D.R. of Yemen (SM/81/214) and the paper on recent economic developments (SM/81/232) were discussed at Executive Board Meeting 81/158 of December 16, 1981. Information on developments during 1981 was obtained during the staff visit to Aden in May 1982.

GDP remained in the range of 25-30 per cent. External assistance, in the form of grants and project and commodity loans, increased in 1981 and the domestic bank-financed deficit of the Government was limited to about 8 per cent of GDP, as compared with an average of 11 per cent in the preceding three-year period. Monetary expansion slowed considerably, with domestic liquidity rising at 12 per cent as compared with 32 per cent in 1980, in part as a result of the decline in the balance of payments surplus. About two thirds of the increase in domestic assets in 1981 was due to bank financing of the government deficit. The overall balance of payments position, which had shown a surplus of US\$56 million in 1980, was in virtual balance in 1981, largely as a result of an acceleration in the development effort accompanied by a more rapid increase in imports. At the end of February 1982, gross reserves were slightly higher than a year earlier at about US\$260 million, equivalent to just under four months of imports at the 1981 level.

#### IV. Staff Appraisal and Proposed Decision

The P.D.R. of Yemen has suffered destruction and economic disruption as a result of the floods. A full assessment of the damage and emergency repair and rehabilitation efforts are under way with the support of international agencies and donor countries. Available information indicates that the bulk of external assistance by far will be in the form of project loans and that disbursements during 1982 will be limited. Also, the authorities have indicated that their cash and in-kind grants have been primarily for relief purposes and that their overall magnitude was small. Thus, the increase in the 1982 current account deficit could translate into an almost equivalent rise in the overall payments deficit.<sup>1/</sup> It is likely, however, that, as resources are shifted from planned development projects to the reconstruction effort, a significant portion of the additional reconstruction-related imports could be accommodated through a shift in the composition of imports so that the adverse effects on the current account and overall payments positions may be mitigated somewhat. The staff considers that the overall deficit for 1982 may be in the range of US\$60-65 million; the consequent decline in reserves, however, would be considered serious in the circumstances, especially in view of the country's narrow export base (the value of commodity exports is roughly 5 per cent of that of imports) and the vulnerability of other sources of external receipts.

The authorities have indicated in their communications with the Fund the general approach they intend to take in dealing with the emergency that has arisen and have stated their intention to formulate an adjustment program as soon as circumstances permit. They have also indicated their

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<sup>1/</sup> It should be emphasized that these estimates are subject to large uncertainties and that a final assessment of the economic and financial effects of the floods may not be available for 2-3 months. The staff expects to review with the authorities the economic impact of the floods and the remedial measures taken, in the context of the forthcoming Article IV consultation discussions scheduled for October-November 1982.

intention to collaborate with the Fund in finding a solution to the balance of payments problem and in formulating an adjustment program as needed. In the meantime, they have requested an emergency purchase under the Fund's tranche policies. This request is consistent with earlier Fund practice in a number of cases regarding the provision of financial assistance in cases of natural disasters. The Yemeni authorities stated that they do not intend to impose new restrictions on payments and transfers for current international transactions, nor introduce any multiple currency practices, nor impose any new or intensify existing import restrictions for balance of payments purposes.

Accordingly, the following draft decision is submitted for the consideration of the Executive Board:

1. The Government of the People's Democratic Republic of Yemen has requested a purchase equivalent to SDR 15.375 million.
2. The Fund notes the intention of the Government of the P.D.R. of Yemen as stated under paragraphs 6, 7, and 8 of Attachment I dated May 10, 1982, to EBS/82/104, and approves the purchase in accordance with the request.

The Ministry of Finance  
The People's Democratic  
Republic of Yemen

May 10, 1982

Mr. J. de Larosiere,  
Managing Director,  
International Monetary Fund,  
Washington, D.C. 20431

Sir:

1. During the period March 29-April 1, 1982 large areas of the People's Democratic Republic of Yemen were struck by the worst floods in the country's recorded history. The death toll was nearly five hundred men, women and children. Nearly 60 per cent of the country's total agricultural land was affected; in most cases the damage to crops, animal life, and infrastructure was total.

2. The People's Democratic Republic of Yemen hereby submits a request for an emergency drawing, equivalent to the first credit tranche of SDR 15.375 million, the proceeds of which we intend to use to help finance an emergency reconstruction and rehabilitation program in the affected areas and additional imports needed to replace the loss of domestically supplied agricultural products.

3. In the attached statement I describe, in as much detail as is available to us at this time, the economic impact of the floods and especially their effect on imports, exports, and the balance of payments as a whole. In addition, I have outlined the approach we will take to formulate an adjustment program to deal with the balance of payments and other economic effects of the floods during the remainder of 1982 and beyond.

Very truly yours,

/s/

Mahmood Saeed Madhi  
Minister of Finance

Attachment

May 10, 1982

STATEMENT ON THE MAIN FEATURES OF THE PEOPLE'S DEMOCRATIC  
REPUBLIC OF YEMEN ECONOMIC AND FINANCIAL POLICY TO  
DEAL WITH THE EMERGENCY CAUSED BY THE FLOODS

1. During the period March 29-April 1, 1982, large areas of the country were hit by the worst floods in the country's recorded history. The areas affected included the Governorate of Abyan, a primary agricultural area in the country, as well as the two neighbouring governorates of Shabwa and Lahaj. Against an average annual rainfall of 150 mm, these areas received 280 mm of rainfall in the above four-day period. The water descended from the mountain slopes surrounding the area and rushed toward three narrow valleys, gathering momentum and sweeping before it entire villages, substantial agricultural infrastructure and equipment, animal herds, agricultural crops, and much of the rich soil of the valley floors.
2. The damage to infrastructure was extensive. Thousands of rural dwellings were destroyed, so were a number of dams and bridges, roads, irrigation canals, artesian wells, levees, and terraces. We have begun emergency repairs in the critical areas, primarily to minimize the potential damage that could occur during the coming flood season (July-September), but permanent reconstruction and rehabilitation could take several years. Some of the infrastructural facilities may have to be relocated and/or redesigned to enhance their chances of survival in similar situations in the future. Preliminary engineering surveys have already commenced. In the meantime, we have begun the process of importing the needed equipment and materials to replace lost equipment and repair destroyed facilities. Preliminary estimates of the total cost of such imports range between US\$22-25 million, nearly all of which will have to be undertaken during the remainder of 1982.
3. The damage to existing livestock and crops and the loss of potential agricultural output from subsequent seasons have also been considerable. Replacement of a part of the livestock for immediate needs would require the additional importation of US\$6-8 million of meat, poultry, eggs, and dairy products. The main crops affected include the export crop of cotton as well as domestically consumed cereals, tobacco, sesame, potatoes, onions, and other vegetables and fruits. The reduction in export receipts due to the partial destruction of the cotton crop that had already been harvested and the total loss of the next season's harvest is estimated at US\$10 million in 1982. In addition, the cost of additional imports of the home consumption crops for the remainder of 1982 could run as high as US\$15 million. Finally, some stocks of certain crops, as well as of seeds, fertilizers, pesticides, and other agricultural imports have been destroyed. Their replacement by imports would add another US\$2 million.



4. Our preliminary projections of the balance of payments outcome for 1982 prior to the floods indicated a current account deficit of US\$287 million and an overall deficit of US\$30 million. In the absence of measures, the impact of the replacement and rehabilitation program in 1982, including the loss of exports and the additional imports as indicated above, would have been to widen the current account deficit to about US\$345 million. However we intend to take measures, as indicated in paragraph 6 below, to limit this deficit to a manageable US\$320 million or about 27 per cent higher than the actual in 1981. In addition, we expect to secure grants and concessionary loans so that the overall deficit can be limited to US\$70 million for the year as a whole (exclusive of any IMF drawings).

5. The needed emergency relief, repairs and reconstruction program for 1982 will add about YD 5 million to budgetary current expenditures and about YD 15 million to the capital budget. Although the overall budget deficit was originally projected at YD 110 million and would have been YD 130 million with the added emergency expenses, we intend to take measures, both on the revenue and the expenditure sides of the budget, to limit the total deficit to YD 115 million. The bank financed deficit, which would have risen to about YD 75 million will be limited to about YD 55 million for the year as a whole.

6. In order to provide the necessary strength in the balance of payments to deal with the impact of the floods we have already begun the process of amending the 1982 public sector import program by allowing more flexibility in shifting priorities toward the immediate requirements of the relief and reconstruction effort. The private sector will continue to receive its full foreign exchange allocations without restriction. We are currently considering specific administrative measures to simplify existing exchange and trade system procedures toward facilitating further the flows of goods, services, and transfers; the implementation of these measures will be expedited. Concerning the external financing of the additional emergency costs, we will continue to make every effort so that through grants and concessional loans our debt service burden will remain small. Beyond that, appropriate demand management policies, primarily through the budget, will be pursued so as to restrain the underlying pressures on domestic resources and on the balance of payments. More specifically, every effort will be made to sustain the expansion of budget revenues and to restrain the growth of current government spending. Within the development program resources will be shifted from ongoing or imminent projects to the repair and reconstruction projects in the areas affected by the floods. This will not only ease the pressure on domestic resources but will also accelerate the restoration of domestic agricultural production with positive effects on the balance of payments in the latter part of 1982 and beyond.

7. Because of our preoccupation with the immediate task of providing emergency relief and repairs in the affected areas and because of the extent and complexity of the damages we have not yet completed our detailed assessment of the economic impact of the floods. We, however, expect to do that soon and then to proceed to take further measures to deal with the emergency that has arisen. In any event, we intend to collaborate with the Fund in finding a solution to the balance of payments problem and in formulating an adjustment program as needed, as soon as circumstances permit. In the meantime, the P.D.R. of Yemen will not impose new or intensify restrictions on payments and transfers for current international transactions, nor introduce any multiple currency practice, nor impose or intensify existing import restrictions for balance of payments purposes.

8. The Yemeni authorities believe that the general policies outlined in this statement as well as the more detailed program to be formulated as soon as circumstances permit are adequate to achieve the objectives of dealing with the balance of payments problems that have arisen from the emergency. In any event, the authorities will take any further measures that may become appropriate for this purpose during 1982 and will remain in consultation with the Fund in accordance with its policies. Moreover, after a complete assessment of damages has been made, we will take this into account in reviewing our development plans and in formulating appropriate financial policies for the later periods so as to maintain the momentum of our country's economic development within a framework of financial stability.

P.D.R. of Yemen: Relations with the Fund 1/

Date of membership:	September 29, 1969.
Status:	Article XIV.
Quota:	SDR 61.5 million.
Fund holdings of currency:	Fund holdings of Yemeni dinars amounted to SDR 61.13 million or 99.4 per cent of quota (of which SDR 2.14 million or 3.5 per cent were under the oil facility).
SDR position:	Holdings of SDRs amounted to SDR 3.13 million, or 13.9 per cent of net cumulative allocations of SDR 22.58 million.
Trust Fund loan disbursements:	SDR 12.02 million (first period) and SDR 16.32 million (second period).
Direct distribution of profits from gold sales:	US\$4.59 million.
Gold distribution (four sales):	24,819.000 fine ounces.
Exchange system:	The Yemeni dinar is pegged to the U.S. dollar at YD 1 = US\$2.89524.
Last Article IV consultation:	September 1981; the Staff Report (SM/81/214) was discussed by the Executive Board on December 16, 1981.
Technical assistance:	An advisor from the Central Banking Department panel is currently on assignment with the Bank of Yemen.

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1/ As of May 30, 1982.