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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/100

3:00 p.m., July 8, 1983

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
	N. Toe, Temporary
	L. E. J. Coene, Temporary
	P. D. Péroz, Temporary
	C. A. Salinas, Temporary
	T. A. Connors, Temporary
	T. Alhaimus
	T. Yamashita
J. E. Ismael	Jaafar A.
	D. I. S. Shaw, Temporary
	H. Arias, Temporary
	G. Grosche
	C. P. Caranicas
	V. K. S. Nair, Temporary
	J. E. Suraisry
	L. Ionescu, Temporary
	R. Bernardo, Temporary
	H. Alaoui-Abdallaoui, Temporary
	M. Camara, Temporary
	E. Portas, Temporary
	A. Lindø
	C. Taylor
	Wang E.

J. W. Lang, Jr., Acting Secretary
S. J. Fennell, Assistant

Also Present

Asian Department: S. Kashiwagi, A. N. Mansur, K. Saito, D. A. Scott. Exchange and Trade Relations Department: D. K. Palmer, Associate Director; M. Guitian. Legal Department: W. E. Holder. Advisor to Executive Director: I. R. Panday. Assistants to Executive Directors: J. Bulloch, P. Leeahtam, W. Moerke, Y. Okubo, J. G. Pedersen, J. Reddy, P. S. Tjokronegoro, N. U. Haque.

1. MALAYSIA - 1983 ARTICLE IV CONSULTATION

The Executive Directors continued from the previous meeting (EBM/83/99, 7/8/83) their consideration of the staff report for the 1983 Article IV consultation with Malaysia (SM/83/128, 6/14/83; and Cor. 1, 7/6/83). They also had before them a report on recent economic developments in Malaysia (SM/83/144, 6/27/83).

Mr. Jaafar said that, with respect to fiscal policy, his authorities were in complete agreement with the views expressed by the Executive Directors. By introducing austerity measures, the authorities had shown their flexibility and pragmatism in fiscal management. Revenues had increased by 24 percent, and development expenditure had been substantially reduced, by 28 percent, in the first five months of 1983. The Government was aware that further adjustments were needed on both the revenue and, in particular, the expenditure sides. They had initiated a comprehensive review of expenditures, both capital and operational, for the current year's budget. That review was of a fairly fundamental nature, and expenditure would be directed only to those projects that yielded returns in the form of increased economic growth, increased revenue, and savings in foreign exchange. Subsidies and transfers provided by the Government would be reduced, and certain public enterprises would be turned over to the private sector or operated jointly, with the Government having a minority share. Prices in the public sector would be adjusted to reflect better the cost of services rendered.

The authorities' efforts to reduce public expenditure and to facilitate the growth of private sector activity would reduce the role of the Government significantly, Mr. Jaafar explained. With respect to crowding out the private sector, given the high savings ratio and the projected reduction in government borrowing needs, the availability of credit to the private sector would be increased significantly.

On the revenue side, the authorities would continue to rely on oil revenues, but their reliance would not mean that other sources of revenue would be overlooked, Mr. Jaafar went on. In that connection, the staff had been in close contact with the authorities in an effort to improve the tax system.

The external imbalance was due, in part, to increased imports as a result of development projects, Mr. Jaafar continued. His authorities had embarked upon a program to reduce both the dependence on imports by actively promoting import substitution, and the size of the deficit on services and transfers by transporting their own exports.

On the question of possible drawings under the compensatory financing facility, Mr. Jaafar indicated that the authorities had discussed the matter with the staff. Owing to the world recession, Malaysia had experienced an export shortfall estimated at over 50 percent of quota. Furthermore, there was a balance of payments need. In the past, those conditions would have been sufficient to allow a country to make a drawing under the compensatory financing facility. However, at present the authorities would have to take adequate measures to improve the fiscal situation before they could make a request. A number of measures had already been taken, and the authorities intended to take further action to correct both the fiscal and the external imbalances. During the first five months of 1983, government financial data had improved. There was no reason why a request for a drawing under the compensatory financing facility should not be brought before the Executive Board, and he hoped that the matter could be reconsidered in the light of new information.

More generally, the staff had insisted on strong adjustment programs for three countries in his constituency before they could make a purchase of more than 50 percent of quota, even though it had been clear that the balance of payments difficulties in those countries had been caused by external developments beyond the authorities' control, Mr. Jaafar commented. The undue stiffening of the conditionality for the use of the compensatory financing facility was highly objectionable and contrary to the spirit of that facility. He hoped that the Executive Board would have an opportunity to review that matter at the time of the meeting on July 18.

The staff representative from the Exchange and Trade Relations Department responded that in his experience the existence of an export shortfall and a balance of payments need alone did not qualify a country for a drawing under the compensatory financing facility. It had been made explicit in the requirement of cooperation that policies should be appropriate to deal with the balance of payments difficulties. Malaysia's balance of payments position and fiscal deficit were not sustainable. When the authorities adopted an appropriate adjustment package, the requirement of cooperation would be met.

The Acting Chairman then made the following summing up:

Directors agreed with the staff's views contained in the report for the 1983 Article IV consultation with Malaysia. They commended Malaysia's record of economic growth and stability in the 1970s, including a reduction in the incidence of poverty, but noted that the economy had been affected by the international recession that had begun in mid-1980. They also noted that, notwithstanding the adverse effect of external factors on the demand for Malaysia's exports, economic growth in 1981 and 1982 had been sustained at a high level by buoyant domestic demand.

Commenting on the economic policies pursued in recent years, several Directors observed that the large increase in expenditures resulting from expansionary fiscal policies during 1980-82 had cushioned the impact of weakened external demand. However, these policies had also contributed to the substantial weakening of the balance of payments and could crowd out private expenditure unduly. Directors commended the authorities for reducing their reliance on fiscal policy to stimulate domestic demand through expenditure restraint measures in mid-1982. However, they noted that both total expenditure and the overall deficit had increased in 1982 and that, even with continued expenditure restraint and substantial new tax measures, the fiscal deficit in 1983 might be reduced only slightly. Directors, therefore, expressed concern with the momentum of rising expenditures in recent years and the present magnitude of the fiscal deficit. In these circumstances, they welcomed the Government's broad review of its expenditure programs and urged the strengthening of measures to reduce the fiscal deficit. The slowing of domestic credit expansion in 1982 was welcomed.

Economic growth was expected to rise in 1983, notwithstanding uncertainties regarding the strength of the international economic recovery. The deficit in the current account of the balance of payments was projected to decline somewhat as demand in Malaysia's export markets firmed up. However, the external outlook for the medium term was not for a reduction in the current account deficit, and external debt and debt service would continue to rise. In this setting, Directors expressed concern that the external payments position might prove unsustainable, especially with the expiration of grace periods on the extensive market borrowings since 1981. Directors noted that the excellent credit rating enjoyed by Malaysia and its access to foreign resources could be used to support implementation of an orderly adjustment strategy.

Directors observed that the vitality of the export sector was crucial for the longer-term development prospects of Malaysia. In this context, the ongoing efforts to improve productivity in primary exports was commendable. While regarding Malaysia's exchange rate policy to be broadly appropriate, Directors stressed that the maintenance of export competitiveness should continue to receive high priority. There was widespread commendation for Malaysia's success in maintaining a liberal exchange and trade regime.

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

2. DEVELOPMENT COMMITTEE AGENDA - POSTPONEMENT

The Acting Chairman informed the Executive Directors that the World Bank Committee of the Whole meeting to discuss the agenda for the September 1983 meeting of the Development Committee had been postponed. The Fund Committee of the Whole would therefore have to postpone its discussion as well.

The postponement by the World Bank committee had arisen out of a preliminary and informal discussion of a group of Bank Directors with the World Bank's management during the week ended July 1, the Acting Chairman explained. At that time, differences of opinion had been expressed regarding specific items relating to World Bank activities to be included on the agenda. The World Bank management had therefore decided to postpone the meeting of the Committee of the Whole and, instead, to have an informal meeting with all World Bank Directors. That meeting had taken place on Wednesday, July 6. In light of the wide range of views expressed on the content of the agenda and some procedural issues, the World Bank was reformulating the agenda, which would be reviewed by the Fund management and by the Chairman of the Committee before being circulated to the Committee of the Whole. He hoped that the new agenda could be circulated during the following week. A meeting of the Fund Committee of the Whole would not be scheduled until the World Bank Committee had completed its consideration of the agenda.

It was expected that the revised draft agenda would include a new item relating to the future of the Development Committee, the Acting Chairman stated. That broad topic had been discussed in one of the informal meetings of Ministers at the end of April 1983, at which time the Ministers had asked the Chairman and the World Bank and Fund managements to prepare a paper for discussion by Ministers at their meeting on September 26.

The Managing Director had recently met with Mr. Clausen to discuss some of the possible items for inclusion in that paper, the Acting Chairman concluded. It was expected that the paper would be circulated in the early part of August and discussed by the two Committees of the Whole toward the end of August, so that it would be ready for circulation to members of the Development Committee for their consideration at the time of the meeting.

The Executive Directors took note of the statement by the Acting Chairman.

APPROVED: December 19, 1983

ALAN WRIGHT
Acting Secretary