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May 13, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Socialist People's Libyan Arab Jamahiriya - Staff Report
for the 1985 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1985 Article IV consultation with the Socialist People's Libyan Arab Jamahiriya, which has been tentatively scheduled for discussion on Monday, June 3, 1985. A draft decision appears on page 17.

Mr. Thayanithy (ext. 7113) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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SOCIALIST PEOPLE'S LIBYAN ARAB JAMAHIRIYA

Staff Report for the 1985 Article IV Consultation

Prepared by the Staff Representatives for
the 1985 Article IV Consultation with the
Socialist People's Libyan Arab Jamahiriya

Approved by S.H. Hitti and J.T. Boorman

May 10, 1985

I. Introduction

The 1985 Article IV consultation discussions with the Socialist People's Libyan Arab Jamahiriya (hereinafter referred to as the Jamahiriya) were held in Tripoli during the period March 6-12, 1985. The Jamahiriya representatives were led by the Deputy Governor of the Central Bank of Libya and included senior officials of the Bank and of the Secretariats of Agriculture, Economy and Light Industry, Heavy Industry, Housing, Oil, Planning, Shipping and Communications, and Treasury. The mission also met with the Secretary for the Treasury and the Governor of the Central Bank. The mission was composed of Messrs. S.H. Hitti (Head), M.A. El-Erian, M. Shadman, and S. Thayanithy (all of MED), and Ms. M. Bullough (Secretary - RES). The previous consultation discussions were held in October 1982 and the Staff Report (SM/82/228), together with the report on Recent Economic Developments (SM/82/237), were considered by the Executive Board on January 7, 1983.

The Jamahiriya continues to avail itself of the transitional arrangements of Article XIV.

II. Background

The production and export of oil dominate economic activity in the Jamahiriya. In recent years, the oil sector has contributed around one half of real GDP, while oil revenues have accounted for some 80 percent of total budgetary receipts and for virtually all export earnings. A principal objective of policy has been to utilize these revenues to accelerate economic and social development. The institutional framework for fulfilling this objective has been undergoing fundamental changes since 1977 aiming primarily at the establishment of a system of self-government based on the full participation by the people in the governance of the country's political, social, and economic institutions. 1/ The Jamahiriya's development

1/ For details, see SM/80/170, pp. 2-3.

policies are formulated within a framework of comprehensive national planning. The 1976-80 Five-Year Transformation Plan aimed at reducing the dependence on the oil sector, expanding the economy's absorptive capacity, and developing and upgrading the indigenous manpower resources. This emphasis was retained in the 1981-85 Plan which intended to achieve an annual growth rate in the non-oil sectors of over 10 percent.

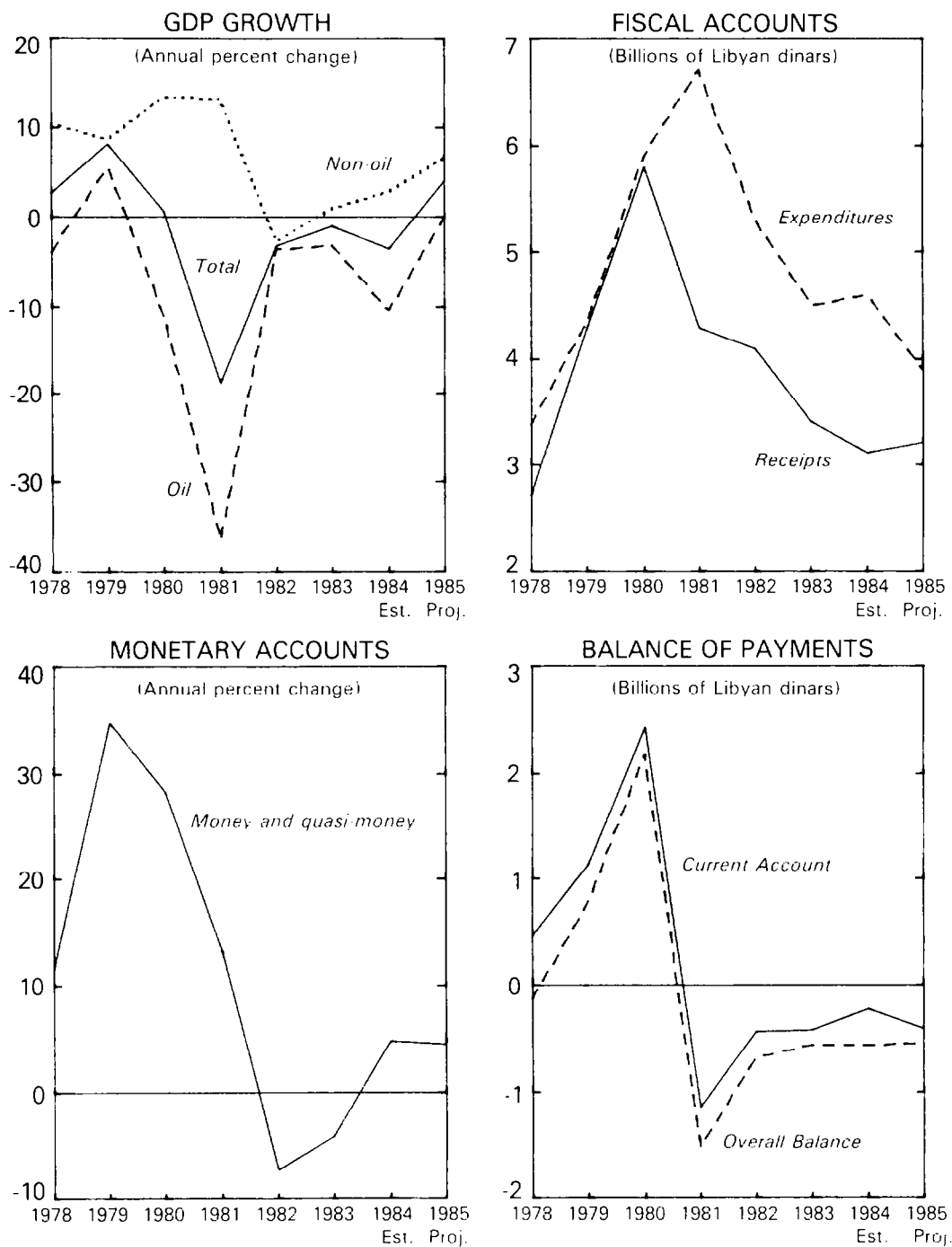
Economic developments in the Jamahiriya over the 1978-82 period reflected closely conditions in the international oil market. In the sub-period ended 1980, favorable changes, principally in the Jamahiriya's oil export unit values, permitted a rapid pace of economic growth, the maintenance of a comfortable fiscal position, and a substantial buildup of foreign reserves. Real non-oil GDP grew by 9 percent in 1979 and a further 13 percent in 1980, in response to the vigorous stimulus of government expenditures (Chart 1). The impact of these higher fiscal outlays on the Jamahiriya's budgetary balance was more than offset by the rapid rise in oil revenues. Accordingly, the overall fiscal deficit was reduced from LD 0.7 billion (11.5 percent of GDP) in 1978 to LD 0.2 billion (1.6 percent of GDP) in 1980. ^{1/} At the same time, the Jamahiriya experienced favorable balance of payments outcomes. The current account surplus steadily increased to LD 2.4 billion (23.2 percent of GDP) in 1980, mainly as a result of higher petroleum export earnings and growing receipts from foreign portfolio investments; the latter factor reflected the rising level of reserves and higher international interest rates. The overall payments position improved correspondingly, from a deficit of LD 0.1 billion (2.3 percent of GDP) in 1978 to a surplus of LD 2.2 billion (20.7 percent of GDP) in 1980. As a result, gross foreign assets of the Central Bank of Libya (including the currency cover) rose to a record level of US\$14.2 billion in end-December 1980, equivalent to some 16 months of imports. The growth in liquidity (money and quasi-money), which largely reflected the balance of payments surplus, averaged 31.5 percent over the two-year period 1979-80. The Jamahiriya operated a price control system and a subsidy program covering essential commodities. Consumer price changes reflected administrative pricing adjustments. Domestic inflation, as measured by an adjusted consumer price index, amounted to 8 percent in 1980. ^{2/} ^{3/}

^{1/} LD 1 = US\$3.3778.

^{2/} The Jamahiriya's consumer price index was not compiled in 1980-81 due to the cessation of collection of price data. The average compound rate of increase in the index between 1979 and 1982 is shown for these years.

^{3/} The official price index, which exhibited an annual growth of 11 percent in 1980, was adjusted to take account of the technical limitations arising from the treatment of the housing component. Specifically, the recent revision in the compilation of the official consumer price index excluded dwelling costs from the weighting system. Since these costs have been stabilized, this revision contributes to an overstatement of changes in living costs. Accordingly, the staff has adjusted the official index by taking account of this element.

CHART 1
SOCIALIST PEOPLE'S LIBYAN ARAB JAMAHIRIYA
PRINCIPAL ECONOMIC TRENDS



Source: Data provided by the authorities, and staff estimates and projections.



The Jamahiriya's economic situation changed significantly after 1980 as a result of the lower world demand for oil caused by effective conservation measures, widespread recessionary conditions, and a decline in OPEC's share in world exports as other producers expanded their market shares. After averaging some 2 million barrels per day (mb/d) in the second half of the 1970s, oil production declined to about 1.2 mb/d in 1982. This, combined with falling export unit values, contributed to a reduction in economic growth and the emergence of substantial fiscal and external imbalances. These imbalances were particularly pronounced in 1981 as expenditure reduction measures could not be implemented due to spending commitments already made. However, starting in 1982, the authorities reduced public expenditures and this contraction of fiscal outlays, affecting especially construction and related activities, had an immediate impact on real non-oil GDP which, after expanding by 13 percent in 1981, declined by 3 percent in 1982 (Table 1). The impact was also reflected in the improvement in the Jamahiriya's fiscal deficit position from LD 2.4 billion (25.2 percent of GDP) in 1981 to LD 1.3 billion (14.6 percent of GDP) in 1982. This amelioration would have been greater had it not been for the further fall in oil receipts and the decline in non-oil revenue attributable, in part, to lower profit transfers from public corporations and the decrease in import duty collections resulting from the slowdown in overall economic activity.

The deterioration in the fiscal position in 1981 led to a considerable increase in net bank claims on the Treasury, at the same time as the recourse to the banking system by non-Treasury sectors became a major source of liquidity injection; the latter reflected the supplementing of financial resources of existing and newly established public sector enterprises. The adoption of a tighter fiscal stance in 1982 reduced the expansionary influence of government borrowing from the banking system, thereby contributing to the reduction in overall liquidity. In addition, the authorities introduced a more restrictive credit policy toward public sector enterprises. Domestic inflation, as measured by the adjusted consumer price index, averaged some 8 percent throughout the period.

Balance of payments changes during 1980-82 were similar to fiscal developments as they reflected primarily the levels of oil export receipts and the impact on imports and other payments of changes in the authorities' expenditure policy. Accordingly, the overall balance of payments experienced a sharp reversal in 1981 to a deficit of LD 1.5 billion (16.3 percent of GDP) after the record 1980 surplus. The reductions in fiscal outlays in 1982 led to a decline of 25 percent in import payments, which more than offset the further drop in oil exports, lower receipts from investment income resulting from falling international interest rates and lower levels of foreign assets, and increased outward remittances by expatriates working in the Jamahiriya. The resulting improvement in the current account was the principal cause for the amelioration in the overall external position to a deficit of LD 0.7 billion (7.8 percent of GDP). Since the Jamahiriya continued to refrain from incurring significant foreign borrowing, a

Table 1. Socialist People's Libyan Arab Jamahiriya: Selected Indicators, 1980-85

	1980	1981	1982	1983	Prelim. 1984	Proj. 1985
	(In percent change)					
GDP at constant prices	0.6	-18.8	-3.3	-1.1	-3.7	4.0
Non-oil GDP at constant prices	13.4	13.2	-2.8	0.9	2.8	6.6
Oil production	-13.4	-33.7	0.8	-9.1	-10.0	--
Consumer price index-unadjusted <u>1/</u>	11.1	11.1	11.1	10.6	10.0	10.0
Consumer price index-adjusted <u>1/</u> <u>2/</u>	8.4	8.4	8.4	8.0	7.5	7.5
Total fiscal revenues	34.9	-25.1	-6.2	-15.2	-10.4	3.6 <u>3/</u>
Total fiscal expenditures	36.3	12.3	-20.2	-15.6	1.9	-15.0
Money and quasi-money	28.3	13.2	-7.3	-4.2	4.7	4.5
Exports	37.2	-32.8	-7.0	-9.9	-10.6	-11.4
Imports	20.1	40.4	-24.6	-18.2	-9.1	-9.0
Nominal effective exchange rate (end of period, depreciation-)	8.9	19.2	14.4	15.4	13.0	...
	(In millions of Libyan dinars)					
Overall fiscal position	-167.8	-2,355.8	-1,270.9	-1,054.8	-1,497.3	-700.0
(As percent of GDP)	(-1.6)	(-25.2)	(-14.6)	(-12.4)	(-18.9)	(-7.7)
Current external payments balance	2,444.4	-1,150.8	-438.7	-416.3	-229.3	-416.4
(As percent of GDP)	(23.2)	(-12.3)	(-5.1)	(-4.9)	(-2.9)	(-4.6)
Overall external payments balance	2,181.9	-1,519.9	-675.0	-561.8	-574.4	-542.7
(As percent of GDP)	(20.7)	(-16.3)	(-7.8)	(-6.6)	(-7.3)	(-6.0)
Gross official reserves <u>4/</u>	4,202.4	2,774.0	2,108.9	1,591.0	1,075.0	532.3
(In months of imports) <u>5/</u>	(16.4)	(7.7)	(7.8)	(7.2)	(5.3)	(2.9)

Sources: Data provided by the authorities; and staff estimates and projections.

1/ The index was not compiled for 1980-81. The average annual compound rate of increase in the index between 1979 and 1982 is shown for the years 1980-82.

2/ Adjusted for technical limitations resulting from treatment of the housing component.

3/ Budget estimate.

4/ Gross foreign assets of Central Bank (including currency cover).

5/ Of current year.

further substantial drawdown of international reserves occurred. The gross foreign assets of the Central Bank (including the currency cover) fell to US\$7.1 billion at the end of 1982, equivalent to eight months' imports of that year.

The Libyan dinar has been pegged to the U.S. dollar, the intervention currency, at the rate of LD 1 = US\$3.3778 since February 1973. The exchange and trade system is subject to comprehensive controls with respect to both current and capital transactions, although some restrictions had been gradually liberalized since the mid-1960s. However, in response to the deteriorating external position in the early 1980s, the authorities intensified restrictions on foreign exchange allowances for travel purposes, and regulated imports through the vehicle of a commodity budget which was also used to promote import-substituting activities. 1/

III. Report on the Discussions

The consultation discussions centered on the Jamahiriya's adjustment efforts in the wake of the changed circumstances in the international oil market. The discussions were hampered by weaknesses in the Jamahiriya's data base. 2/ In particular, as noted below in the relevant sections, analysis of economic and financial developments was clouded by the unavailability of oil revenue data, the substantial discrepancies between fiscal and monetary accounts, and the large changes in the net unclassified assets of the banking system. Notwithstanding these limitations, the broad conclusion that emerged from the discussions was that the authorities had made substantial progress in adjusting the economy to a sharply reduced income level. Despite this, however, it appeared that considerable fiscal and external deficits will persist and that additional measures were needed in order to restore financial balance in the economy.

1. Oil sector developments and policies

Average crude oil production declined by 9 percent in 1983 and by a further 10 percent in 1984 to 990,000 b/d and exports also followed a declining trend. During the two years, the official sales prices of Libyan crudes were reduced by about 15 percent in February 1983. The Jamahiriya had some reservations regarding certain aspects of implementing the pricing formula adopted by OPEC in January 1985 but the authorities expected to resolve these issues in consultation with other members. The Jamahiriya representatives stated that production and pricing policies were determined in cooperation with OPEC and that the Jamahiriya was willing to do its share in stabilizing the international market. In line with this policy, the Jamahiriya had accepted

1/ See Section V.3 of the report on Recent Economic Developments.

2/ Refer to Appendix II for details on the coverage and currentness of data reported for inclusion in International Financial Statistics.

progressive reductions in its production ceiling to the present level of 990,000 b/d because of weak demand and a decline in OPEC's market share. The representatives considered that the 1985 outlook was difficult to forecast, but, in general, output was expected to approximate the production ceiling. Domestic prices of petroleum products have been adjusted periodically to encourage efficient use of energy resources and presently, these prices are close to the international level equivalents and in fact involve an element of taxation.

Major new discoveries in the oil sector included two offshore fields and one onshore field; the impact of these findings on the oil reserve position has not yet been evaluated. With regard to refining capacity, the construction of the Ras Lanuf refinery, with a production capacity of 220,000 b/d, was completed in August 1984 raising total refining capacity to 358,000 b/d. Output of this refinery in 1985, the bulk of which is destined for exports, is not anticipated to exceed 150,000 b/d. The construction of a 570-kilometer gas transmission line from Brega to Misuratah has been completed; this line will feed the Ras Lanuf refinery, the Misuratah steel complex, two planned ammonia plants in Sirte, and to the extent available, cement plants. Work on continuation of this line from Misuratah to Homs (100 kilometers) is already under way. Most petrochemical plants produced at close to capacity in 1984. With regard to export of petrochemical products, the Jamahiriya representatives stated that export prices were determined on a commercial basis and were competitive. Moreover, these products had so far enjoyed a competitive advantage due to the country's proximity to the European market. However, the imposition of a 13-14 percent import duty by the European Community in 1984 might create difficulties in late 1985 and 1986.

2. Non-oil sector developments and policies

After expanding at a sharp pace in 1983, value added in agriculture declined by 3.7 percent in 1984 due to adverse weather conditions which affected cereal output. The Jamahiriya representatives stated that production policies in the Jamahiriya were designed to provide incentives in the form of guaranteed producer prices, agricultural credit, and extension services. In this context, farmers had the option to sell their output either to cooperatives or directly to consumers, and they were also encouraged to form unions to improve facilities for production. In 1984 the authorities launched a large-scale irrigation project, known as the Great Man Made River Project (hereinafter referred to as the River Project), designed to transport water by a pipeline network from underground aquifers in Sarir and Tazerbo in the desert to the coastal farmlands. The first stage of the project, scheduled for completion by 1992 at a cost of US\$3-3.3 billion, will provide irrigation for the cultivation of vegetables and cereals, as well as for the grazing of livestock. The second phase of the project would extend the supply of water to Sirte in the west of the country. The entire project would take ten years for completion. The Jamahiriya representatives stated that because of the importance

of this project, it had been placed under a new Secretariat with its own independent budget to be financed from domestic resources. However, because of declining oil revenues, the option of external financing has not been ruled out.

Although value added in manufacturing rose by close to 30 percent in 1983-84, production levels remained substantially below capacity in several industries. The underutilization of capacity has been attributed to certain technical problems. Current policy aims at a greater utilization of existing capacity with emphasis on light industries. The importation of spare parts and raw materials receives priority in the commodity budget and special attention continues to be accorded to industrial training. Encouragement will be given to the establishment of production ventures as partnerships between members of a family or other individuals working on a cooperative basis. The reduction in construction activity in 1983-84 reflected decreasing public expenditures on infrastructural projects. Furthermore, since the resources available to the Savings and Real Estate Investment Bank were below expectations due to the decline in government revenues, the pace of housing construction slowed down. However, in 1985 commercial banks are to resume extending housing loans and a resurgence of construction activity is expected. Additionally, more than 4,000 units for low-income groups are to be constructed with financing through the Savings and Real Estate Investment Bank.

With a steep cutback in government spending, affecting especially construction and related activities, in combination with a weak performance in agriculture in 1984, the non-oil GDP rose by 0.9 percent and 2.8 percent in 1983 and 1984, respectively. The Jamahiriya representatives said that these developments reflected essentially the implementation of policies designed to bring about the adjustment necessitated by the sharp fall in oil revenues. However, an upturn in activity was expected to gather momentum in 1985 when non-oil sectors are projected to expand in the range of 6-7 percent. The most important components of this growth were in manufacturing output (12 percent) and in construction (11 percent); the latter was accounted for to a large extent by the River Project. The mission commented that the targeted substantial acceleration in economic growth seemed to be inconsistent with the expectation for a further decrease in imports and in foreign workers. The Jamahiriya representatives responded that the faster growth was expected to result from more intensive capacity utilization, growth in the indigenous labor component, and productivity gains. The foreign labor requirements of the River Project would be met as needed.

The main objective of employment policy in the Jamahiriya has been to effect a change in the composition of the labor force by increasing the participation of Libyans and reducing the dependence on foreign labor. The number of foreign workers fell from 280,000 in 1980 to 263,000 in 1984; the latter represented 28 percent of the labor force. Training programs for Libyans have been accelerated, and several

training and technical institutions have been established. Returning Libyans trained abroad have also aided the process of substitution of foreign labor and the authorities were encouraging the transfer of Libyans from the service sectors to the commodity-producing sectors.

The available price index, adjusted to reflect dwelling costs, shows annual price increases of about 8 percent. The Jamahiriya representatives said that the prices of basic food commodities were maintained unchanged, but the price of cigarettes was increased by 50 percent in 1983 and by 67 percent in 1984. The price of gasoline was also raised by 20 percent in 1983. The prices of several other inessential items and services were also increased. The policy of subsidizing basic food commodities has been maintained even though official policy continues to aim at the gradual reduction of consumer subsidies. In this regard, the subsidy on imported meat was eliminated in 1984.

The Jamahiriya's representatives stated that the Transformation Plan for 1986-90 was in the preliminary stages of preparation. The strategy of the Plan would be basically the same as that of the current Plan, that is, to develop non-oil sectors and to reduce the economy's dependence on oil. The main goal would be to complete current projects and to effect increased utilization of existing production units. The River Project would be the most important project, but its expenditures would be kept outside the development budget in the first phase. The targeted annual growth rate of the non-oil sectors would be about 4 percent, partly reflecting the long gestation period of the River Project. The growth targets of the Plan were scaled down, relative to those of the previous Plan, in line with the reduced availability of financial resources.

3. Fiscal developments and policies

Faced with persistent declines in oil revenues after 1980, the authorities focused their fiscal policies on efforts to align the expenditure level with financing availabilities. Precise quantitative analysis of fiscal developments, however, was hampered by lack of reliable data on key elements. As official data on oil revenues from 1980 were not made available, the mission prepared tentative estimates of these revenues. Although the Jamahiriya representatives made some comments regarding their accuracy, these indirect estimates are necessarily subject to a considerable margin of error. The oil revenues thus estimated, together with the official data on non-oil revenues and on expenditures, show that the overall fiscal deficit, after a sharp decline in 1982, averaged LD 1.3 billion in 1983-84; this was roughly comparable to its level in 1982. The monetary data, however, show that less than one half of the overall deficit in 1984 was covered by net borrowing from the banking system, while in 1983 there was a substantial improvement in the Government's net position vis-a-vis the banking system. The mission said that, in the absence of external financing, the data based on these estimates pointed to large discrepancies between the financial accounts.

The Jamahiriya representatives confirmed that the general pattern of fiscal developments showed a large deficit in 1981 followed by substantially reduced deficits in the three years 1982-84. They stressed, however, that the fiscal data were preliminary and subject to revisions as various accounts were being audited and the final accounts for the past years firmed up. In general, they believed that the annual overall deficit was more likely to have been in the range of LD 0.5-1.0 billion than in the higher range cited by the mission. This tended to align the fiscal deficit more closely with the monetary data. The Jamahiriya representatives also confirmed that no external financing of the budget had been incurred. With regard to 1983, the authorities explained that in that year there was an increase of about LD 1 billion in "other assets" of the Central Bank which consisted largely of credit to the Government temporarily recorded in the suspense accounts. The mission took note of the preliminary nature of the fiscal data and expressed the hope that timely and accurate statistics would be compiled in the future to assist the authorities in assessing developments and formulating policies.

Data provided by the authorities showed that non-oil revenues rose by 11 percent in 1983 and by 4 percent in 1984. These increases were attributable to the recovery in economic activity in 1983-84, and larger receipts from income taxes in 1983 resulting from the salary increases of public sector employees effected in 1982. The proceeds of the new revenue measures implemented in 1983-84 were not reflected in the budget. Thus, the incremental revenue from the taxes of 20 dirhams ^{1/} per liter of gasoline and of 20 dirhams per packet of cigarettes imposed in 1984 was earmarked for the River Project which had its independent budget.

Measures were implemented from 1982 aimed at reducing administrative expenditures. A number of Libyan employees in the administrative services were transferred to the commodity-producing sectors. Salary increases in the public sector had not been granted since 1982. In addition, there was a suspension of purchases of furniture and equipment. Despite these measures, however, total administrative expenditures continued to rise during 1983-84. With regard to development expenditures, wide-ranging cutbacks were effected from the initial allocations under the Plan. These consisted of the postponement of certain new projects and the suspension of other projects considered not to be in urgent need of completion. As a result, actual development expenditures declined by nearly a quarter during 1983-84. Development outlays for the first four years of the 1981-35 Plan amounted to LD 9.2 billion, compared with the planned allocation of LD 18.5 billion; the implementation ratio for the entire Plan period was estimated at about 60 percent. The Jamahiriya representatives said that these cutbacks were necessary to adjust to the lower level of revenues and were also intended to reduce the dependence on foreign labor and

^{1/} LD 1 = 1,000 dirhams.

pressures on the balance of payments. Supplementary expenditures declined to about LD 1 billion in 1983-84. While details of the supplementary expenditures were not available, a small portion of the decline in this item was explained by a drop in commodity subsidies.

The 1985 budget projects a balance between non-oil revenues and administrative expenditures (excluding defense), with each estimated at LD 1.2 billion, and allocates LD 1.7 billion for development expenditures. The mission commented that the administrative budget for 1985 appeared to be based on optimistic assumptions, particularly with respect to expected non-oil revenues. Moreover, past experience suggested that actual administrative expenditures tended to exceed budget allocations. The Jamahiriya representatives stated that while the budget did not include any new revenue measures, they expected an improvement in tax collection due to both increased coverage and training of tax officials. They also said that the financial accountability law was amended in February 1984 to enhance the Treasury's supervisory responsibilities over the public bodies. Stricter financial control and accountability were expected to enhance the flow of revenue to the Treasury. The electricity and telecommunications utilities had been turned over from the relevant Secretariats to public companies whose operations will be outside the budget. The profits from these and other corporations were expected to increase in 1985. The transfer of these functions would also have the effect of reducing the administrative expenditures of the Secretariats. As for development expenditures, they said that the emphasis in 1985 would be on the completion of projects under way. The mission expressed the view that even if the budgeted level of non-oil revenues does in fact materialize, the authorities succeed in holding administrative expenditures to the level estimated in the budget, oil revenues in 1985 approximate LD 2 billion, and development expenditures turn out as budgeted at LD 1.7 billion, that would leave only LD 0.3 billion to finance supplementary expenditures. While these are difficult to predict ex ante, should such expenditures amount to about LD 1 billion as estimated for 1984, the overall deficit in 1985 would be some LD 0.7 billion. The Jamahiriya representatives concurred that an overall fiscal deficit in 1985 was likely to be incurred but stressed that official policy was to minimize its size in preparation for accelerated efforts to strengthen fiscal performance under the next Plan.

4. Monetary and credit developments and policies

Domestic liquidity declined by 4 percent in 1983 due entirely to the contractionary impact of the external sector. As for 1984, data for the first ten months of the year indicated that, despite a further considerable decline in net foreign assets, domestic liquidity rose by 1.4 percent and for the year as a whole is forecast to rise by about 5 percent. The expansion in domestic liquidity in 1984 is expected to reflect almost entirely a rise in net claims on the Treasury necessitated by the persistence of the fiscal deficit. With

respect to credit to other sectors, such borrowing remained by and large unchanged during the 1983-84 period. The representatives indicated that the interest rate structure has not changed since 1980. 1/

The Jamahiriya representatives explained that domestic credit developments reflected mainly the movements in the Treasury's accounts with the banking system. They stressed that an effort had been made to restrain the growth of domestic liquidity in order to strengthen demand management and improve balance of payments performance. Thus, domestic liquidity had declined annually during the 1982-83 period compared with a 9 percent annual increase in nominal non-oil GDP. Monetary expansion in 1984 was also estimated to be substantially below the nominal non-oil GDP growth rate. Regarding credit to other sectors (mostly public enterprises), the representatives indicated that policy aimed at extending credit on a rollover basis, thus contributing to the containment of bank credit. Moreover, public enterprises were expected to operate on a commercial basis and to meet their operating expenditures from current revenues. The representatives stated that the rapid rise in unclassified assets in 1983 was principally due to certain payments made by the Central Bank on behalf of the Government, and temporarily recorded in the suspense accounts of the Central Bank. The mission suggested that a thorough examination of the unclassified items in the monetary accounts would be desirable. The representatives stated that while the Central Bank was reviewing this matter, they were convinced that these developments were temporary in nature and would be resolved.

With regard to the 1985 outlook, the mission observed that preliminary estimates indicated that the combination of overall balance of payments and fiscal deficits with a moderate increase in credit to other sectors suggested that liquidity in 1985 might increase by some 4-5 percent. The Jamahiriya representatives indicated that due to many uncertainties related to the level of oil exports and revenues, the outlook for 1985 was difficult to forecast at this time.

5. Balance of payments developments and prospects

Official data show that sizable current and overall external deficits were experienced in 1983-84. The current account deficit was reduced sharply in 1984 as lower imports and remittance outflows offset the further decline in export and investment income receipts. However, due to the deterioration in the capital account reflecting outflows related to the activities of the foreign investment entities, the overall deficit amounted to an estimated LD 0.6 billion, broadly the same level as in 1983. The Jamahiriya representatives stated that the external sector deficits reflected mainly the changes in the oil market; the Jamahiriya's oil receipts, which account for virtually all

1/ As indicated in the report on Recent Economic Developments, interest rates vary between 2.5 percent for interbank loans and 9 percent for four-year fixed-term deposits.

export earnings, had dropped by 10 percent annually in these two years. Additionally, investment income continued to decrease, partly reflecting the reduction in the stock of foreign reserves; gross foreign assets of the Central Bank had been drawn down to LD 1.1 billion at end-1984 (equivalent to five months of 1984 imports) of which some LD 0.7 billion was tied up in the legal currency cover. Foreign liabilities of the banking system remained small and official external debt for civilian purposes was insignificant.

The mission presented tentative balance of payments projections for 1985 showing a position similar to the developments in 1983-84 with the overall deficit decreasing marginally from its level in the previous two years. The Jamahiriya representatives stated that the authorities planned to continue pursuing their tight monetary and fiscal stance as part of a demand management policy aimed at eliminating the deficit in 1985 and they believed that objective might have been attainable were it not for the further weakening in the international oil market. Nevertheless, a reduction in the overall balance of payments deficit is intended for 1985 and, to this effect, the commodity budget, which is aimed at regulating imports in accordance with the country's economic and financial requirements, had been set at LD 1.5 billion, 9 percent below that for 1984. Overall, they believed that while a deficit in 1985 appeared unavoidable, it was likely to be less than indicated in the mission's projections.

There was a qualitative discussion of the medium-term external outlook based on an analysis of hypothetical changes in key elements in the balance of payments. While acknowledging the tentative nature of such an exercise, the mission noted that under conditions of continued weakness in the oil market and absence of significant policy changes, and given the structure of the external accounts, imports would need to be contained severely if recourse to foreign borrowing were to be limited. As an illustration, it was noted that under the assumption of constant nominal import expenditures, annual payments deficits of LD 0.5 billion appeared in prospect during the remaining years of the 1980s. The Jamahiriya representatives were of the opinion that the mission's observations did not take into account sufficiently the probable decline in foreign payments, especially for imports. They pointed out that since 1981, the authorities had succeeded in reducing imports considerably and added that the formulation of the next Plan would take into account the prospective availability of foreign exchange and would be consistent with the elimination of the overall payments deficit after 1985. The intention of the authorities to move in this direction was indicated by the modest growth target of the Plan. The policy of improving external sector performance would also be assisted by strengthening the demand management stance, enhancing the import substitution process, and effecting further reductions in the reliance on foreign labor.

6. Developments and policies in the exchange and trade system

Under the existing policy of pegging the Libyan dinar to the U.S. dollar at the fixed rate of LD 1 = US\$3.3778, the dinar's real and nominal effective exchange rates have appreciated sharply since 1980 (Chart 2). While this development has had a favorable impact on import unit values, it has stimulated the demand for foreign goods and services. The mission thought that it would be useful for the authorities to examine the advantages of exercising a greater degree of flexibility in the pricing of foreign exchange and to review the need for making a correction for the substantial effective appreciation of the currency that has taken place in recent years. Such a step would complement a tight expenditure policy and contribute over a medium-term perspective to the development objectives, particularly import substitution, and in general to more efficient resource allocation. The Jamahiriya representatives said that there were many considerations to be taken into account in this area; these included the prevailing low price elasticities of demand for foreign goods resulting from the Jamahiriya's narrow production base outside the hydrocarbon sector, and the possibility that the beneficial effects of a depreciation would be offset by an upward adjustment of expenditures, given the expenditure commitments and their high import component. They stated that the exchange rate policy was currently under careful review but so far no decision had been made as to whether to change the present arrangement and/or to make a correction for the appreciation of the currency.

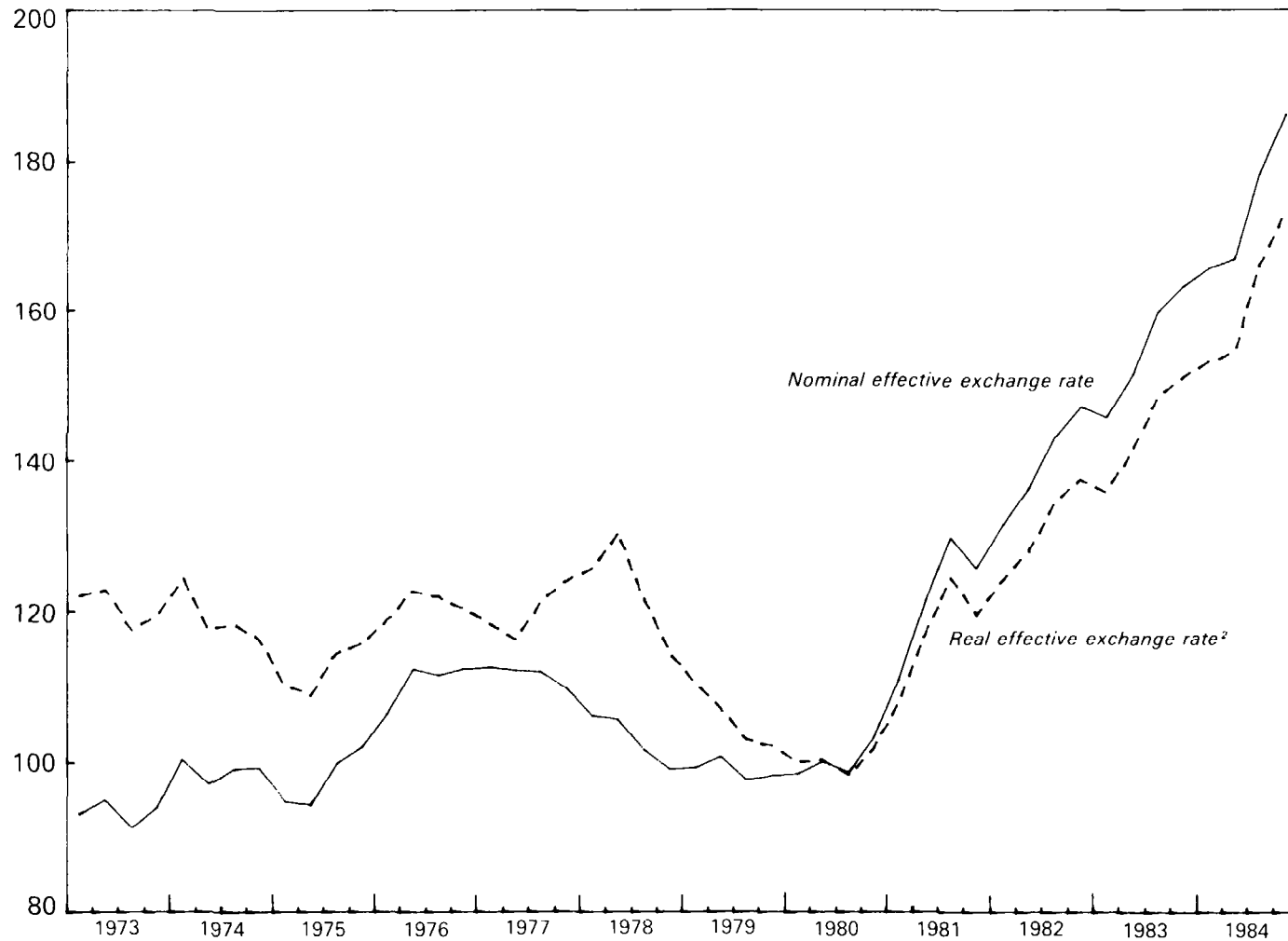
The authorities had provided the mission with information on changes in the exchange and trade system. ^{1/} The representatives confirmed that the reductions in travel allowances, for which the Fund had granted approval, were still in effect. They stated that these restrictions had been introduced temporarily for balance of payments reasons and affirmed their intention to liberalize them as soon as possible. Regarding the recent reductions in allowable transfer ratios for foreign workers' remittances, the representatives explained that such an action was necessary in order to guard against illegal capital transfers. Recent investigations had suggested that normal local expenditures by nonresidents exceeded the amounts allowed for under the previous regulations and, as a result, the unused transfer allowances might have been utilized by other ineligible individuals for capital transactions. Regarding reports on delays in the making of payments for current transactions, the representatives replied that only minor delays had arisen from time to time resulting from basically technical considerations such as incomplete supporting documentation and the need to ensure the correctness of payment claims. As soon as all the technical specifications were completed, the required payments were made promptly.

^{1/} See Section V.5 of the report on Recent Economic Developments.

With regard to the trade system, the mission inquired about exports of Libyan crude made in settlement of payment obligations incurred by the Government. The representatives stressed that the Jamahiriya did not solicit or welcome noncash oil trade, that trade under this category was limited to a few special cases, and that the average unit price for these transactions was in line with contracts in accordance with the official sales policy. The representatives asserted that the trade agreements recently concluded between the Jamahiriya and each of Morocco and Tunisia did not include payment features.

CHART 2
SOCIALIST PEOPLE'S LIBYAN ARAB JAMAHIRIYA
EFFECTIVE EXCHANGE RATES¹

(1980 = 100)



Sources: Data provided by the authorities; IFS and staff estimates.

¹An increase in the index reflects an appreciation.

²Based on adjusted consumer price index.

IV. Staff Appraisal

The economy and finances of the Jamahiriya continue to be strongly influenced by developments in the international oil market. With a sharp and continuing decrease in the country's oil receipts after 1980, a major policy objective of the authorities became adjusting the economy to the new circumstances. The magnitude of the adjustment effort facing the Jamahiriya authorities was very large. The available preliminary estimates indicate that between 1980 and 1984 oil revenues were cut by one half. In response, the authorities acted to trim public spending by approximately one third over the three-year period 1982-84. The tightened expenditure stance was supplemented by restraints on the extension of credit to the other sectors, with credit outstanding remaining essentially unchanged over the 1982-84 period. In addition, in the context of their centrally planned economy, restrictions were used for regulating the private sector's access to foreign exchange for certain invisible payments and budgeted imports were reduced. These policies resulted in slowing down the pace of economic activity, particularly in the construction sector and, in combination with weak agricultural performance in 1982 and 1984, caused the non-oil economy to expand only marginally over the three-year period 1982-84. With respect to the balance of payments, the effects were to reduce considerably the current and overall deficits. There was agreement between the authorities and the staff mission that fiscal and external deficits will persist in 1985 but the authorities believed that the staff estimates of these deficits might be on the high side.

While the overall pattern of developments described above is generally clear, the quantitative estimates are subject to a considerable margin of error because of the preliminary estimation of certain data, particularly with regard to the crucial factor of oil revenues. In the monetary accounts, the very large growth in the net unclassified liabilities of the banking system clouds the analysis of monetary developments and there are large discrepancies between the monetary and fiscal accounts. The authorities need to put together for their own use an integrated and up-to-date series of financial and economic accounts to provide a basis for policy formulation for the period ahead.

The expenditure restraints that have been implemented by the authorities of the Jamahiriya to bring about balance between revenues and expenditures both internally and externally were commendable. The required adjustment was not only large initially, but was also aggravated by the continuing fall in oil revenues. Despite these shortfalls in income, it is noteworthy that the authorities did not resort to foreign borrowing in order to sustain a higher expenditure level. Their policy was to allow the external deficits to be reflected in foreign reserves changes as these assets had been built up to substantial levels in the surplus period of 1979-80. The Central Bank's reserves, however, have been reduced sharply and currently the free reserves are equivalent to less than two months of imports.

Further alignment of the level of expenditures relative to resource availabilities and, to some extent, the enhancement of non-oil revenues, remain the crucial factors for restoring fiscal and external balance in the Jamahiriya. The point of view of the Jamahiriya representatives was that restoration of balance would be pursued vigorously in the context of the next Five-Year Plan, 1986-90. The staff is concerned that the persistence of the external deficit had led the authorities to reduce allocations for imports budgeted under the commodity budget (which includes consumer and intermediate goods) and to intensify restrictions on access to foreign exchange for certain invisible payments. Such measures do not constitute sustainable solutions to the Jamahiriya's problems as they merely suppress the imbalances without removing their underlying causes. Moreover, the authorities have at their disposal a range of other policies that would contribute to the restoration of external and internal balance. A change in the Jamahiriya's exchange rate policy is one option the authorities may consider. Appropriate demand management and exchange rate policies will assist in strengthening balance of payments performance over the medium term and pave the way for relaxing import and exchange restrictions.

The reduction in travel allowances constitutes a restriction subject to Fund approval under Article VIII. In view of the intention to liberalize this restriction as soon as possible, the staff recommends that the Executive Board grant approval for it until June 30, 1986, or the next Article IV consultation with the Socialist People's Libyan Arab Jamahiriya, whichever is the earlier. While the staff notes that the changes in transfer allowances for nonresidents were made basically to exercise greater control on illegal capital transfers by residents, the staff is nevertheless concerned that this intensification of an existing regulation, as well as the reduction in budgeted imports, constitute a reversal of policy, followed for several years up to mid-1981, to exercise a greater degree of flexibility in the administration of the exchange and trade system. The staff hopes that the authorities will resume in the near future the policy of relaxing exchange and trade restrictions.

In the past, consultation discussions with the Jamahiriya were held in alternate years. While the staff believes that a shorter cycle would be desirable in view of the current and prospective difficulties in the external sector, during the recent discussions the authorities expressed preference for maintaining a 24-month cycle. Therefore, it is recommended that the next consultation discussions be held on that basis.

V. Proposed Decision

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

1. The Fund takes this decision relating to exchange measures of the Socialist People's Libyan Arab Jamahiriya subject to Article VIII, Section 2, and in concluding the 1985 Article XIV consultation with the Socialist People's Libyan Arab Jamahiriya, in the light of the 1985 Article IV consultation with the Socialist People's Libyan Arab Jamahiriya conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. As described in SM/85/132, the authorities reduced foreign exchange allowances for certain travel abroad with effect from April 7, 1982. The intensified restriction is subject to approval under Article VIII, Section 2(a). The Fund notes the intention of the authorities to liberalize this restriction as soon as possible and, in the circumstances of the member, grants approval for the retention of this restriction until June 30, 1986, or the next Article IV consultation with the Socialist People's Libyan Arab Jamahiriya, whichever is the earlier.

Socialist People's Libyan Arab Jamahiriya - Fund Relations

(As of March 31, 1985)

I. Membership Status

Date of membership	September 1958
Status	Article XIV

A. Financial Relations

II. General Department

(a) Quota	SDR 515.7 million
(b) Total Fund holdings of Libyan dinars	SDR 272.2 million or 52.8 percent of quota
(c) Fund credit	None
(d) Reserve tranche position	SDR 243.5 million or 47.2 percent of quota
(e) Current operational budget (maximum use of currency) <u>1/</u>	SDR 8.5 million (receipts)
(f) Lending to the Fund	None

III. Socialist People's Libyan Arab Jamahiriya has not used Fund resources to date.

IV. SDR Department

(a) Net cumulative allocation	SDR 58.8 million
(b) Holdings	SDR 138.4 million or 235.5 percent of net cumulative allocation
(c) Current designation plan (maximum designation)	None

1/ March-May 1985.

B. Nonfinancial Relations

V. Exchange System

The Libyan dinar has been pegged to the U.S. dollar at the rate of LD 0.29531, buying, and LD 0.29679, selling, per US\$1 since February 1973.

VI. Last Article IV Consultation

The last Article IV consultation discussions were held during October 1982. The staff report (SM/82/228) was discussed by the Executive Board on January 7, 1983. The Executive Board's decision (Decision No. 7295-(83/7)), adopted January 7, 1983) was as follows:

1. The Fund takes this decision relating to exchange measures of the Socialist People's Libyan Arab Jamahiriya subject to Article VIII, Section 2, and in concluding the 1982 Article XIV consultation with the Socialist People's Libyan Arab Jamahiriya, in the light of the 1982 Article IV consultation with the Socialist People's Libyan Arab Jamahiriya conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. As described in SM/82/237, the authorities reduced foreign exchange allowances for certain travel abroad with effect from April 7, 1982. The intensified restriction is subject to approval under Article VIII, Section 2(a). The Fund notes the intention of the authorities to remove this restriction as soon as possible and, in the circumstances of the member, grants approval for the retention of this restriction until March 31, 1984, or the next Article IV consultation with the Socialist People's Libyan Arab Jamahiriya, whichever is earlier.

VII. Technical Assistance

A staff member from the Bureau of Statistics visited Tripoli in August 1978 to advise on the compilation and presentation of general statistics. Another staff member from the Balance of Payments Division visited Tripoli in March 1979 to advise on balance of payments compilation. A staff member from the Bureau of Statistics visited Tripoli simultaneously with the mission to advise on the compilation and presentation of monetary statistics.

VIII. Resident Representative/Advisor

None.

Socialist People's Libyan Arab Jamahiriya - Statistical Issues

1. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for the Socialist People's Libyan Arab Jamahiriya in the April 1985 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Central Bank of Libya, which during the past year have been provided on an infrequent basis, and the currentness of the data is generally inadequate.

Status of IFS Data

		<u>Latest Data in April 1985 IFS</u>
Real Sector	- National Accounts	1981
	- Prices	December 1979
	- Production	January 1985
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	n.a.
	- Financing	n.a.
	- Debt	n.a.
Monetary Accounts	- Monetary Authorities	December 1984
	- Deposit Money Banks	October 1984
	- Other Financial Institutions	1981 (partial)
External Sector	- Merchandise Trade:	
	Value (Exports)	January 1985
	(Imports)	December 1981
	Prices	February 1985
	- Balance of Payments	1983
	- International Reserves	January 1985
	- Exchange Rates	February 1985

2. Outstanding statistical issues

a. National accounts

National accounts data had not been reported to the IFS by the Libyan authorities since 1978. It was established during the mission that the provision of these data on a regular basis will be resumed in the near future.

b. Prices

Data on consumer prices were not collected during 1980 and 1981, so that there is a gap in the time series for these years. The basis of the index (1964 = 100) was amended prior to recommencing the data collection in January 1982. It is understood that the Census and Statistics Department is considering a new household expenditure survey.

c. Government finance

There are no data in IFS and the GFS Yearbook does not include a presentation for the Socialist People's Libyan Arab Jamahiriya. This matter was raised during the mission and officials in the Treasury and the Central Bank agreed in principle to provide data to the Fund for publication.

d. Monetary accounts

As a result of a recent technical assistance mission on money and banking statistics, various revisions to the monetary authorities' accounts published in IFS were agreed, thus bringing these data in line with Fund concepts. The authorities also agreed to report data for IFS more regularly in order to maintain the currentness of the Libyan country page. It was also agreed that the coverage of the section on "Other Financial Institutions" would be expanded to include eventually five institutions (two offshore banks and three specialized credit banks). In addition, the currentness of these data would also be improved.

Socialist People's Libyan Arab Jamahiriya - Basic Data

Area	1.76 million square kilometers
Population (mid-1984)	3.6 million
Currency	Libyan dinar (LD)
Exchange rate (since February 1973)	LD 1 = US\$3.3778
GDP per capita (1984)	LD 2,178 = US\$7,357

	1980	1981	1982	1983	Prov. 1984	Staff Proj. 1985
Oil sector						
Crude production (mb/d) <u>1/</u>	1.81	1.20	1.21	1.10	0.99	0.99
Oil revenues (LD billions)	4.94	3.42	3.23	2.52	2.13	2.00
Average official sale price of crude oil (US\$ per barrel) <u>2/</u>	34.72	41.00	37.00	35.25	30.40	30.40

(In percent)

Ratios to GDP (in current market prices)						
Gross domestic investment	23.0	30.1	27.2	24.5	24.6	...
Total fiscal revenues	55.0	46.4	46.9	40.4	39.0	35.4
Total fiscal expenditures	56.6	71.6	61.5	52.8	57.9	43.2
Fiscal deficit	1.6	25.2	14.6	12.4	18.9	7.7
Money and quasi-money	39.0	49.7	49.6	48.4	54.5 <u>3/</u>	50.0
Exports, f.o.b.	61.7	46.7	46.8	42.9	41.3 <u>3/</u>	32.0
Imports, f.o.b.	29.2	46.1	37.5	31.2	30.5	24.3
Current account balance	23.2	-12.3	-5.1	-4.9	-2.9 <u>3/</u>	-4.6

(In thousands)

Employment	812.8	927.1	...
Indigenous labor	532.8	664.0	...
Expatriate labor	280.0	263.1	...

	1980	1981	Provisional 1982	1983	1984	Budget 1985
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(In millions of Libyan dinars)

Public finance						
Revenues	5,789.2	4,334.6	4,067.0	3,448.1	3,090.2	3,200
Expenditures	5,957.0	6,690.4	5,337.9	4,502.9	4,587.5	3,900
Administrative	(1,145.4)	(1,350.6)	(1,461.0)	(1,567.6)	(1,645.3)	(1,200)
Development	(2,551.6)	(2,872.8)	(2,365.9)	(2,096.3)	(1,812.2)	(1,700)
Supplementary	(2,260.0)	(2,467.0)	(1,511.0)	(839.0)	(1,130.0)	(1,000) <u>4/</u>
Surplus or deficit (-)	-167.8	-2,355.8	-1,270.9	-1,054.8	-1,497.3	-700 <u>4/</u>

Socialist People's Libyan Arab Jamahiriya - Basic Data (Concluded)

	1980	1981	1982	1983	Jan.-Oct.		Staff
					1983	1984	Proj.
							1985
	(In millions of Libyan dinars)						
Money and credit (changes during period)							
Money and quasi-money	904.7	542.2	-341.3	-178.8	-102.0	58.4	194.0
Foreign assets (net)	2,181.9	-1,519.9	-675.0	-561.8	-408.3	-368.7	-543.0
Domestic assets (net)	-1,277.2	2,062.1	333.7	383.0	306.3	427.1	737.0
Claims on							
Treasury (net)	-929.1	679.5	370.9	-500.0	-208.3	507.3	...
Claims on							
other sectors	274.5	845.1	83.4	-48.3	-53.6	7.7	...
Other items (net)	-622.6	537.5	-120.6	931.3	568.2	-87.9	...

	(In percent)						
Money and quasi-money	28.3	13.2	-7.3	-4.2	-2.4	1.4	4.5
	1980	1981	1982	1983	Prov. Est. 1984		Staff Proj. 1985

	(In millions of U.S. dollars)						
Balance of payments							
Current account							
balance	8,256.7	-3,887.1	-1,481.9	-1,406.2	-774.5	3/	-1,406.5
Exports, f.o.b.	21,919.2	14,730.9	13,701.0	12,348.2	11,042.4	3/	9,778.0
Imports, f.o.b.	-10,370.2	-14,563.0	-10,975.8	-8,977.2	-8,160.8		-7,423.7
Services and							
private							
transfers (net)	-3,292.3	-4,055.0	-4,207.1	-4,777.2	-3,656.1	3/	-3,760.8
Capital and official							
transfers (net)	-903.6	-497.2	-587.7	-308.7	-858.6	3/	-426.6
Errors and							
omissions (net)	16.9	-749.6	-210.4	-182.7	-307.1	3/	--
Overall balance	7,370.0	-5,133.9	-2,280.0	-1,897.6	-1,940.2	3/	-1,833.1
Gross external assets							
(end of period)	15,325.8	10,347.5	8,052.3	6,095.6	4,155.4	3/	2,322.3
Central Bank of Libya	14,194.9	9,370.0	7,123.4	5,374.1	3,631.1		...
Commercial banks	1,130.9	977.5	928.9	721.5	524.3	3/	...

1/ Million barrels per day (mb/d).

2/ Prices shown are of Zuweitina 40.5° API as of January 1 each year.

3/ Staff estimate.

4/ Staff projection.