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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 89/136

10:00 a.m., October 23, 1989

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	C. Enoch
	J.-F. Cirelli
	D. McCormack
	Zhang Z.
	C. S. Warner
	J. Prader
E. T. El Kogali	L. B. Monyake
	M. J. Shaffrey, Temporary
E. V. Feldman	R. J. Lombardo
L. Filardo	M. A. Fernández Ordóñez
	N. Kyriazidis
M. Finaish	
	M. Pétursson
M. R. Ghasimi	O. Kabbaj
	B. Goos
	K.-H. Kleine, Temporary
	E. Kiriwat
	A. Raza, Temporary
A. Kafka	
	N. Toé, Temporary
	M. Al-Jasser
G. A. Posthumus	G. P. J. Hogeweg
K. Yamazaki	S. Yoshikuni
	K. Ichikawa, Temporary

L. Van Houtven, Secretary and Counsellor
D. de Vos, Assistant

Also Present

Exchange and Trade Relations Department: S. Kanesa-Thasan. Legal Department: J. K. Oh. Middle Eastern Department: A. S. Shaalan, Director; P. Chabrier, Deputy Director; H. P. G. Handy, C. Sassanpour. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Advisors to Executive Directors: M. B. Chatah, Z. Iqbal, D. Powell. Assistants to Executive Directors: H. E. Codrington, S. K. Fayyad, J. Gold, A. Hashim, M. Hepp, L. K. Hubloue, A. Iljas, L. I. Jácome, M. E. F. Jones, R. Marino, N. Morshed, S. Rouai.

1. SOCIALIST PEOPLE'S LIBYAN ARAB JAMAHIRIYA - 1989 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1989 Article IV consultation with the Socialist People's Libyan Arab Jamahiriya (SM/89/201, 10/2/89; and Cor. 1, 10/3/89). They also had before them a background paper on recent economic developments in the Socialist People's Libyan Arab Jamahiriya (SM/89/208, 10/16/89).

Mr. Finaish made the following statement:

Since the early part of this decade, economic policy in Libya, as in other oil exporting countries, has been dominated by the need to adjust to the turnaround in the international oil market. The enormity of the turnaround can be seen in the decline in Libya's income from oil exports, which, after reaching a peak of about $22 billion in 1980, declined steadily to an annual level of about $5.5 billion in the period 1986-88.

In response to the sharp decline in export receipts, the Libyan authorities, beginning in 1982, embarked on a strong adjustment effort. This effort centered on fiscal retrenchment to reduce domestic absorption, combined with more direct measures to reduce imports of goods and services and thus contain the weakening of the external position. The adjustment strategy was guided, among other things, by the twin objectives of avoiding external borrowing and maintaining a prudent level of reserves. On the whole, the authorities' efforts have met with considerable success. This can be seen in fiscal performance, and in balance of payments data, which show a substantial decline in the overall external deficit from about $5 billion in 1981 to less than $100 million in 1987. As one would expect, however, the policy of financial restraint and import tightening has contributed to a slowdown of economic activity.

Over the past two years, a significant strengthening of the adjustment strategy has taken place, with the added objective of revitalizing the non-oil sectors of the economy. While maintaining the tight financial policies already in effect, the authorities adopted a number of important policy changes in order to broaden the scope for private sector activity. A significant degree of import liberalization was also undertaken. As a result, economic activity recovered significantly, with non-oil GDP growing by 3 percent in 1988, including a 10 percent increase in real value added in manufacturing, and 5 percent growth in agriculture. The improved production performance in 1988 was also helped by the increase in the inflow of expatriate workers in the context of enhanced regional cooperation between Libya and its neighbors.

The authorities intend to continue the process of gradual economic liberalization in the period ahead. This will be done in a pragmatic manner without losing sight of the social objectives, priorities, and institutional framework of the Libyan economy. Within these bounds, however, measures are being taken to encourage private sector investment by individuals, and small partnerships in agriculture, industry, trade, and other services. Steps have also been taken to transfer ownership of some small and medium-scale public sector industries to workers. These and other measures are expected to help sustain a moderate growth rate of about 3 percent in real non-oil GDP in the next two years. Over the longer term, a significant contribution to growth is expected to come from the increased agricultural production associated with the major irrigation project, which will bring water to the coastal farmlands by a pipeline network from desert aquifers.

While seeking to revitalize the non-oil economy through structural measures, including the easing of import controls, the authorities have continued to tighten their financial policies. In fact, over the past six years, there has been a steady decline in public spending. In 1989, fiscal expenditures are projected to be about 8 percent lower than in 1988, and 40 percent lower than in 1984. Budgetary cutbacks have covered recurrent and capital outlays, as well as supplemental expenditures. The tight wage policy and the recent reduction of the subsidized list of consumer goods have also reflected the general policy of fiscal restraint.

Over the past two years, non-oil revenues have registered substantial increases, increasing by 21 percent in 1988 alone, largely as the result of increased import activity associated with trade liberalization, and strengthened tax and duty collection. It should be mentioned in this connection that the major irrigation project, referred to earlier, is financed outside the central budgetary process. As of mid-1989, total domestic revenues collected for the project amounted to $2.8 billion.

Reflecting the policy of budgetary tightening, the fiscal deficit has declined steadily in recent years. In 1989 it is projected to be less than one third of its level in 1986. Although the preparations for the 1990/91 budget are still at an early stage, the authorities intend to continue their policy of fiscal restraint.

Developments in Libya's balance of payments have reflected oil-market fluctuations, as well as the authorities' adjustment policies. In 1987-88, the combination of a continued decline in oil export receipts and a significant increase in imports of goods and services has resulted in a substantial widening of the current account deficit. In 1988, the overall balance of

payments position also recorded a substantial deficit, which was financed by a drawdown of reserves. However, the authorities are of the view that the 1988 outcome was a one-time reaction to the pent-up demand for imports. In their estimate, the overall deficit in the balance of payments in 1989 will be in the order of $0.5 billion, which could be financed by a relatively small drawdown of reserves. The authorities agree with the staff on the need to balance the growth and external objectives over the medium term. To the extent that developments in the external position turn out to be different from the authorities' expectations, I have no doubt that the current policy stance will be carefully reassessed.

Over the medium term, however, the issue of balancing the growth and external objectives will also be influenced by the authorities' effort to promote non-oil exports, particularly by the private sector. Toward that end, an Export Promotion Council was established in 1988 with the purpose of helping local exporters to penetrate foreign markets. Exporters will also be allowed to retain up to 40 percent of their foreign exchange earnings in special accounts to be used for financing imports. The success of export diversification will depend on many factors, including competitiveness and market access. The authorities believe that the current exchange rate system is not a hindrance to increased production of tradables. However, market access remains a concern, particularly since Libya is already being affected negatively by the restrictions imposed by the European Communities (EC) on the import of petrochemicals from a number of developing countries.

Finally, the authorities wish to reiterate their disappointment at the continuation of the freeze imposed on Libya's assets by the U.S. Government since January 1986. They continue to believe that the U.S. action has serious implications for international financial relations and should, therefore, be of serious concern to the international community, and to the Fund in particular.

To conclude, since the past Article IV consultation with Libya two years ago, the authorities have continued to follow a policy of financial restraint, coupled with increased emphasis on private sector initiative and participation. The authorities intend to continue on this path while adhering to a policy of avoiding external borrowing. Their ability to achieve their growth and balance of payments objectives will continue to depend primarily on developments in the oil market. This is one element of uncertainty that no doubt complicates economic management, not only in Libya but also in oil exporting countries in general. But, as in the past, the authorities will continue to stand ready to respond quickly and prudently when the need arises.

Mr. Al-Jasser said that the Libyan economy, like other oil exporting economies, had been undergoing a tremendous adjustment, owing to the severe decline in oil revenues. Libya's oil revenues had declined from $22 billion in 1980 to $5.6 billion in 1987, a decline of 75 percent. Therefore, it was to the authorities' credit that they had adjusted the economy to lower oil revenues without resorting to external borrowing. Moreover, the fiscal deficit had been brought down meticulously from 27 percent of GDP in 1981, to only 10 percent in 1988. That reduction had been achieved mostly by controlling government expenditures while raising non-oil revenues. He was pleased to note from Mr. Finaish's opening statement that the fiscal consolidation would be continued.

More significant, however, were the Government's initiatives to improve the efficiency of the economy by decentralizing the decision-making process, Mr. Al-Jasser continued. Giving market forces greater leeway to determine prices of goods and services would only help allocate resources more efficiently. In that regard, he welcomed the authorities' decision to phase out subsidies on certain goods, since that would remove distortions from the price system. Moreover, allowing Schumpeterian "entrepreneurial innovation" to play a constructive role in the economy should be a most welcome development. Hence, the authorities were to be commended for allowing private initiative in import and export trade, as well as in the internal distribution of goods. Those structural measures should be continued, since they could only enhance the potential of the economy and promote the diversification of its non-oil productive base. In fact, the fruits of those policies were already showing up in a positive real growth rate of 3.2 percent in non-oil GDP.

Therefore, he agreed with the staff that an expansion of the sphere of private activity, combined with a more flexible pricing policy and fewer controls, was essential for the long-term growth and prosperity of the Libyan economy, Mr. Al-Jasser stated. The planned liberalization of the foreign trade system would definitely help in the ongoing adjustment process.

He welcomed the authorities' emphasis on the importance of maintaining stability in the oil market, Mr. Al-Jasser said. He also joined them in urging other countries to roll back all the restrictions imposed on Libya's petrochemical exports, or those from any other country.

Mr. Toé made the following statement:

> We are in general agreement with the staff appraisal, and support the proposed decision.
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> We welcome the progress made by the authorities in their efforts to adjust the economy of the Jamahiriya to the steep and continuing decline in oil revenues. It is pleasing to note the encouraging developments that have taken place in the economy since the conclusion of the past Article IV consultation: economic growth has resumed in the non-oil sector; the budget

deficit has been reduced substantially; private sector involvement in the economic process has been increased; and both domestic and external trade are being liberalized gradually. Particularly welcome is the authorities' recent decision to expand the list of authorized importers to include private companies and partnerships; we urge the authorities to speed up the approval of the necessary regulations, so that the decision can be implemented soon.

Given the social objectives and the institutional framework of the Jamahiriya, the authorities' recent steps allowing individuals and partnerships to participate in the economic process merit commendation, and they should be encouraged to persevere in their efforts at economic liberalization. In this regard, the comments of Mr. Finaish in the fourth paragraph of his opening statement are reassuring.

The Jamahiriya is in a better position to achieve a higher level of economic performance in the 1990s for the benefit of the Libyan people, with the completion of the first phase of the Great Man-Made River Project, the important policy changes introduced to broaden the scope for private sector involvement, and the authorities' intention to develop and deepen these initiatives in the light of evolving circumstances. But it should be emphasized that for these policy changes to be effective, they need to be supported by appropriate domestic policies and a favorable international environment.

We concur with the staff that the challenge facing the authorities at the current juncture is to make progress toward achieving a more open and efficient economic order without causing unacceptable international reserve losses. In the authorities' efforts to meet this challenge, it will be of paramount importance that the export products in which the Jamahiriya enjoys a clear comparative advantage be accorded free access to the markets of industrial countries. Like Mr. Finaish, we are of the view that the extent to which foreign markets will be accessible to Libyan products will be critical to the success of the authorities' strategy geared at export promotion and diversification. However, as observed by the staff, it is also clear that there is a need for early adoption of a set of comprehensive and well articulated macroeconomic and structural policies that will foster a stable environment conducive to the enhancement of private sector participation in the economic process, and that will lay the foundation for steady and noninflationary growth over the medium term. In this connection, the availability and accessibility of reliable data is an important requirement for the adequate analysis of economic and financial developments. We therefore urge the

authorities to develop and maintain a reliable and comprehensive data base. To this end, the authorities may wish to take advantage of the Fund's technical assistance.

Mr. Enoch made the following statement:

I can support the proposed decision, and join the staff in urging the authorities to liberalize the exchange system, together with other aspects of the economy. The limited actions taken to create greater freedom for both external trade and internal private sector activity are very welcome, but there must be considerable doubt as to how effective these actions will be, unless the authorities introduce further measures in these fields.

Foremost among these must be a more flexible exchange rate. I would agree that this would not have more than a marginal short-run effect on overseas earnings, given the small size of the non-oil export sector. However, there has been pent-up demand for imports, and a continued high level of demand for both finished goods and inputs may well be expected for some time, while, as the staff scenarios show, a rapid drain on reserves may be in prospect. In these circumstances, I agree with the staff that exchange rate flexibility would be the best means of addressing the external imbalances.

Exchange rate flexibility would also serve to promote import substitution and the diversification of activity. I very much welcome the steps taken to encourage private economic initiative, and it would be unfortunate if new activity were to be choked off through lack of either output demand or input supply because of an inappropriate exchange rate. In this context, the staff is right to emphasize the need to liberalize prices and other controls, including the introduction of more flexible and realistic interest rates.

In the process of liberalizing the economy, fiscal policies have a key role to play. The authorities have achieved a remarkable reduction in the fiscal deficit in the face of sharply reduced oil revenues, and I welcome their intention to eliminate subsidies. However, I note the staff's view that further progress is required to make room for increased private sector activity and to alleviate balance of payments pressures.

The lack of clarity in fiscal accounting, including the omission from the budget of the irrigation project, and the weight of supplemental expenditures, is a matter of some concern. Regarding the irrigation project, revenue is apparently collected in local currency; but, according to the background paper, 85 percent of the project expenditure is expected to be

in foreign currency. I would be interested in staff comments on whether the project is therefore likely to be a significant drain on reserves. Also, what contribution is the project expected to make to growth and, in particular, to import substitution?

The lack of full fiscal accounts is not the only data weakness. The problem of statistical deficiencies was emphasized at the time of the last consultation two years ago, and remains of concern. It is disturbing that no measure for inflation is available, and I hope that the authorities will move quickly to resolve this and other statistical issues.

Mr. Yoshikuni made the following statement:

As one of the major oil exporting countries, Libya has faced the difficulties arising from declining oil prices since the beginning of the current decade. In response to this problem, the authorities have implemented various adjustment policies. I agree with the staff that, in general, those policies have been successful in avoiding serious economic crises and in setting the stage for sound growth in the 1990s. In particular, we are encouraged by the recent achievements in three areas: the remarkable reduction in the fiscal deficit, despite stagnant oil revenues; the resumption of growth in the non-oil sector; and the expansion of economic activity in the private sector. These areas are closely related, and the achievements in them will lead to the emergence of a virtuous cycle that will make the Libyan economy more efficient, market based, and less dependent on oil revenues. I encourage the authorities to continue their efforts to consolidate the economic adjustment process in that direction. In doing so, however, the authorities should take a number of additional measures aimed at further increasing economic activity by individuals, while also rationalizing the public sector.

I have some caveats that merit attention. Despite the ongoing diversification of the economy, little progress has been made in the area of non-oil exports, which remain a negligible amount in total current receipts. While the establishment of the Export Promotion Council is a welcome development, it is questionable whether non-oil exports will increase to much more than a token amount unless the distortions in the domestic economy are addressed in a comprehensive manner. According to page 47 of the background paper, exports of various products are still prohibited. At the same time, most of these products are subject to price controls. On the other hand, as the staff has rightly pointed out, the lack of exchange rate flexibility has weakened the competitiveness of the Libyan economy. Under these circumstances, the diversification of exports will require a

combination of various measures to reduce and eliminate the rigidity of the economy, namely, the liberalization of export restrictions coupled with elimination of price controls, along with a policy allowing the exchange rate to adjust to a level that would provide sufficient incentive to exports. In this vein, I agree with Mr. Enoch that a flexible exchange rate policy not only promotes exports, but also contributes to import substitution.

At the same time, such a restructuring of the economy should go hand in hand with appropriate demand management, to avoid deterioration in the external balance and to contain inflation. The recent loss of foreign exchange reserves, arising from the easing of travel regulations, is a cause for concern. In protecting the reserve position, the authorities should not resort to selective measures that reverse the liberalization process.

Substantial progress has already been made in reducing the fiscal deficit. In particular, I am impressed by the continuing curtailment of administrative outlays, with a view to shifting public sector activity to the private sector. Furthermore, some progress has been made in improving fiscal data, including the identification of borrowing by the Treasury from the banking system. Much remains to be done, however, in the area of fiscal statistics to make the public sector activities more transparent. Inclusion of the major irrigation project in the fiscal budget, as suggested by the staff, would be an important step toward providing a clear account of resource allocation in Libya. Insufficient data is not limited to the public sector. In particular, the lack of comprehensive and up-to-date statistics on national expenditure and prices makes it difficult to come up with a detailed analysis of the real economy, which, in turn, will prevent the flexible management of macroeconomic policies. I support the proposed decision.

Mr. Kleine noted that the authorities had been quite successful in adjusting their economic and financial policies to the sharply reduced levels of oil income over the past couple of years. Despite their efforts, however, there remained major domestic and external imbalances that needed to be addressed as matters of urgency.

Probably the only promising means for Libya to have both sustainable growth and external financial stability was to liberalize its economy and to give the private sector considerably more scope for development, Mr. Kleine said. A more active private sector would likely prove essential for the diversification of the economy. While some concrete steps had been taken already to assign the private sector an increased role, extensive state controls and interventions in economic activity were

still the rule. Most prices were determined administratively; interest rates appeared to be negative in real terms; and extensive trade and exchange controls were still in place.

The authorities had argued that a more rapid liberalization process could jeopardize the external accounts and lead to a reduction in reserves, Mr. Kleine observed. While such a course of events could not easily be dismissed, a piecemeal type of liberalization and major uncertainties with regard to the future course of policy could send the wrong signals to market participants. Economic activity by individuals could provide a larger impetus to growth and stability than at present. Such activity would benefit greatly from a quicker lessening of price and exchange controls, and from the implementation of more adequate interest rate and exchange rate policies. He fully endorsed the staff's appraisal on those crucial issues.

The authorities could draw lessons from other countries' experience, Mr. Kleine stated. For instance, too much gradualism in policy correction could, and would most likely, run counter to the authorities' growth and stabilization objectives. There had to be a critical mass of structural reforms right at the outset of a program, for the adjustment process to bear fruit. Of equal importance seemed to be a medium-term policy framework that would outline the overall direction of policy.

On previous occasions, the Board had expressed its concern at the weak data base in Libya, Mr. Kleine recalled. As Appendix II of the staff report showed, there continued to be major statistical shortcomings, which were both regrettable and disappointing. Widespread data weaknesses hampered the development of a more reliable assessment of the overall economic situation, particularly of the public sector's financial position. In the latter connection, he shared the staff's recommendation that the authorities should integrate the accounts of the major irrigation project into the budget. He supported the proposed decision.

Mr. Kiriwat recalled that, at the past Board discussion on Libya, Directors had expressed concern at the stagnation in economic activity. Therefore, he was encouraged to note that activity was growing in the non-oil sector, which had benefited from the authorities' various measures, who expected continuing moderate growth until 1990. He agreed with the staff that a more flexible pricing policy and fewer controls would facilitate full utilization of the opportunities provided by the recent measures; he urged the authorities to seize every opportunity available to hasten the process.

He commended the authorities' perseverance in cutting back expenditure, which had been reduced further by 3 percent in 1988, Mr. Kiriwat continued. They had rightly planned to continue restraining public spending through to 1990, while making further efforts to increase revenues. In that connection, and in view of the fact that the balance of payments position had deteriorated recently, it was imperative that

clear priorities be set for development expenditures. He agreed with the staff's call for greater restraint in public consumption.

The staff's medium-term projections for 1989-91 showed a moderate growth of imports over the period, and a continuation of the recent uptrend in service payments, which would result in a virtual depletion of Libya's reserves by end-1991, Mr. Kiriwat stated. The authorities, however, believed that the recent sharp growth of imports had been a one-time only reaction to pent-up demand, and that the recent rapid rise in service payments could not be sustained over the medium term. The staff or Mr. Finaish could usefully elaborate on developments in those areas in 1989. In that connection, the Central Bank's net foreign assets had declined by $0.5 billion in the first half of 1989.

He shared the authorities' concern about the restrictions imposed by some countries on the import of Libyan petrochemicals, Mr. Kiriwat indicated. His chair had always been concerned about growing protectionism in industrial countries, which tended to retard growth in developing countries. He supported the proposed decision.

Mr. Warner made the following statement:

> The authorities continue to respond pragmatically to the impact of the decline in oil prices on the fiscal and external accounts. In particular, public expenditures appear to have been cut sharply, and new revenue sources have been sought in response to declining oil receipts. However, efforts to improve domestic growth in the non-oil sector and to ease trade and payments restrictions have resulted in an increased external deficit and large reserve losses. The external situation could become a constraint on reform efforts, and points to the need for greater flexibility in price, interest rate, and exchange rate policies, to complement the fiscal adjustment.
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> Considerable progress has been made in recent years in reducing the fiscal deficit through expenditure restraint and higher non-oil revenue receipts, primarily as a result of increased import duties and excise taxes on consumer durables. However, the continuing inadequacy of fiscal data, and discrepancies between the fiscal deficit and the financing of the deficit by the banking sector, make it difficult to assess the true budget situation and its impact on the economy. While some progress is being made in developing more complete data, it is still difficult to determine with confidence the actual magnitude and trend of public expenditures, and also the impact on the economy of the financing of the budget deficit. I join Mr. Enoch and Mr. Kleine in noting that this situation underlines the importance of continuing to improve data collection, so that economic policy decisions can be based on complete and reliable information.

The recent deterioration in the current account balance in part reflects a welcome improvement in growth in the non-oil sector, and liberalization of trade and exchange controls. In this regard, we note that the staff considers the authorities' projection of an increase in oil revenues in 1989-91 in the $7-8 billion range as optimistic. Moreover, both of the import scenarios suggested by the staff imply a substantial improvement in the overall external position, and therefore could be considered best-case scenarios. Timely and effective adjustments need to be contemplated should experience indicate such assumptions are unsound. The continued need to diversify the economy and thereby to build up the non-oil sector industries has been noted appropriately by earlier speakers. I join them in emphasizing the need for action in this area. As long as the economy remains largely insulated from external competition by trade and payments restrictions, it will be difficult to build up an efficient economic structure to permit Libya to participate fully in the growth of world trade.

In these circumstances, pressures could mount to slow down or halt recent reform efforts aimed at strengthening the private sector. Such action would be unfortunate, since diversification of the Libyan economy is needed to reduce vulnerability to fluctuations in the oil market. We support the suggestions by the staff of the measures that could be taken to complement fiscal restraint. In particular, the continued reduction of agricultural subsidies should promote more efficient land use, as well as reduce the drain on the budget. Greater flexibility in interest rates would reduce excess demand pressures and encourage domestic savings. Similarly, adoption of a more flexible exchange rate policy would improve the competitive position of start-up and developing industries, and permit a further relaxation of inefficient exchange restrictions and multiple currency practices.

Mr. Ghasimi made the following statement:

We welcome this opportunity to discuss the 1989 Article IV consultation with Libya and support the proposed decision.

During the past four years, Libya has suffered from the fall in international oil prices, like all other oil exporting countries. In fact, owing to lower prices and production cutbacks, Libyan oil exports in 1988 declined by more than two thirds compared with 1981.

The authorities are to be commended for their response to such an adverse exogenous phenomenon. Although their adjustment efforts so far have been somewhat cautious, they are, nevertheless, steps in the right direction. In such circumstances, and

by taking advantage of the satisfactory level of reserves, the authorities have undertaken a program of relative liberalization of the economy, which is heavily dependent on state intervention. The staff and Mr. Finaish have indicated that recent economic and financial developments in the Jamahiriya have set the stage for the direction of the economy in the 1990s.

It is heartening to note that this has already led to the resumption of growth in the non-oil sector, thanks to the greater role attributed to private initiative in the economy. This is clearly apparent in retail distribution, services, and small-scale industrial activities. As indicated by Mr. Finaish, favorable prospects in the agricultural sector associated with the major irrigation project are expected to play an important role in the overall growth prospects of the economy. We welcome the authorities' intention to promote non-oil exports, and we consider that the establishment of the Export Promotional Council is a step in the right direction. Needless to say, further development of non-oil exports is essential to reduce the economy's reliance on a single export commodity. Naturally, easier access to international markets will be crucial in this respect. The opening up of import trade to the private sector will definitely be an important move toward enhancing the role of the private sector in the economy. It is also noteworthy that the authorities consider these commendable moves as only a beginning, and expect to develop them further in the light of evolving circumstances.

However, for this scenario to materialize fully, we agree with the staff that there is room for diminishing price and exchange controls, and for the exercise of greater flexibility in the economy.

While progress has clearly been made in reducing the fiscal deficit--from LD 1.52 billion in 1984 to LD 0.48 billion in 1989--through a sizable increase in non-oil revenues and restrained expenditure policy, much more could certainly be achieved by continuing with the right policies. Such an approach would allow for an expansion of activities in the private sector, and hopefully also for an alleviation of pressures on the balance of payments. Indeed, those pressures resulted in a widening of the current account deficit during past years. However, we agree with the staff that this widening was due mostly to the release of pent-up demand for foreign goods and services, after many years of restrictions.

Given the comfortable level of reserves--despite sharp decreases during the past two years--the authorities should be encouraged to pursue their policy of liberalization, coupled with prudent fiscal and monetary policies.

My own authorities reiterate their sympathy for the Libyan authorities' view on the implications for international financial relations of the freeze on Libya's assets.

Mr. Raza made the following statement:

The staff report, supported by the opening statement of Mr. Finaish, clearly brings out the problems associated with the heavy dependence of a country on oil market developments. With the price of crude oil, even in nominal terms, remaining depressed, and the external environment not being congenial, Libya has been passing through a difficult period. Real GDP has generally declined in each year of the current decade.

Both the staff report and Mr. Finaish's opening statement are clear in noting that, in a bid to extricate the economy from those difficulties, the authorities have been making efforts not only to diversify the production base by rejuvenating the non-oil sector, but also to make other necessary structural adjustments. Thus, the non-oil sector's share in GDP has already risen from just under one half of output in 1983, to about two thirds in 1988; the sectors that have grown particularly fast during this period are manufacturing, utilities, agriculture, and education. There also are indications of the improved performance of those sectors.

The authorities have been able to raise more resources and to prune expenditure, and thereby to improve the fiscal position. Furthermore, in line with the changing production base, the share of the non-oil sector in the total revenue of the Government nearly doubled during the period 1983-88. We note that the Treasury has taken credit for the sale of the equity shares of U.S. oil companies. We welcome the authorities' intention to continue with this policy.

Regarding monetary policy, there was a considerable increase in the Central Bank's claims on the Treasury and the commercial sector. Its expansionary effect was, however, more than neutralized by the sizable external deficit. Although no data are available, the authorities believe that prices have remained fairly stable. While this is welcome, the staff could clarify whether the relative stability in prices is with reference to administered prices, or whether it reflects the authorities' perception of market realities.

The sharp deterioration in the external payments balances remains a major cause for concern. The near and medium-term prospects are also not reassuring. In the staff's first scenario, which appears more plausible, the overall balance of payments position would worsen further. In fact, in that

scenario, the staff believes that the Central Bank's foreign exchange reserves would be depleted completely by 1991. In this connection, we understand the difficulties and problems created by the restrictions imposed by a group of developed countries on the import of petrochemicals and other commodities. Those barriers should be dismantled. At the same time, we agree with the staff and with Directors that flexibility in the management of the exchange rate is necessary to promote non-oil exports, to help further liberalization of foreign trade, and to enhance the profitability of domestic investment. We also agree with the staff about the need for a flexible interest rate policy.

I share the concern expressed by Directors over the weak data base, and the lack of current data, which makes it difficult to assess the existing situation, and to design, let alone monitor, any adjustment program. The problem needs to be tackled on a priority basis. I support the suggestion made by Directors that the Fund provide technical assistance with a view to implementing a timely program for strengthening the data base and making the data available with a minimum time lag.

Mr. Zhang said that he concurred with the staff's analysis and its appraisal, and that he supported the proposed decision. Satisfactory developments had taken place in the past two years under the Libyan adjustment strategy, given its added objective of revitalizing the non-oil sector. Economic activity had recovered significantly, with non-oil GDP growing by 3 percent in 1988; the authorities expected similar growth in 1989/90. The fiscal deficit, after declining sharply to LD 945.2 million in 1987, had narrowed to LD 641.2 million in 1988. Fiscal developments thus far in 1989 suggested that the actual fiscal outcome would likely approximate the budgeted amount. The emphasis on raising revenues and restraining expenditures would continue into 1990.

The authorities had taken the initiative of providing a broader range of opportunities to individuals and partnerships to enable them to play a greater role in the economy, Mr. Zhang remarked. It was encouraging to note that those initiatives would be expanded. An appropriate lessening of price and exchange controls and appropriate use of flexible interest rate and exchange rate policies would greatly facilitate the participation of individuals and partnerships in economic activity and would increase competitiveness. At the same time, it was important that the international environment for Libyan exports be improved.

Mr. El Kogali made the following statement:

The Jamahiriya's successful record of adjusting its expenditure to reduced income without adversely affecting the social welfare of its people is indeed commendable. Although public involvement in economic activity is still extensive, it is to

the authorities' credit that liberalization measures are gaining pace. In particular, the moves to promote individual initiative in economic activity are encouraging.

We continue to be impressed by the pragmatism and competence shown by the authorities in managing their oil and petrochemical industries, which provide the country with its main source of income. To reduce its vulnerability to fluctuations in oil prices, Libya has continued to expand its refining capacity, particularly as the profit margin on refined petroleum products remains good and no marketing difficulties have been encountered. However, its drive to acquire marketing outlets for its petrochemical products continues to be frustrated by the restrictive measures imposed by some European countries on the import of those products from developing countries. We fully share the authorities' concern in this regard. Efforts by developing countries to diversify their economies in areas where they have a comparative advantage need to be encouraged, not only in theory, but also in practice.

Even though the oil sector still constitutes a large fraction of Libya's GDP, Table 1 of the background paper shows the non-oil sector to be growing steadily. In particular, I welcome the improved performance in the agricultural and manufacturing sectors. Those sectors have benefited from the incentives offered by the Government to private investment, and from the easing of import controls. Looking ahead, the completion in 1990 of the first phase of the Great Man-Made River Project will solve the problem with the availability of water, which has greatly hindered agricultural production and the drive toward self-sufficiency in food. In general, there is great potential for growth in the non-oil sector, which the authorities can exploit by encouraging greater economic participation by the private sector. In that connection, the staff's argument against excessive regulations and price controls needs to be heeded.

Regarding the external sector, the progress made in liberalizing trade is commendable. Notwithstanding the pressure it has placed on the balance of payments, the policy of relaxing import and travel restrictions has benefited the economy. While we commend the authorities for their prudent policy of avoiding foreign borrowing, I note that pressure is building on official reserves. For example, the $2.5 billion deficit in the overall balance of payments in 1988 was financed predominantly by a drawdown in official reserves. The two scenarios presented by the staff clearly show the effect of imports on reserve levels, and Mr. Finaish's presentation of the authorities' views on this matter is reassuring. I would, however, be interested

in hearing the staff's comments on the optimum scenario in the context of the trade-off between liberalization and growth versus reserve depletion.

Against this background, we also sympathize with the authorities' concern regarding the continued freeze of Libyan assets by the U.S. Government. As my chair stated during the past Article IV discussion on Libya, we hope that the circumstances that led to this situation will change.

In Appendix II, the staff report clearly shows that Libya's data base remains weak. With the uncertainties and fluctuations connected with the oil market projections, it is vital for the Jamahiriya to improve its data base and thereby enable it to plan its economy better. I therefore encourage the authorities to make use of the technical assistance offered by the Fund.

I wish the Libyan authorities well in the management of their economy, and request that Mr. Finaish conveys these wishes.

The staff representative from the Middle Eastern Department said that revenues for the Great Man-Made River Project were being derived from domestic currency sources and that the expenses of the Project were in foreign currency. That was not an unusual situation for the financing of any project. The staff had viewed the Project in a macroeconomic framework, examining it to the extent that it impinged on the overall balance of payments position. While reserves had been declining for a number of reasons--although not excessively--the Project did not appear to have posed a substantial problem.

It was not possible to estimate with any confidence the enhanced prospects for growth deriving from the expanded capacity that would result from the Project, the staff representative continued. The staff had not had the benefit of the World Bank's involvement in Libya, and therefore had not received any relevant Bank appraisal. Nonetheless, the staff had every reason to believe that the Project would significantly boost the agricultural sector, which had been dogged for many years by structural impediments, and which had been vulnerable to changes in weather conditions. The staff hoped that the Project would increase the agricultural sector's contribution to GNP from its extremely low level of about 3 percent in recent years. Clearly, the Project also had significant implications for import substitution, if not for exports.

The staff did not have any new information that would facilitate balance of payments projections beyond those in the staff report, the staff representative stated. The decline in the Central Bank's net foreign asset position in the first half of 1989 reflected that institution's increased foreign liabilities, associated, in turn, with a rise

in foreign deposits held at the Central Bank by two offshore official entities, the investment company and the Libyan Arab Foreign Bank.

Exports that were prohibited by the authorities were either basic commodities that were in short supply domestically, or subsidized goods, the staff representative added. The selective prohibition was clearly directed at deterring illegal exports to neighboring countries.

While the most recent consumer price index data reflected the price situation of several years ago, the authorities had indicated that they considered the underlying price situation to have been relatively stable, the staff representative from the Middle Eastern Department observed. No information was available beyond that.

Mr. Finaish said that he agreed that data from Libya were insufficient and that the statistical base should be upgraded. The question had been discussed with the authorities during the Annual Meetings, at which time they had requested Fund technical assistance, particularly for the monetary and external accounts. He hoped that the situation would have improved significantly by the time of the next consultation.

He agreed with the Directors who had emphasized the need to strengthen and broaden the process of economic liberalization with a view to securing a general revitalization of the economy and a faster growth rate in the non-oil sector, Mr. Finaish indicated. The authorities would not differ in that regard, but would point to other considerations that were also of some significance. For instance, liberalization would have to take place within the Jamahiriya's existing institutional and political framework, and the country's social priorities; structural changes were therefore not without limit in the case of Libya. Moreover, the process of liberalization would have to be a gradual one, given that the economy had been subject to regulation for a number of years and that the private sector would require some time before it could assume larger responsibilities in trade and investment. The authorities, nevertheless, would still need to strike a balance between domestic growth objectives and external equilibrium, which would be easier to achieve if they succeeded in promoting non-oil exports and import substitution.

While the reforms undertaken thus far might seem modest, the authorities considered the steps taken to have been significant, Mr. Finaish added. Not only were trade and investment being opened up, restrictions on travel had been eased. The resulting $0.5 billion increase in travel expenditure abroad in 1988 had increased optimism among the population and had led to an increase in needed imports. The latter had benefitted Libya's trading partners, as has been noted in the Board discussion on the Article IV consultation with Tunisia (EBM/89/63, 5/24/89).

The authorities would concur with the Directors who had mentioned that the exchange and interest rates were important instruments for promoting investment in tradable goods, but it was not clear whether one could come to firm conclusions on exchange rate policy in the existing

circumstances, Mr. Finaish considered. Unless the pricing system in Libya was changed fundamentally, exchange rate adjustments would be of little consequence. Also, there was no clear evidence that Libyan exports were uncompetitive at current exchange rates, a point that applied to interest rates as well. Although both the exchange and interest rates were important instruments, there was insufficient information at present to judge their current levels to be inappropriate.

The large-scale irrigation project was important for the future of Libya and was a cause for much hope, Mr. Finaish indicated. Indeed, it was probably the single largest civil engineering project in the world. Its total cost would be about $25 billion, with the first stage estimated currently to cost about $4.3 billion, of which $2.4 billion had been spent already, and the second stage--signed three weeks ago with a Korean construction company--estimated to cost about $5.3 billion. Approximately $15 billion of the total cost would be devoted to transporting water, and about $10 to developing infrastructure for agriculture and utilities. The two water pipelines in the first stage of the project, which would irrigate 50,000 hectares of agricultural land, had been expected to be completed by 1995, but had been delayed by at least one year. In any event, water would be pumped to one of Libya's cities by 1991, and would be pumped further north by the mid-1990s. As he had indicated in his opening statement of June 1989, the total domestic revenues collected for the project had amounted to about $2.8 billion, and had not had an impact on the balance of payments, as noted by the staff.

Regarding the question of the external trade restrictions imposed on Libya, he would refer Directors to the Board discussion in January 1986 and to that of the past Article IV consultation in October 1987, Mr. Finaish continued. External restrictions had been imposed before 1986. Indeed, the United States had banned all imports of Libyan crude oil in February 1982, had extended the ban to the import of petroleum products in November 1985, and had imposed a further ban on oil trade in January 1986. The authorities had hoped that the situation would change when President Reagan had allowed five oil companies to resume their operations in Libya in January 1989, followed by discussions with the Libyan national oil companies. However, U.S. oil companies had not been able to resume their operations because the sanctions in place had prevented them from bringing equipment and personnel to Libya, and from selling Libyan oil in the U.S. market. Most recently, in June 1989, President Bush had sent a message to the U.S. Congress, stating that "the policies and actions of the Government of Libya continue to pose an unusual and extraordinary threat to the national security and foreign policy of the United States. I shall continue to exercise the powers at my disposal to apply economic sanctions against Libya as long as these measures are appropriate." He noted that U.S. oil companies were still holding discussions with the Libyan national oil companies.

As mentioned by the staff and the press, following the victory by Libya in three cases before the High Court in London, the U.S. Treasury had allowed two U.S. banks to release some of the Libyan assets previously

frozen by the United States, Mr. Finaish noted. Bankers Trust had released $282 million in October 1987 and $18 million in November 1988, followed by Manufacturers Hanover's release of $77 million in February 1989. Those court cases had set an important precedent, in the verdict that the Libyan assets frozen in branches of U.S. banks in London were subject to English law, and not to U.S. law. The Executive Board had discussed at length the general issue of whether foreign branches of U.S. banks were subject to U.S. law, or to the laws of the country in which those banks resided.

The Acting Chairman made the following summing up:

Directors were in broad agreement with the staff appraisal. They commended the authorities for their efforts to adjust the economy to sharply reduced levels of oil income through restraining demand by narrowing the deficit in the public finances. Directors noted that the compression of imports through expenditure restraint and administrative measures had contributed to external adjustment while allowing the Jamahiriya to avoid foreign borrowing and to safeguard external reserves.

Directors welcomed the recent decisions by the authorities to begin liberalizing the economy and their steps to begin encouraging private initiatives in the economic process, including steps to allow individuals and partnerships to participate in import and export activities. It was noted that expanded private participation combined with an easing of controls on imports was helping to revive economic activity. The welcome liberalization of imports had, not surprisingly, revealed strong pent-up demand for imports and had resulted in a widening of the external payments deficit and in reserve losses.

Directors were of the opinion that realization of the full benefits of the recent initiatives to liberalize the economy and to improve its efficiency would require strong complementary policies, particularly through the introduction of greater flexibility in pricing, including interest rates and the exchange rate. A number of speakers emphasized that a more flexible exchange rate policy was essential to encourage emerging export diversification and to promote efficiency in foreign exchange allocation, thus lessening the need for administrative controls.

Directors observed that the Jamahiriya had continued to maintain inefficient exchange restrictions and multiple currency practices, and urged the authorities to ease those restrictions as soon as possible. The need for fair access to foreign markets for the Jamahiriya's petrochemical exports was also stressed by a number of speakers. Unless accompanied by supporting policies, Directors felt that the momentum of reform could be jeopardized by the magnitude of potential reserve

losses. Thus, in light of the objectives to encourage more rapid economic development and economic diversification in the Jamahiriya, a number of Directors believed that a less gradual approach would be necessary to achieve those objectives, and suggested that a more comprehensive set of economic and structural policies should be implemented, including the abolition of the still pervasive administrative controls on economic activity.

A number of Directors noted that a lack of comprehensive and timely data had hampered the review of economic and financial developments as well as policy prescriptions. The authorities were encouraged to give priority to improving the quality, availability, and timeliness of economic and financial statistics in order to facilitate the formulation and evaluation of macroeconomic policies for the period ahead. Technical assistance from the Fund could be made available for that purpose. The inadequacy of data for appraising the fiscal position, including budget expenditures, revenues, and deficit financing, was especially noted by Directors. Directors believed that the revenues and expenditures associated with the large irrigation project should be incorporated fully into the budget.

The continuation of the freeze imposed on the Jamahiriya's assets by the U.S. authorities since early 1986 was noted with regret.

The next Article IV consultation with the Socialist People's Libyan Arab Jamahiriya will be held on the 24-month cycle.

The Executive Board then took the following decision:

1. The Fund takes this decision relating to the exchange measures of the Socialist People's Libyan Arab Jamahiriya subject to Article VIII, Sections 2(a) and 3, and in concluding the 1989 Article XIV consultation with the Socialist People's Libyan Arab Jamahiriya, in the light of the 1989 Article IV consultation with the Socialist People's Libyan Arab Jamahiriya conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. The Socialist People's Libyan Arab Jamahiriya continues to maintain restrictions on the making of payments and transfers for current international transactions in accordance with Article XIV, except for the multiple currency practice and exchange restrictions, as described in SM/89/201, that are subject to Fund approval under Article VIII, Sections 2(a)

and 3. The Fund urges the authorities to liberalize the exchange system and to eliminate the multiple currency practice as soon as possible.

Decision No. 9272-(89/136), adopted
October 23, 1989

2. EXECUTIVE DIRECTORS

The Acting Chiarman bade farewell to Mr. Kiriwat and Mr. McCormack upon the conclusion of their service as Alternate Executive Directors.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/89/135 (10/13/89) and EBM/89/136 (10/23/89).

3. PAKISTAN - REPRESENTATIVE RATE FOR PAKISTAN RUPEE

The Fund finds, after consultation with the authorities of Pakistan, that the representative exchange rate for the Pakistan rupee under Rule 0-2(b)(i) against the U.S. dollar is the midpoint between buying and selling rates for spot transactions in U.S. dollars by the State Bank of Pakistan. The State Bank of Pakistan will immediately communicate to the Fund any change in the rate, when it occurs. (EBD/89/310, 10/10/89)

Decision No. 9273-(89/136) G/S, adopted
October 16, 1989

4. RELATIONS WITH GATT - CONSULTATIONS WITH CONTRACTING PARTIES - FUND GUIDANCE

The Executive Board approves the recommendation by the Committee on Liaison with the CONTRACTING PARTIES to the GATT with regard to the guidance statement for the Fund representative attending the GATT consultations with India during the week of October 16, 1989, as set forth in EBD/89/296, Supplement 1 (10/11/89).

Decision No. 9274-(89/136), adopted
October 13, 1989

5. RELATIONS WITH GATT - CONSULTATIONS WITH CONTRACTING PARTIES - FUND GUIDANCE

The Executive Board approves the recommendation by the Committee on Liaison with the CONTRACTING PARTIES to the GATT with regard to the guidance statement for the Fund representative attending the GATT consultations with Korea during the week of October 23, 1989, as set forth in EBD/89/297, Supplement 1 (10/17/89).

Decision No. 9275-(89/136), adopted
October 20, 1989

6. ARGENTINA - TECHNICAL ASSISTANCE

In response to a request from the Argentine authorities for technical assistance in the central banking field, the Executive Board approves the proposal set forth in EBD/89/320 (10/13/89).

Adopted October 18, 1989

7. BRAZIL - TECHNICAL ASSISTANCE

In response to a request from the Brazilian authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/89/311 (10/10/89).

Adopted October 13, 1989

8. COMOROS - TECHNICAL ASSISTANCE

In response to a request from the Comorian authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/89/313 (10/10/89).

Adopted October 13, 1989

9. FIJI - TECHNICAL ASSISTANCE

In response to a request from the Fijian authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/89/319 (10/12/89).

Adopted October 16, 1989

10. MADAGASCAR - TECHNICAL ASSISTANCE

In response to a request from the Malagasy authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/89/312 (10/10/89).

Adopted October 13, 1989

11. TUNISIA - TECHNICAL ASSISTANCE

In response to a request from the Tunisian authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/89/314 (10/10/89).

Adopted October 13, 1989

12. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/89/241, (10/16/89), by Advisors to Executive Directors as set forth in EBAP/89/241 (10/16/89) and EBAP/89/243 (10/17/89), and by an Assistant to Executive Director as set forth in EBAP/89/244 (10/18/89) is approved.

13. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/89/242 (10/16/89) is approved.

APPROVED: June 15, 1990

JOSEPH W. LANG, JR.
Acting Secretary