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#12

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 60/36

10:00 a.m., July 15, 1960

H. M. Cochran, Acting Chairman

Executive Directors	*Alternate Executive Directors*
B. N. Adarkar	I. G. Patel
E. Asp	Th. Asgeirsson
The Earl of Cromer	
	J. Waitzenegger
	A. W. McCasker
	J. A. Montealegre
C. Gragnani	
	H. Koinzer
P. Lieftinck	
W. Müller	J. Urrutia
	C. L. Read
	A. Mansour
Soemarno	A. J. Mouzughi
F. A. Southard	
	I. S. Sun
	M. Toussaint
	P. M. Jayarajan

A. C. Frost, Acting Secretary
F. Hodel, Assistant Secretary

Also Present

European Department: R. Evensen, C. L. Merwin. Exchange Restrictions Department: U. Sacchetti, T. Yoshida. Legal Department: J. Gold, General Counsel; J. G. Evans, A. S. Gerstein, G. Nicoletopoulos. Middle Eastern Department: D. Boushehri, H. J. Costanzo, A. Mahhouk, A. K. El Selehdar. Office of Administration: P. Thorson, Director; J. Saper. Office of the Treasurer: Y. C. Koo, Treasurer; P. Ehrlich, R. Kroc. Technical Assistants to Executive Directors: G. Koenig, G. A. Low, R. M. Mays-Smith, P. Sundaram, R. Wilson. Trainees: S. Al-Deiri, A. Sakezly.

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1. Approval of Minutes

The draft minutes of Meetings 60/22, 60/25, 60/27, 60/28 and 60/29 were approved.

2. Use of the Fund's Resources - Pakistan

The Executive Board took up a request from Pakistan for a drawing of US$12,500,000 from the Fund (EBS/60/71, 7/12/60) and considered the staff's analysis and recommendation that the Fund not object to the request (EBS/60/71, Sup. 1, 7/12/60).

The representative of the Legal Department informed the Board that the technical deficiency in the member's cabled request, of which the Board had been advised, had not yet been corrected. It was to be understood, therefore, if the Board agreed to the staff recommendation that the decision would be taken subject to the correction of that deficiency.

Mr. Mansour then made the following statement:

I wish to make a few observations which I hope will help to dispel any doubt that may exist about Pakistan's need for this drawing.

Pakistan's request for a drawing of US$12.5 million falls within the gold tranche. Its present quota is $150 million of which $16 million was paid in gold: $3.5 million when Pakistan joined the Fund with a quota of $100 million and $12.5 million equal to 25 per cent of the increase in quota to $150 million. Pakistan has never before used the resources of the Fund despite payments difficulties in previous years. Moreover, in December 1958, the Fund entered into a one year stand-by with Pakistan in the amount of $25 million. There were no transactions under this stand-by and Pakistan cancelled it three months before its expiration.

This will show that Pakistan is a very careful, almost a reluctant member in seeking the Fund's resources. As the staff paper indicated, Pakistan preferred to impose restrictions to correct its external payments position.

At the low point reached in September 1958, foreign exchange reserves were a little more than what is legally required for currency cover and it is from this low level that the reserves have moderately and gradually been built up during the last two years as a result of the government policy to bring the inflation to an end and to stop the decline in foreign exchange assets. There was a considerable improvement in the economic situation which resulted in a substantial reversal of the balance of payments position. As shown in Table I, page 5 of the Appendix, the $204 million in reserves in September 1958 reached a peak of $317 million in the first quarter of 1960, but a downward trend began in May 1960 with a loss of $13 million in reserves, as a result of the latest relaxation of import restrictions, and the Pakistani authorities have ground to anticipate the continuation of the pressure on reserves for the same reasons.

Finally, I wish to say that the free reserves, excluding the currency cover, are hardly sufficient for three months' imports of a country on the eve of its second fiveeffected in the face of declining reserves were intended to give some relief to the economy or if they represented a step toward further liberalization.

The Acting Head of the Middle Eastern Department said the staff had not yet received complete information about the new import measures, but from an examination of the list of commodities covered by the measures the staff felt that the proportion of liberalized imports was significant. The remaining degree of restrictions, however, would continue to be substantial. The use of the word "substantial" in the phrase quoted by Mr. Adarkar was therefore not appropriate. The staff hoped to get a better picture of the exact proportion of imports covered by the measures in the course of the forthcoming Article XIV consultations with Pakistan. At the same time, the staff would look into the policies behind the measures. It could be said, however, that it had been the aim of the Pakistan authorities to proceed with liberalization as rapidly as possible, particularly in the area of needed raw materials. The staff could not at this time say whether the recent measures foreshadowed further liberalization steps.

Mr. Southard asked whether the range of imports for which import entitlements could be used (*ibid.*, footnote 1) included consumer goods or principally raw materials and necessities. The staff representative replied that some consumer goods of the essential type were included as well as raw materials. The new measures might indicate that in the future the export bonus scheme might operate mainly in the area of consumer items.

Soemarno was glad to join the other Directors in supporting the requested gold tranche drawing. In the light of the Fund's policy of giving the member the benefit of the doubt in such cases and in view of Mr. Mansour's clarifying statement, he believed the proposed drawing was consistent with the Fund's principles.

Mr. Read said that, while he agreed that the member should be given overwhelming benefit of the doubt in cases involving drawings within the gold tranche, he also understood that under the Fund's policy on the use of its resources a request for all drawings would include adequate information as to the particular situation which prompted the request. For this reason he appreciated the additional information provided by Mr. Mansour and would be able to support the request.

The Acting Chairman pointed out that the Fund was obliged to act promptly on requests for drawings of this type and where there had not been a recent consultation with the member the staff was not able to provide as much information as where there had been such consultation. It was therefore proper in such cases to look to the Executive Director of the country concerned for additional information.

The other Directors expressed no objection to the staff's recommendation.

The decision was:

The Fund has received a request for a purchase of US$12.5 million by the Government of Pakistan. The Fund does not object to the purchase and notes the statement of the Government of Pakistan that it will comply with the Executive Board decision of February 13, 1952.

year development program and an import system that is still subject to a substantial degree of restrictions despite the recent relaxation.

Lord Cromer said he was happy to support Pakistan's request with which he had no difficulty. He thanked Mr. Mansour for his remarks in explanation and further clarification of the staff paper. It had always been the U. K. Government's view that there should be a high degree of automaticity with respect to drawings in the gold tranche, but he thought the Fund should be given an explanation of applications for such drawings and, in this respect, he felt that the staff paper had fallen short. However, Mr. Mansour's remarks had gone a long way to complete the picture, particularly as he understood him to say that the need for the drawing was related to the reduction in restrictions.

In stating his support, Mr. Southard said he agreed with Lord Cromer that an adequate case had been made out for the drawing and with the view that the Fund's policy with respect to gold tranche drawings should be one of the greatest possible liberality. Mr. Southard's only question concerned the nature of the legal requirement for currency cover and the amount of present reserves which was tied up in that cover. The Acting Head of the Middle Eastern Department replied that as of May 1960 approximately $140 million of the $304 million gold and foreign exchange assets on hand was tied up in currency cover.

Mr. Lieftinck said that upon a first reading of the staff's paper and recommendation he had missed the explanation and justification for the request about which Lord Cromer had spoken. For this reason Mr. Lieftinck said he was grateful for Mr. Mansour's statement which had greatly strengthened the case for a drawing. Mr. Mansour had pointed out that Pakistan's reserves were still very low and he had indicated that there was a connection between the request and a reduction of restrictions. Mr. Lieftinck said he would have hoped that Pakistan could have felt able to go somewhat further in relaxing its restrictions but he understood why it was felt necessary to move carefully, especially in view of the financing problems now being faced in connection with the new development program. There should not be any suggestion, however, that there was any relation between the drawing under discussion and the development financing. As regards Pakistan's exchange reserves position, he thought the figures of the official gold and foreign exchange assets in Table 1 of the staff paper did not tell the whole story. Table 3 revealed that holdings of securities had increased which, of course, was a desirable feature, but did not seem to indicate a weak position. In conclusion, Mr. Lieftinck said he sincerely hoped Pakistan would be able to continue its courageous policies and that the execution of the new development program would not present too difficult problems.

Mr. Adarkar also was pleased to support Pakistan's request, particularly because he believed the Fund's policy with respect to gold tranche drawings should be liberal. As regards Pakistan's import policy, he had noted the statement in the staff paper that "a substantial part of imports is now covered by arrangements which do not limit the volume of imports" (*ibid.*, p. 2), and he asked if the staff could indicate more precisely what this meant. He had noted that, while Pakistan began to suffer a decline in foreign exchange reserves last May, it introduced further import liberalization in July. He asked if the staff had any information on the policies underlying these measures. Having in mind Pakistan's new development program, he wondered if the liberalization measures

3. 1960 Consultations - Libya

The Executive Board discussed the report and recommendations of the staff on the 1960 Article XIV consultations with Libya (SM/60/41, 6/2/60, Cor. 1, 6/23/60 and Cor. 2, 6/29/60).

At the request of Soemarno Mr. Mouzughi made the following statement:

Despite the fact that reliable data on some sectors of Libya's economy are, at the present time, rather difficult to obtain, the staff was able to prepare a valuable report, which, though somewhat concise, gives a clear picture of the economic and financial situation in Libya. I take this opportunity to congratulate the staff for their good paper and to express, on behalf of the Libyan Government, its deep appreciation for the spirit of cooperation and understanding with which the Fund mission has conducted this first Article XIV consultations with Libya.

It is gratifying to mention that, at the time the Fund paper was distributed, another valuable study of the Libyan economy was issued by the World Bank mission, which, at the request of the Libyan Government, had worked for several months in the appraisal of the country's recent economic developments and prospects.

With the detailed assessment of the present economic factors and trends contained in the report before us, I think only very little, if any, is left to add, and I would therefore limit myself to comment on a very few points.

Since Libya became independent eight years ago, it has been engaged in the difficult task of building up its economy by developing it on a sound and solid basis without endangering its internal monetary stability and payments position. Great problems are still facing Libya in its effort to achieve this goal. Some of these problems are made clear in the general and economic background in Part II of the staff paper. As it is pointed out in the report, the Libyan authorities are fully aware of the fact that, in spite of the enormous effort made so far, the country is still far from having reached a satisfactory stage of economic stability, which would certainly help in solving the major problems toward an adequate economic growth.

It is with the view of strengthening the economic organization that the Libyan authorities have decided to reorganize the Development Council and to gather all the other development agencies under this new Council. It is anticipated that this Council--with the realistic assessment of Libya's needs and potentialities stated in the World Bank's report--will be able to plan and implement a well-coordinated program of development based on a more rational reallocation of the present and anticipated resources of the country.

During recent years Libya has adopted a policy, which is aimed at encouraging the inflow of foreign capital for investments in the various sectors of the economy, particularly for the exploration of natural resources of the country. As a result of this policy which provides for adequate incentives and guarantees, a number of oil companies are engaged in large operations in various parts of the country. So far oil has been found in over twenty places in quantities which are described as very encouraging. In a country like Libya, where only 25 per cent of the national income is received by the largest sector--still dependent on agriculture and animal husbandry for living, and which accounts for well over 50 per cent of the total population--the discovery of oil is of great importance and much is expected from this new source of income in the effort to provide a better standard of living, as well as, to diversify the economy of the country.

Libya's estimated gross national income has shown a sharp increase in recent years from about £L 15 million in 1950 to well over £L 50 million at the end of 1959. To a large extent this increase was due to an increase in foreign military expenditure and external assistance, while during the last three years it was mostly due to an increase in the expenditure of foreign companies for exploration of oil. However, only very little, if any, of this increase in national income was due to an increase in gross domestic output or internal productivity.

As it is mentioned in the staff paper, this large and continuing increase in foreign revenue gave way to a steady favorable balance of payments and to an accumulation of foreign exchange reserves, which amounted to about £L 28 million at the end of 1959.

Although the Libyan economy, seen from this angle, seems to have been expanding at an impressive pace, the economic situation cannot be described as a very healthy one, since it is not based on a self-sustained growth. This fact is evident in the large trade deficit met, to a great extent, from these external sources which, however, could not be considered as definitely stable, and consequently, Libya's balance of payments position could not be regarded as fundamentally strong.

An important feature of the present Libyan economy, referred to in the staff paper, is the existence of an inflationary trend. The initial impulse of this trend came from an increase in the level of aggregate effective demand brought about by the increasing flow of foreign funds into the country. This inflow of funds has been the main factor in the present large monetary expansion. Another factor that has contributed to the expansionary movement is the expansion in the commercial bank credit, mostly for the financing of the increasing volume of imports. The staff has stated on page 13, Part I of the report, that a policy permitting a further expansion of imports may be one of the most readily available instruments for maintaining stability. Considering that about 70 per cent of Libya's imports are under the provision of the so-called open general license and that at the present time there is no shortage of goods at current prices in the local market, the Libyan authorities are doubtful whether a further liberalization of imports would solve or even reduce the problems of inflationary pressure, since the increase in the amount of imports is not expected to be significant, apart from the fact that it would tend to affect only a small proportion of the population.

The main purpose of the remaining restrictions on imports, which do not contain discriminatory features, is to encourage and protect local production. However, while it is evident that Libya has moved very fast toward the complete removal of restrictions, I would like to draw attention to the statement of the Libyan authorities on page 10, Part I of the report, in which they regard the present restrictions imposed on payments or trade as an exception to their movement toward further liberalization measures.

The Libyan monetary authorities maintain that essential goods should be provided at best prices wherever they come from, but should first come from domestic production where possible, and from imports only where necessary. Imports should not be entirely restricted but regularized by an appropriate system of taxation. As regards monetary expansion, the monetary authorities are of the opinion that a well-coordinated development, fiscal, commercial, and credit policy is essential for coping with this problem. Initial steps have already been taken in this direction and other steps are under consideration.

In conclusion, it may be of some interest to mention that two events have taken place in the restrictive system after the consultations. The first one is the decision relating to the Libyan-Italian Property Agreement by which Italians are allowed to transfer another £L 1 million to Italy before the end of 1960 in respect of funds approved for transfer to Italy under the Agreement but not so remitted because of the limitation of the £L 300,000 annual quota. In addition, it was decided to permit remittance of the proceeds of sales of movable and immovable property belonging to Italians not coming within the terms of the Libyan-Italian Agreement, within an overall limit of £L 1 million by the end of December 1960.

The second event was in connection with the Libyan-Egyptian Trade and Payments Agreement. As it is stated in the report, this payment agreement is the only one which Libya maintains at the present time in order to regularize gradually the traditional barter trade with Egypt, which for geographical and historical reasons is an indispensable market for some Libyan goods, particularly livestock. This Agreement has been replaced by a new one with effect from June 1, 1960. The new Agreement provides that transactions exceeding £ 3/4 million will be paid for in pounds sterling or other convertible currencies agreed upon by the two parties, and thus the bilateral feature of this arrangement is significantly reduced.

Lord Cromer wished at the outset to welcome Libya's first Article XIV consultation with the Fund and to commend the staff on the competent report it had submitted to the Board. He also thanked Mr. Mouzughi for his helpful remarks in clarification of the report. Libya was at present a poor and undeveloped country and the problems it faced were very great. This was graphically set out on page 5 of Part II of the report where it was stated that only between 5 and 10 per cent of the whole country was capable of either settled farming or shifting cultivation and grazing and, at present, under 1/2 per cent of the total area was under continued farming. Moreover, Libya was faced with serious problems of soil erosion which according to one report threatened to erase the present arable soil in under 50 years unless drastic measures were taken. However, this unpromising situation had been completely transformed by very promising discoveries of oil and, provided the present hopes were realized, Libya's prospects now looked much more encouraging.

The transition, Lord Cromer said, would present as it did elsewhere some difficult problems, and the staff paper gave an interesting analysis of these and the methods the Libyans were using to overcome them. However, as the paper said, last year, after a number of years of relative price stability, the cost of living seemed to have risen by as much as 15 to 20 per cent (*ibid.*, Part I, p. 9), and the paper concluded that "the question of preventing a serious inflation in Libya may well be a major problem in the immediate future" (*ibid.*, p. 13).

Lord Cromer said that it seemed to him that the principal cause of inflation in Libya at present was not so much a shortage of goods as a shortage of skilled workers and accommodation which led to inflated salaries and continually rising rents. However, this had been accentuated by a sharp increase in the money supply which apparently rose 31 per cent last year (*ibid.*, p. 9). Part of this increase was the result of an expansion of credit to the private sector, and it was interesting to note the various ways in which the central bank was working to gain a greater control over the banking system (*ibid.*, p. 8). But from the table on page 36 of Part II of the report it was obvious that a further cause of the monetary expansion had been the accumulation of foreign exchange which was not only sufficient to give 100 per cent cover to the note issue, but also left free reserves equivalent to about six months' imports at the 1959 rate. These reserves seemed adequate for Libya's present needs, and he agreed with the staff that further import liberalization would seem possible.

Lord Cromer was glad to hear Mr. Mouzughi say that Libya's new agreement with the Egyptian Region of the U. A. R. provided for settlement in convertible currencies for the balances in excess of £ 3/4 million. The new agreement was certainly an improvement, and it was to be hoped that further progress could be made once the Egyptian Region's £ 2 million debit balance had been paid off.

Finally, Lord Cromer wished to congratulate the Libyan authorities on the success they had so far had and to wish them good luck for the future.

Mr. Gragnani commended the staff on its clear description of the Libyan economy and its analysis of the country's main problems. He also thanked Mr. Mouzughi for his illuminating and useful introductory remarks. The recent discovery and exploitation of oil fields and the ensuing royalty payments were having similar effects on the economy of Libya to those encountered elsewhere, and Libya would have to make a major effort to avoid or reduce to a minimum the resulting inflationary pressures. He concurred in the view usually expressed in these cases to the effect that the country concerned should put to good use its foreign exchange receipts and go forward with economic development at not too rapid a rhythm in order to avoid inflation or keep it under control. Given the predominance of public expenditure in Libya it was to be hoped that the Development Council would not undertake a policy of moving too fast. In the fight against inflation he would not wish to understress the benefit which could be derived from a further reduction of import restrictions. He recalled the important liberalization undertaken since 1959, and he felt that Libya would proceed further along these same lines as its balance of payments position improved. But he did not believe that the contribution of further liberalization to financial stability in Libya was paramount since he felt that the main element in this respect was the control of public expenditure. Finally, Mr. Gragnani wished the Libyan Government every success in the task ahead.

Mr. Southard had little to add to the staff's comprehensive report, Mr. Mouzughi's helpful elaboration and the remarks of the other speakers. As usual, he had found this first staff report on Libya interesting, and he was pleased to note that notwithstanding evident difficulties there had been up to now a very satisfactory degree of success in avoiding inflation and building up reserves. In saying this, however, he was not unaware that during 1959 relatively new evidences of inflationary pressure had appeared notably, as already pointed out, in the increase in the cost of living arising out of shortages of resources. He agreed with the staff judgment that, although there was some room for caution, there was at the same time room for further action in the field of import liberalization. As Lord Cromer had pointed out, the present reserve position left a good margin above the amount held for currency cover. Further on the domestic side, Mr. Southard drew attention to the statement in the report that the commercial banks were charging 7 to 12 per cent interest on 90-day credits to merchants *(ibid.)* indicating that there was probably room for some expansion of commercial banking.

Turning to the external side, Mr. Southard noted that Libya was pursuing sound policies in liberalizing its restrictions. With respect to the general policy on bilateralism, the report said "the primary interest of Libya's financial policy is to purchase needed goods at best prices wherever they come from, and this consideration militates against the conclusion of new bilateral payments agreements" *(ibid.*, p. 12). The recent liberalizing of the arrangement with the Egyptian Region of the U. A. R. indicated that this policy was being carried out. While he could see the logic of the staff's analysis on maximum import liberalization as one weapon in the battle against inflation, he also understood Mr. Mouzughi's point that in the absence of a greater shortage of goods the Libyan authorities would not expect further import liberalization to result in any important damping off of inflation.

Mr. Lieftinck congratulated the staff for its good first report on Libya and thanked Mr. Mouzughi for the helpful additional information contained in his introductory statement. Mr. Lieftinck observed that Libya was a country which faced some very difficult problems even though it had ample financial resources, thanks to expenditures by foreign governments (which were now tapering off) and large capital outlays by oil companies. Recalling his own experience with another country which had a similar problem of a large capital inflow into a restricted economy, Mr. Lieftinck said such a situation required careful maneuvering by the Government not only in avoiding inflationary pressures but in developing the social structure, because usually in such countries a small minority received the main share of the benefits from the capital influx while the great majority of the people did not benefit to the same extent. He agreed that the liberalization of imports was one of the measures which recommended itself to bring about a suppression of the inflationary impact, and he thought Libya could go further in this direction. But this would not solve Libya's difficulties. The real problem was the disproportionate availability of purchasing power in a limited part of the community and an insufficiency of locally produced commodities. This required a combination of policies; on the one hand, anti-inflationary policies and, on the other, policies of stimulating internal growth which was very difficult in a country where there was a scarcity of real resources as in Libya.

While he felt that the staff had correctly recommended greater import liberalization, Mr. Lieftinck thought much more was needed in Libya. For example, the supply of domestic goods should be stimulated which might, of course, require some protectionism, and this would have to be balanced against the desirability of free importation. The country also needed to promote the sharpest kind of internal competition, and it had to avoid bottlenecks and monopolistic positions. Moreover, great economy in public expenditures would be helpful and development expenditures should be concentrated on rapidly maturing projects. Recurrent government expenditures should be financed from domestic revenues to the greatest extent possible. It would, of course, require great attention to bring about an increase in the yield from domestic taxation and tap sources other than import duties. This would be desirable not only because of the monetary impact but because of the impact on the social structure. In addition, all possible steps should be taken to stimulate savings and control credits, but he wondered if the Libyan monetary authorities had sufficient instruments at their disposal. In this connection he directed attention to the following statement in the April 1960 IBRD report entitled "The Economic Development of Libya": "There are limits to what the Government can do to control an inflationary process of this kind in which the initiating factor has been increased expenditures by foreign governments and oil companies" (p. 277). It was a blessing for Libya to have large oil resources; they opened up great possibilities for the future but also serious problems. In conclusion, Mr. Lieftinck wished the Libyan authorities success in the years ahead.

Mr. Mansour joined the other Directors in congratulating the staff on its good first report on Libya and in thanking Mr. Mouzughi for his illuminating introductory remarks. The Libyan economy had been built on solid grounds even at a time when the country's resources were limited. The new situation gave rise to great possibilities for the future, and it was to be hoped that the same wise policies aimed at a stable economy would continue. A considerable amount of import liberalization had already been achieved, and he felt that the remaining restrictions did not have as great an impact on the price level as one would be led to conclude from the statement in the report that the cost of living had risen by 20 per cent. This seemed to be limited to a small sector of the population and resulted from the increased expenditures of the oil companies. Mr. Mansour said he also believed that, despite a comfortable reserve position, the Libyan authorities would have to watch the reserves carefully, not only because of the vulnerable nature of the economy but also because the country was about to undertake a development program.

As regards the trade and payments arrangements between Libya and the Egyptian Region of the United Arab Republic, Mr. Mansour pointed out that the Egyptian Region was a natural customer for Libya's limited exports and the original arrangement had been worked out in order to regularize the method of trading between the two areas in a way which would result in a balance between them. The arrangement had been very fortunate for both countries. Under the new agreement the countries had moved on to a settlement which was a favorable development for both Libya and the Egyptian Region.

In concluding, Mr. Mansour said he hoped the Libyan economy would flourish as a result of the oil discoveries and that Libya would have the means at its disposal to step up its economic development so that there would be a balanced economy and a better life for the Libyan people in the future.

Lord Cromer wished to make it clear that he had welcomed the new Libyan-Egyptian trade and payments arrangements as an improvement over the original agreement. Mr. Mansour said that, despite its payments aspects, the first agreement also had been of benefit to the two countries.

Mr. Koinzer said he was in general agreement with the findings and appraisal of the staff, and he appreciated Mr. Mouzughi's additional helpful remarks. The other speakers had already pointed to the main problems which Libya faced and he would not repeat them. He wished, however, to associate himself with Mr. Lieftinck's comprehensive analysis of the situation. He agreed that the country's main problem arose from the increased inflow of foreign revenues resulting in high purchasing power for a part of the population not matched by local production. This problem would continue into the future, unless the Libyan economy was not put on a broader basis, in both the industrial and agricultural sectors. He was encouraged to hear that the Libyan authorities were aware of the necessity to diversify the economy. However, as Mr. Lieftinck and the staff had stressed, it would be dangerous if in the development effort the Libyan Government were to release its resources too quickly because this would endanger stability.

Mr. Koinzer thought it was probably true, as Mr. Mouzughi had said, that a further liberalization of imports would not solve the problems of inflationary pressure because only a small segment of the population would be affected by such action, but he felt that the staff had been right to suggest this as one method by which Libya could attempt to offset the inflationary forces in the economy. He felt some sympathy for Libya's wish to protect some of her new industries against the inflow of foreign goods. However, this protection should be only temporary. Libya would have to avoid building up uneconomic production which would not be competitive and waste the resources of the economy. Finally, Mr. Koinzer joined the other Directors in wishing the Libyan authorities all success in the future.

Mr. Adarkar said he had read the staff report with great interest and he thanked Mr. Mouzughi for his helpful statement. Other speakers had mentioned the great need for development in Libya which was endowed with rich natural resources while only a small proportion of its income was accounted for by domestic production. In cases of this kind, he thought the Fund should watch the developments in the realm of production as well as those in the monetary field. The oil discoveries had opened up much promise for Libya but there was much to be done before that promise would become a fact. On the external side, he sympathized with the view of the Libyan authorities that the balance of payments contained many uncertain elements and that they therefore would have to proceed cautiously toward further liberalization of imports. In some respects the staff view was not in accord with this. In its recommendation the staff had said that "there is no balance of payments obstacle to removing restrictions on imports" (SM/60/41, Part I, p. 15, 6/2/60). In another place the report said that "the import licensing as a whole had only a mild effect on restricting import demands" (*ibid.*, Part II, p. 39). Mr. Mouzughi had pointed out that at present there was no shortage of goods in Libya. It therefore appeared that liberalization by itself could not have much effect and would create monetary problems.

Concerning the argument that further liberalization seemed justified by Libya's present favorable reserve position, Mr. Adarkar thought it had to be kept in mind that, even if the oil discoveries fulfilled expectations, Libya would still have to carry out an extensive program of development in order to attain a balanced economy. It was said in the staff report that "the Libyan economy could benefit from pushing ahead with the development program, but a run-down of government deposits, especially if accompanied by a balance of payments surplus, would increase the magnitude of the problem facing the monetary authorities" (*ibid.*, Part I, p. 13). This might very well be true, but other countries in a similar situation had seen that the stepping up of development was accompanied by a substantial increase in imports which helped to neutralize the inflationary effect of development expenditure. It was not uncommon for a developing country with large resources to find that as soon as the development got into stride the reserves went down. The Fund should therefore avoid stressing the temporary monetary aspects and should emphasize that the most important economic policy objective of countries like Libya should be to make a proper use of available resources. For this reason he felt that the staff's recommendation in the last sentence of paragraph 4 of the proposed decision was too limited and one which he would not wish to support. Mr. Adarkar also noted that some of the Libyan restrictions were maintained primarily for protective reasons (*ibid.*, p. 11) and he questioned whether the Fund's decision should comment on these even though they might have balance of payments implications. Accordingly, he would later propose that the sentence in paragraph 4 which he had mentioned should either be deleted or appropriately modified.

Mr. Jayarajan said he was in general agreement with the views expressed by Mr. Adarkar. While Libya had large reserves, it was about to undertake a development program. The recent oil strikes were very encouraging but the country would have all the greater need for its foreign exchange resources when it reached a more advanced stage in its development. For this reason, the Fund should be more cautious in its recommendations to the member and not go so far as to say that the country could undertake further import liberalization. Moreover, in the light of Mr. Mouzughi's statement that further liberalization was not likely to have much disinflationary effect, it did not seem appropriate for the Fund to urge Libya to liberalize imports. Mr. Jayarajan added that he believed Libya had more of a shortage of services than of goods. Like Mr. Southard, he had also had some difficulty in understanding why such high interest rates existed in a country with a developed banking system and especially now that the National Bank of Libya was entitled to engage in commercial transactions. He hoped the staff would comment further on this point and explain whether the Banking Law provided for higher cash reserves against deposit liabilities than the 20 per cent presently maintained.

The Acting Head of the Middle Eastern Department stated that under present legislation the 20 per cent cash reserve requirement was a maximum and could not be increased. With respect to interest rates, the staff believed that the present high level reflected the large demand for funds associated primarily with the sharp increase in imports during recent years. The whole field of bank credit and credit control was understood to be under study by the Libyan authorities at the present time.

Soemarno confirmed that the high interest rates were to be explained by a large demand for credit because of the increase in imports. They also reflected a shortage of banking facilities. The central bank authorities were reluctant to engage in normal commercial banking even though they had been authorized to do so. It was felt that more commercial banking institutions would have to be set up and in this connection applications from Libyan nationals, as well as foreign banks desiring to establish branches in Libya, were now under study.

Mr. McCasker said his principal observation related to paragraph 4 of the recommendations which he would raise later in the discussion. At this time he wished to support the other speakers who had commended the quality of the staff report and to associate himself with the good wishes for Libya's further development.

Mr. Mouzughi had no further comments on the points made in the discussion except to thank the Directors for the good wishes extended to the Libyan authorities.

The discussion turned to the text of the draft decision recommended by the staff. At the suggestion of Mr. Montealegre it was agreed to change the fourth sentence in paragraph 3 to refer to "undue credit expansion" rather than "undue private credit expansion." The Acting Head of the Middle Eastern Department explained that it had been intended to refer to expansion of credit to the private sector; the question of credit extension as such to the public sector did not arise as the public sector at the present time held large cash balances.

In line with his earlier remarks, Mr. Adarkar suggested deletion of the last sentence of paragraph 4 reading "The Fund believes that under present circumstances, there is no balance of payments obstacle to removing restrictions on imports, and that further import liberalization would contribute to offsetting the expansionary forces now operating in the economy." Alternatively, he would suggest that the sentence be modified to stress that Libya should pursue policies aimed at a wise utilization of resources and the containment of inflationary forces.

Soemarno said that, while he would consider either of Mr. Adarkar's proposals appropriate, he felt that a more moderate change would also be acceptable to the Libyan authorities and suggested that the sentence be modified as follows: "The Fund believes that, in the light of the present balance of payments position, further import liberalization would be feasible." The Libyan authorities doubted the restraining effects of a further increase in imports since only luxury items would be affected by such action. Moreover, as the staff had said in the report, the import licensing system as a whole had only a mild effect on restricting import demands (*ibid.*, Part II, p. 39). Hence, he would prefer to delete the statement that further import liberalization would contribute to offsetting the expansionary forces in the economy and hoped his amendment would be accepted.

The Acting Head of the Middle Eastern Department observed that Soemarno's text omitted two points covered in the staff's draft. The first was the point that under present circumstances there was no balance of payments obstacle to removing restrictions on imports. In making this statement, the staff had in mind the current level of exchange reserves, the level of foreign aid (which was lower now than in earlier years) and prospective earnings from oil operations in the immediately foreseeable future. It was recognized that over a longer period the stability of foreign exchange receipts, from aid and oil in particular, was subject to uncertainties, but it was thought that the present balance of payments position should not be a hindrance to further liberalization. The staff understood that the Libyan authorities agreed with this and did not believe it could be said that there was any conflict of views on this matter. The staff would not object to the deletion of the reference because it took Soemarno's text, in stating that further liberalization would be feasible, to confirm that at present there was no balance of payments obstacle to such action. The staff had some hesitation in accepting the second omission--that is, deletion of the last part of its draft. This phrase indicated that under present circumstances import liberalization would contribute to offsetting the existing inflationary forces and implied that this contribution would have to be accompanied by other measures to deal with the expansion. The staff agreed, as is indicated in both Parts I and II of the report, that the impact of further liberalization, in view of the present extent of the Open General License and the liberal administration of licensing, might be small, and it was clear that credit and fiscal measures were also required. It should be noted that the phrase in question was the only statement in the draft decision which indicated any Fund concern over expansionary forces now operating in the Libyan economy. The staff recognized that the 1959 situation of a large increase in reserves and sharp expansion of money supply might be temporary and that 1960 probably would not see such a large expansion as imports caught up with the increase in money incomes and as development expenditures accelerated and had further impact on import demand. Finally, the staff representative stated that he wished to make clear that, while most restrictions were maintained for protection, there remained some restrictions which were not so motivated and that the sentence in question was directed to these.

Mr. McCasker said he had difficulty with the sentence under discussion because it was too categoric in its wording and to some extent gave the impression of a permanent recommendation. Even though it was said to refer to present circumstances, the sentence spoke of "removing restrictions" which to his mind suggested a more or less permanent step. Bearing in mind the points made by Mr. Adarkar and Mr. Jayarajan, a rather more flexible approach seemed to be appropriate at the present time. Although the present balance of payments situation was very satisfactory, Libya obviously had great development problems; there was a large deficit on trade account and there could be no certainty about some of the favorable elements in the present balance of payments. He therefore would support Soemarno's proposed revision.

Mr. Southard said he was also willing to accept Soemarno's text but not for the same reasons as Mr. Adarkar and Mr. McCasker. In the first place, the revision satisfactorily covered the staff's point concerning the feasibility of further liberalization. As to the staff's second point, Mr. Southard said he had not been impressed enough by the likely impact of further liberalization in offsetting the expansionary forces to contest the Libyan view as stated by Mr. Mouzughi. If the staff felt that the Fund should more broadly indicate its concern about the developing inflationary pressures, the point should be made in paragraph 3, though he thought that paragraph amply reflected the existence of such pressures and referred to the Libyan Government's awareness of them. While he agreed to the deletion of the last clause, he wished to make it clear that in his view it was entirely proper for the staff and the Fund to address attention to the likely monetary effects of import liberalization. The mere fact that some of the restrictions were for protective reasons was of no importance. In certain nonbalance of payments quantitative restrictions cases the Fund might well wish to point to the monetary effects.

Lord Cromer said he had been unhappy about the last part of the sentence in question because he read it as indicating that further import liberalization would be a major factor in offsetting the expansionary forces. He believed most readers would read it as he had and therefore he preferred to delete the clause. He had no difficulty with the rest of the sentence and agreed with Mr. Southard's remarks on it. Lord Cromer also said he did not share Mr. McCasker's fear about the finality in the word "removing." On balance he preferred the sentence as drafted by the staff without the last clause, but he was prepared to accept Soemarno's amendment.

Mr. Gragnani thought the first part of the staff's text went too far, especially since the staff report said that at the beginning of 1960 the payments position in prospect appeared somewhat less favorable than in 1959 (*ibid.*, Part I, p. 3). As for the second part of the sentence, he favored deletion not because the statement was not true from a general point of view but because it was less true for Libya and because it gave the impression that further import liberalization was the main measure to be taken to offset the inflationary forces.

Mr. Lieftinck said that, while he could have gone along with the staff's text, he also thought the last part gave the impression that import liberalization should be considered the main measure in offsetting expansion. He was, of course, in favor of import liberalization but other measures were also highly desirable. If it should be decided to delete the last clause, there would then be no indication of the Fund's concern about the inflationary forces, as the staff had pointed out. He therefore proposed that the following sentence be added to paragraph 3 which was only descriptive in its present form: "The Fund believes that a comprehensive program aiming at containing inflationary forces resulting from the large inflow of external resources is highly desirable." Finally, Mr. Lieftinck said he would prefer to keep the first part of the text submitted by the staff.

Mr. Adarkar said he was prepared to accept Soemarno's modification but he was still troubled because the Fund's recommendation would be limited to one minor factor since it was recognized that further import liberalization would only affect imports on luxuries. What was required was a wise utilization of resources, as he had said before. He would therefore favor the addition to paragraph 3 proposed by Mr. Lieftinck, but preferred Soemarno's text on the first point. Mr. Adarkar also said he agreed with Mr. Southard's observations concerning the Fund's right to comment on the monetary effects of restrictions, including those for protective purposes.

Soemarno said he would have no objection to adding a reference to the monetary expansion which Libya was facing, as suggested by Mr. Lieftinck, but he did object to linking the restraining influence to import liberalization as set forth in the staff's text. He suggested that Mr. Lieftinck's point, which the staff also shared, could be made by adding the following sentence to paragraph 3: "The Fund notes with satisfaction that the Libyan authorities are aware of the need for comprehensive efforts to contain inflation."

Mr. Lieftinck thought that on the important matter of containing inflation the Fund should speak for itself. Mr. Southard thought that where it was clear that the country was fully aware of the situation the Fund would gain in its relationship with the member if it recognized that fact. Mr. Lieftinck said he would not press his point, but he was not fully convinced that the Libyan Government intended to draft a comprehensive program for the purpose.

The Acting Chairman felt that in this first Article XIV consultation with Libya it would be desirable for the Fund to follow the line taken by Soemarno and Mr. Southard. Moreover, the record would be clear on the various points of view submitted. The Directors agreed and accepted the two revisions proposed by Soemarno.

The decision was:

1. The Government of the United Kingdom of Libya has consulted the Fund under Article XIV, Section 4, of the Fund Agreement concerning the further retention of its transitional arrangements.

2. Since achieving independence in 1951, Libya has experienced a rapid rate of expansion in economic activity, particularly in the foreign trade and public sectors, based primarily on foreign sources of income. In spite of a rapid expansion of imports and only a small increase in exports, Libya has achieved a net surplus in its balance of payments in recent years because of special government receipts from abroad and increasing private expenditures of petroleum companies.

3. An accumulation of foreign assets and expansion of credit to the private sector, offset only in part by an increase in cash balances of the Government and in savings deposits of the private sector, have led to steady increases in the money supply. There was a particularly sharp expansion of the money supply in 1959 and inflationary pressures on prices and wages became evident during the year, notwithstanding a substantial liberalization of imports adopted early in the year. The Government continues to accumulate cash balances, but the prospective reorganization of development activities could result in increasing expenditures and some net use of balances in the near future. The monetary authorities have recently moved to improve their controls over bank credit and have indicated their readiness to prevent undue credit expansion. The authorities are also studying the possibilities of institutional changes to achieve closer coordination of credit, fiscal and development policies. The Fund notes with satisfaction that the Libyan authorities are aware of the need for comprehensive efforts to contain inflation.

4. The Fund welcomes the establishment of external convertibility of the Libyan pound, and also the relaxation of restrictions, particularly on imports, which was achieved in 1959. A wide range of imports is now freely permitted under an open general license, but quotas are established and specific licensing required for imports of certain items which can be produced locally or which are considered luxuries. The Fund believes that, in the light of the present balance of payments position, further import liberalization would be feasible.

5. In concluding the 1960 consultations, the Fund has no other comments to make on the transitional arrangements maintained by Libya.

4. 1960 Consultations - Finland

The Executive Board took up the report and recommendations of the staff on the 1960 Article XIV consultations with Finland (SM/60/47, 6/15/60, Sup. 1, 7/12/60, and Cor. 1, 7/13/60).

Mr. Asp made the following statement:

On behalf of the Finnish authorities I wish to thank the staff for the good and comprehensive consultations report on Finland. It is a pleasure to note that the report is quite up to date, as only two months have passed since the Fund mission concluded the consultations in Helsinki. A separate supplement covers the most recent developments, relating to bilateral agreements and import controls. The staff has also issued corrections to the report, taking into account most of the comments of the Finnish authorities.

As the report indicates, the recovery of production that set in at the end of 1958 turned into a new phase of expansion in the autumn of 1959. Simultaneously with the expansion of production, a gradual shift in the principal expansive forces has taken place. During the first stage of recovery, the increase in production mainly occurred in the consumer goods industry, but later the rise in the foreign demand for Finnish export goods, as well as in the domestic investment demand, became the main forces behind the economic expansion. This increase in domestic investment activity has taken place mainly in the private sector of the Finnish economy, especially in machinery and transportation equipment, as well as in industrial and commercial buildings. Accordingly, in financing of investments, long-term credits from domestic banks and from abroad, and self-financing of the companies, have grown in importance.

So far, this development has brought about a considerable increase in the real national income, as well as a significant reduction in unemployment, without causing inflationary pressures. Consequently, the collective wage agreements for 1960 involve only moderate wage increases, and the price level has generally remained fairly stable. On the other hand, the strong economic upswing has already resulted in a substantial increase in imports, and the authorities have taken steps to keep the total demand within reasonable limits.

The main expansive factor in the money market this year has been the increase in private bank credit, especially that of the commercial banks. In spite of the continued favorable development in bank deposits, the credit expansion has already reached a point where the effect of the tightening of the penalty rate system, made at the end of last year, is being increasingly felt. In order to reduce the demand for credit, the central bank at the beginning of June gave the banks an opportunity to widen the margin for the rates of interest charged on loans granted. The higher rates are intended to be applied primarily to credits which are likely to increase the demand for and the import of consumer goods and the investment in stocks.

During the first months of this year, the expansionary effect of the increase in bank credits has been counteracted not only by the decrease in official gold and foreign exchange reserves, but the state finances have also contributed to the tightening of the money market. Thus in January-April, the surplus on current and capital account was Fmk 5.5 billion, as against the deficit of Fmk 1.6 billion in the same period of 1959.

In this connection it can be noted that the outlook for state finances for the year 1960 is considered to be satisfactory. The approved budget for 1960, including the supplementary budget passed in June, estimates that the current revenue will be some 7 per cent higher than for the year 1959. However, during the first four months of 1960, the revenue was some 13 per cent higher than a year ago. The estimate of revenue in the 1960 budget is therefore still considered to be rather conservative. While on the other hand the increase in expenditure in 1960 is expected to be less than that of the revenue, the need for borrowing in 1960 is likely to be much less than the budget authorization of Fmk 34.8 billion; in fact, in the middle of June it was estimated that Fmk 21.5 billion will be sufficient, which amount is smaller than the contractual amortization of government debt in 1960.

The development of Finland's foreign trade during April-May was similar to that of the first quarter of the year; the value of both exports and imports was considerably higher compared with the corresponding period of 1959, but imports continued to grow much faster than exports. In the first five months of this year the deficit in the trade balance reached Fmk 45 billion, or about $140 million, the corresponding deficit in 1959 being Fmk 12.4 billion, or about $38 million. For the remaining part of the year, the foreign trade is expected to be more balanced, as imports may be expected to decline from their present record level, and exports should rise in view of the favorable market for products of the wood-working industries. For the whole year, the deficit in the trade balance is, however, expected to be of such magnitude that it will not wholly be offset by net earnings from invisibles. Therefore, the balance of payments on goods and services is likely to show some deficit in 1960, as against a surplus of $29 million in 1959, and $76 million in 1958.

Since the beginning of 1960 all branches of the Finnish export industry--excluding newsprint--have been working at full capacity, and for the time being the market outlook is quite favorable. In the long run, the prospects for the Finnish exports to the western markets will naturally be influenced by the development of the regional trade groupings and on Finland's relations to them. Finland's relationship to the European Free Trade Association has, as you know, already for some time been under discussion with representatives of this trade group.

The report and the supplement describe the measures taken since the last consultations which have aimed at further liberalization of Finland's restrictive system. I should like to mention here only a few of them. The discrimination against imports from the United States and Canada has been completely eliminated. The bilateral payments agreements with France, Iceland, Paraguay, and Uruguay have been terminated. In addition, Greece and Turkey, while not yet ready to take the full step, have both recently agreed to an arrangement which brings the final goal much closer. The Finnish authorities have also expressed their readiness to work for the elimination of bilateral payments agreements with other Fund members, and a general understanding to terminate the agreements has already been reached with Israel and Spain.

The supplement to the report also refers to the recent introduction of a negative list for free listed imports, resulting in some further relaxation of restrictions, and the abolition of the so-called reciprocity principle, which until now has considerably hampered the simplification of the Finnish licensing system and the removal of certain forms of discrimination.

The draft decision recommended by the staff is fully acceptable to the Finnish authorities, but I shall later propose some minor verbal changes in it.

Lord Cromer wished first to thank the staff for its excellent report and Mr. Asp for his remarks in amplification of the staff paper. At the time of Finland's last consultation with the Fund, Lord Cromer noted, she had achieved an impressive degree of stability following the very successful devaluation of the Finnish markka which had been backed up by appropriate fiscal and credit measures. However, for a variety of reasons, some of which were outside Finland's control, there were still only slight signs of recovery in economic activity, and unemployment had reached a high level. He was glad, therefore, to hear Mr. Asp say that there had been considerable change in the employment picture. It was also very encouraging to read in the present paper that in the past year production had expanded rapidly, and there had been a very satisfactory rise in gross national product in spite of some disappointing results in agriculture because of a drought. Finland thus provided a good example of how successful the policies advocated by the Fund could be if they were resolutely and patiently carried out.

The expansion in the Finnish economy, Lord Cromer said, had started with a rise in consumption, and he was interested to see from the report that, as economic activity gained momentum, much of the increase in bank lending was in the form of "consumption credits," including the finance of hire purchase contracts (SM/60/47, Part I, p. 4, 6/15/60). The paper stated that the Bank of Finland had recommended to the Government that the question of hire purchase be studied because it was becoming more and more important in the Finnish economy (*ibid.*, p. 10). This was indeed an important and relatively new subject, and it was interesting to speculate on how significant a role it played in the first stage of the Finnish recovery. The rise in consumption was followed by a very satisfactory rise in investment which was 9 per cent larger than in 1958 and represented a very high figure of 32.7 per cent of the gross domestic product (*ibid.*, p. 3). This was all the more satisfactory as much of the investment was in projects which it was expected would gradually contribute to an expansion of exports.

On the external side, Lord Cromer observed that the situation also had been satisfactory. The deterioration in the trade balance which had taken place in the last year was only to be expected, especially as the imports of capital goods had risen by as much as 40 per cent. However, this deterioration had been matched by an improvement on the capital side of the balance of payments and the general situation remained healthy. Moreover, all the increase in reserves had been in the holding of gold and convertible currency reserves, and there had been some decline in the bilateral balances. This improvement in the composition of the reserves, which last year was somewhat unsatisfactory, was also to be welcomed.

Lord Cromer said his Government particularly welcomed the progress Finland had made in simplifying and liberalizing her restrictive system though, as the staff had said, there was still some room for further improvement. Finland's bilateral agreements with Soviet countries were somewhat of a special case as nearly one quarter of her trade was with these countries. But it was interesting to note that the greater degree of balance on these accounts during the past year had been achieved partly by a restriction by the Finnish authorities on their exports, though, of course, discrimination in favor of some imports from the Soviet countries still remained. In addition to these agreements with Soviet countries, Finland also had a number of bilateral agreements with member countries. His Government welcomed the progress that had been made in eliminating four of these agreements during the past year. They also welcomed the intention recorded in paragraph 6 of the staff's recommendation to eliminate the remaining agreements with Fund members.

In conclusion Lord Cromer wished again to welcome the very satisfactory progress Finland had made during the past year in almost every direction. Having achieved stability, she was now faced with the problem common to many other members of the Fund of maintaining the maximum rate of growth within this framework of stability.

Mr. Jayarajan agreed with Lord Cromer's remarks on the progress Finland had made during the past year, and he commended the staff on its excellent report. At the same time he could not help regretting that Finland still discriminated against a Fund member, Japan. The staff report mentioned that the Finnish representatives had stated that "the main reason for the discrimination against Japan was that Finnish export products were not included in the free import list presently in force in Japan" (*ibid.*, p. 14). He found it difficult to agree that this was a valid reason for discrimination and was glad to see that the staff had said that discrimination against Japan was not justified on balance of payments grounds and should be removed (*ibid.*). While he welcomed Mr. Asp's statement that discrimination against the United States and Canada had been completely eliminated and the fact that the reciprocity principle had been abolished, Mr. Jayarajan expressed the hope that the reconsideration of Finland's discriminatory practices planned for this summer would result not only in a removal of all discrimination against dollar area countries other than the United States and Canada but also against Japan.

In the light of Mr. Asp's full statement and Lord Cromer's comments, Mr. Southard said his remarks would be limited. It seemed clear that Finland had carried out a successful stabilization operation and had been able to take further liberalization measures in the trade and payments field. The economic growth of the country had been good, and the balance of payments showed an improvement in both the level and make-up of reserves. While the prospects for a continuation of stable prices appeared favorable, it was to be noted that the Finnish authorities felt they would have to be watched carefully.

With respect to developments in the restrictive system, Mr. Southard welcomed the elimination of discrimination against the United States and Canada. He had noted, however, that discrimination against other dollar area countries had not been removed and he wondered what the significance of trade with these countries was to Finland's total trade and whether any justification for this continued discrimination had been given to the staff. He agreed with the staff and Mr. Jayarajan that the statement of the Finnish representatives of the reason for the discrimination against Japan (*ibid.*) was not convincing. As regards Finland's trade with the Soviet area and the resulting discrimination against some Fund members, Mr. Southard said he also had noted that the total of this trade was smaller than last year but that it had continued important, especially for metal products. On the whole he felt that a case had been made out consistent with the Fund's decision on discrimination of October 23, 1959 (EBM/59/45, Item 2) and that this was an example of reluctant discrimination on the part of Finland. In the circumstances, the Fund would have to be patient about its removal.

Mr. Southard was glad to see that the staff had so thoroughly examined the question of Finland's discriminatory restrictions on payments for invisibles (SM/60/47, Part I, p. 17, 6/15/60). It seemed desirable for the Fund to look more closely into restrictions on invisibles as more and more of its member countries prepared to move under Article VIII. In the case of Finland, it seemed sufficient to await the further efforts the authorities planned to make in this field.

The representative of the Exchange Restrictions Department stated that in 1959 Finland's trade with "other dollar area" countries was of a very small significance. Trade with Latin America, which included practically all "other dollar area" countries, comprised about 4.5 per cent of Finland's total trade. However, this included trade with Brazil and Colombia (3.0 per cent) which had bilateral payments agreements with Finland, and with Argentina (0.7 per cent) which benefited from free list treatment.

Mr. Koinzer thought the staff had submitted a very good report on the developments in Finland during the past year. It showed an impressive picture of successful economic policy. The rather depressed economic activity of the time after the devaluation had given way to a remarkable recovery which should secure future expansion of the Finnish economy, particularly in the light of the very high rate of investment. It was gratifying to note that Finnish export industries had reached a higher degree of competitiveness than some time ago. Mr. Koinzer also had the impression that there was a growing confidence in the currency and an increasing awareness of the need to keep prices stable which he considered as a most welcome development. Wage increases had been modest and were not higher than the increases in productivity. It was also of interest in this connection that time and savings deposits on the whole had increased considerably whereas index-tied deposits had gone down to 6 per cent of total time deposits as compared with 25.6 per cent in June 1958 (*ibid.*, Part II, p. 16). A close examination of the internal situation, of course, revealed some potential dangers, but the report indicated that the Finnish authorities were aware of them and would act in the appropriate way. Mr. Koinzer wished to associate himself with the position taken by the staff. In this connection, he regretted that Finland was not yet in a position to introduce a system of minimum reserve requirements (*ibid.*, Part I, p. 10), but it was to be hoped that such action would be possible before long.

On the external side, Mr. Koinzer wished to join in welcoming the reduction of restrictions, particularly the enlargement of the global quota system and the further reduction of bilateralism. As regards the policy on foreign investments in Finland, Mr. Koinzer noted that the staff report originally contained the following statement: "Under present regulations, dividends from foreign capital invested in Finland may be transferred abroad freely in the majority of cases, but the Bank of Finland takes a decision to this effect every year" (SM/60/47, Part I, p. 18, 6/15/60). He noted that this statement had been omitted from the corrected version (*ibid.*, Cor. 1, 7/13/60), and wondered what the present position was with respect to dividends.

The representative of the Exchange Restrictions Department stated that since 1960 it had been the permanent policy of the Finnish authorities to permit the free transfer of dividends abroad; the decision was no longer taken on a year-to-year basis.

Mr. Lieftinck said he had read the staff's report with great interest and appreciated the good analysis which had been submitted. He also congratulated the Finnish authorities on the favorable developments the economy had experienced in the past year under conditions of considerable stability. The balance of payments position was again quite satisfactory, but one had to keep in mind that some exceptionally favorable factors had contributed to this result. The fiscal position also had been quite satisfactory; under conditions of an economic boom the Government's revenues had greatly increased and had provided the authorities with a very comfortable income. It could not be overlooked, however, that there were certain institutions in Finland which made for particularly favorable results. He especially had in mind the guaranteed farm income, low interest government loans and the system of index-tied bonds. These factors were not too burdensome in favorable times but could be otherwise when conditions were less favorable, and one wondered whether in the present situation it would not be appropriate to introduce more flexibility for dealing with more adverse conditions.

With respect to the public sector, Mr. Lieftinck said he had some doubts about the expectations with respect to the need of government borrowing and, in this connection, he had noted the statement in the staff's recommendations that "Public bonds will have to be issued only to the extent necessary to redeem maturing debt." According to the report (SM/60/47, Part II, p. 19, 6/15/60), government revenues in the first quarter of 1960 substantially exceeded the estimates, but at the same time supplementary budgets had been introduced. If this went on, the need to issue public bonds might go beyond what was necessary to redeem maturing debt, and for this reason he believed the Fund's decision should be more cautious than the staff had suggested.

In the banking field Mr. Lieftinck noted the increasing liquidity of the banks and that the authorities were aware of the situation. Up to the present time the central bank's main weapon of control had been a system of penalty rates. To a certain extent this had been changed by the June 1, 1960 decision of the Bank of Finland to permit the commercial banks to charge an interest rate in excess of 7 per cent but not higher than 8 per cent on certain amounts (*ibid.*, Part I, p. 10). The report also said that "the Bank of Finland requested the banks to charge a higher interest rate on, for example, advances for imports (other than imports of raw materials and investment goods) and advances for stockpiling and purchase of durable consumer goods. A condition for the increase in certain interest rates is that the weighted average of the bank's interest rates should not be any higher than at the end of May 1960. Consequently, interest rates for certain advances, such as those to small business enterprises engaged in exports, will have to be lowered" (*ibid.*). This demonstrated the small amount of flexibility the central bank had in exercising control over the commercial banks. Clearly, a system of minimum reserve requirements could be helpful.

Finally, Mr. Lieftinck associated himself with the position taken by Lord Cromer and Mr. Southard with respect to the restrictive system. He hoped that the Finnish authorities would soon feel able to undertake further liberalization particularly in the field of invisibles.

Mr. Read wished to join in and associate himself with the satisfaction expressed over Finland's internal and external success and the reduction of its discriminatory practices. He also joined in the hope that Finland would make further progress in the removal of restrictions. Like other speakers, he recognized the special circumstances surrounding Finland's trade with state trading countries, but at the same time he supported the staff when it expressed the hope that "Finland would continue its efforts to multilateralize payments and would aim at limiting the scope of the trade discrimination arising out of the bilateral arrangements" (*ibid.*, p. 17).

Mr. Adarkar also wished to pay tribute to Finland for the remarkable progress it had achieved in the past two years, and he expressed the hope that the recent changes in its restrictive policies, especially the abolition of the reciprocity clause, would enable Finland to reduce discrimination against countries like Japan. With respect to the justification for discrimination against Japan, he agreed with the position taken by Mr. Jayarajan.

In replying to some of the comments and questions, Mr. Asp said, with reference to Lord Cromer's remarks on hire purchase, that this was as yet a relatively undeveloped form of credit in Finland and the report had undoubtedly exaggerated its importance. There were at present two institutions, affiliated with commercial banks, engaged in this type of lending, and their total outstanding credit amounted to only 600 million markkas. The volume of hire purchase credit granted by stores was not known, but the whole question of hire purchase was being studied by a newly appointed committee.

Mr. Asp explained that until recently the law concerning import liberalization specified that free list treatment could be granted only to countries permitting free import of Finnish goods and allowing convertibility for Finnish export earnings. With regard to the trade with Japan, Mr. Asp referred to the report, which stated that the existing discriminatory practices were expected to be reconsidered during this summer. He could not, however, in principle agree with Mr. Jayarajan's criticism. Although the legal provision for reciprocity had now been abolished, a certain amount of reciprocity was, as a matter of fact, a natural basis for favorable trade relations.

Mr. Asp said that Mr. Koinzer's and Mr. Lieftinck's points on monetary policy were valid and explained that the question of strengthening the monetary instruments of the central bank had been for long and still was under careful consideration. Mr. Asp also agreed with Mr. Lieftinck's suggestion that the Fund's decision could be more carefully worded with respect to the Government's need to issue public bonds.

The discussion turned to the text of the draft decision. On Mr. Asp's suggestion it was agreed that the last sentence in paragraph 2 should state that private investment expenditures were "about" 20 per cent higher than in the corresponding period of 1959.

On Mr. Lieftinck's suggestion, the Board agreed to replace the last sentence of paragraph 3 with the following: "It is considered unlikely that there will be need for issuing public bonds beyond what is necessary to redeem maturing debt."

Mr. Asp suggested, and the Directors agreed, that the last sentence of paragraph 4 should read "The Fund notes that the Finnish authorities stand ready to take further action, if necessary, to prevent the pressure of demand from becoming excessive."

Mr. Koinzer thought the penultimate sentence of paragraph 5 should contain a reference to Finland's export performance in 1959 in addition to the import situation which had been mentioned in the staff's text. In the further discussion some other verbal changes were suggested, and it was agreed to replace the fifth and sixth sentences of the paragraph with the following: "In the first months of 1960 both exports and imports were higher than in the corresponding period of 1959, the latter increasing more."

The decision was:

1. The Government of Finland has consulted the Fund under Article XIV, Section 4, of the Fund Agreement concerning the further retention of its transitional arrangements.

2. The recovery of production which started toward the end of 1958 continued at an accelerated rate in 1959, and by the middle of that year the expansion had spread to all sectors of the economy. In 1959 the gross national product increased by 5 per cent in real terms. The employment situation improved. Rises in prices and the cost of living remained moderate. In the first part of 1960 the economy continued to expand. Private investment expenditures were about 20 per cent higher than in the corresponding period of 1959.

3. Increased economic activity led to higher yields from taxes both in 1959 and in 1960. The 1959 budgetary results are expected to show a slight deficit on current and capital account. In 1960 the operations of the public sector should not lead to monetary expansion. It is considered unlikely that there will be need for issuing public bonds beyond what is necessary to redeem maturing debt.

4. In the first half of 1959 the improvement in the balance of payments position led to an increase in the liquidity of the banking system and a lowering of interest rates. Since then bank credit to the private sector has expanded rapidly and in 1960 the banks have again become dependent on central bank credit. Measures have been taken to limit credit expansion. The Fund notes that the Finnish authorities stand ready to take further action, if necessary, to prevent the pressure of demand from becoming excessive.

5. External demand for Finnish export products increased greatly in 1959. Imports also rose substantially but the balance of payments on goods and services account continued to be in surplus. A larger inflow of short-term capital, mainly representing prepayments on exports, contributed to a significant increase of monetary reserves. The composition of these reserves also improved. In the first months of 1960 both exports and imports were higher than in the corresponding period of 1959, the latter increasing more. At the end of March 1960 the net gold and foreign exchange assets of the banking system were equivalent to the value of about three months' imports.

6. Since the last Article XIV consultations Finland has taken measures to relax restrictions on imports, reduce discrimination, decentralize the exchange control, and liberalize invisible transactions. Reliance on bilateral payments agreements with nonstate trading countries has also been reduced. The Fund welcomes these measures and the intention of the Finnish authorities to eliminate bilateral arrangements with Fund members. The Fund believes that Finland is in a position to make further progress toward the liberalization of imports and invisible transactions and the elimination of discrimination. The Fund also feels that the import licensing system could be substantially simplified.

7. In concluding the 1960 consultations, the Fund has no other comments to make on the transitional arrangements maintained by Finland.

5. Cuba

Recalling the Board's recent discussion of Cuba's exchange practices and the reasons for his abstention from the decision taken at that time (EBM/60/35, Item 2, 6/30/60), Mr. Montealegre informed the Executive Directors that he had advised the Cuban authorities of the Fund's action and had received the following cable from the President of the National Bank of Cuba:

> The text of the resolution which was approved by the Board of Directors of the International Monetary Fund regarding the consultations with Cuba completely ignores that, considering the special circumstances prevailing in Cuba, we need to impose certain restrictions on international transactions. This point was gone into thoroughly during the consultations, and we believe it is essential to fairly judge the case of Cuba. Notwithstanding that we realize and appreciate very much your efforts and those of Mr. Rodrigo Gómez, Mr. Jacobsson, and the technical staff, I would like to request that your vote in the minutes of the meeting be recorded in the negative for the resolution adopted in our case.
>
> Ernesto Guevara Bancuba

6. Staff Salaries and Benefits

The Executive Board took up the management's recommendations with respect to Fund salaries and dependency allowances (EBAP/60/68, 6/28/60).

After discussion in executive session, the following decision was taken:

The recommendations regarding Fund salaries and dependency allowances, as set forth in EBAP/60/68, are approved.

Supplementary appropriations for the fiscal year 1961 administrative budget are approved in the amount of $268,000. The following budget categories are hereby increased:

II - Office of Executive Directors

B - Salaries	$11,000
C - Other Compensations and Benefits	3,000

III - Staff

E - Salaries	$184,000
F - Other Compensations and Benefits	70,000
	$268,000

7. Annual Report, 1960

In the absence of a request by any Director for formal consideration in the time specified, the following decision was taken on July 8, 1960 and recorded (SM/60/39, Sup. 8, 7/6/60):

The Annual Report, 1960 (SM/60/39, 5/27/60, Sup. 1, 6/8/60, Sup. 2, 6/15/60, Sup. 3, 6/20/60, Sup. 4, 6/21/60, Sup. 5, 6/24/60, Sup. 6, 6/28/60, Sup. 7, 7/1/60, and Sup. 8, 7/6/60) is approved and shall be printed and circulated to the Governors as soon as possible, together with the letter of transmittal set forth in SM/60/39, Sup. 8 (7/6/60).

8. Fifteenth Annual Meeting

a. Report on Audit – Transmittal to Board of Governors. In the absence of a request by any Director for formal consideration in the time specified, the following decision was taken on July 8, 1960 and recorded (EBAP/60/70, Sup. 1, 7/6/60):

The draft letter to the Board of Governors transmitting the Report on Audit for the fiscal year ended April 30, 1960, as proposed in EBAP/60/70, Sup. 1 (7/6/60), is approved and shall be sent.

b. Transfer of Net Income to General Reserve. In the absence of a request by any

Director for formal consideration in the time specified, the following decision was taken on July 8, 1960 and recorded (EBD/60/96, 7/6/60):

The draft letter to the Chairman of the Board of Governors and the draft resolution on the allocation to the General Reserve of the Fund's net income for the fiscal year ended April 30, 1960, as set forth in EBD/60/96 (7/6/60), are approved and shall be sent.

9. Membership - Portugal

In the absence of a request by any Director for formal consideration in the time specified, the following decision was taken on July 11, 1960 and recorded (EBD/60/98, 7/7/60):

Portugal has requested a further extension of the period during which it may accept membership in the Fund pursuant to the Board of Governors' Resolution No. 14-9. The Executive Directors deem that extraordinary circumstances warrant such an extension and accordingly extend the period until November 30, 1960.

10. Technical Cooperation - Chile

In the absence of a request by any Director for formal consideration in the time specified, the following decision was taken on July 14, 1960 and recorded (EBD/60/100, 7/12/60):

In response to a request from the Government of Chile for continuance of technical assistance, the Executive Board agreed to the proposal contained in EBD/60/100 (7/12/60).

11. Portraits of Managing Directors

In the absence of a request by any Director for formal consideration in the time specified, the following decision was taken on July 6, 1960 and recorded (EBAP/60/69, 6/29/60):

The Executive Board approved the first report of the Committee on Portraits of Managing Directors as set forth in EBAP/60/69 (6/29/60).

12. Executive Board Travel

No objections having been expressed in the time specified to travel by three Executive Directors as set forth in EBAP/60/71 (7/1/60), EBAP/60/73 (7/5/60), and EBAP/60/75 (7/12/60), the Executive Board's approval is recorded.

APPROVED BY THE EXECUTIVE BOARD:
Meeting 60/41, August 17, 1960

H. MERLE COCHRAN
Acting Chairman

ALBERT C. FROST
Acting Secretary