

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 60/9

10:00 a.m., March 11, 1960

Per Jacobsson, Chairman

H. M. Cochran, Deputy Managing Director

Executive Directors

E. Asp

W. Guth

A. Z. Saad

F. A. Southard

B. Tann

Alternate Executive Directors

I. G. Patel

Th. Asgeirsson

G. J. MacGillivray

A. Feuché

B. E. Fleming

J. Hazera

C. P. Caranicas

H. Koinzer

J. Urrutia

H. M. H. A. van der Valk

C. L. Read

A. J. Mouzoghi

J. S. Hooker

M. Toussaint

P. M. Jayarajan

R. L. Horne, Secretary

F. Hodel, Assistant Secretary

Also Present

Won H. Chung, Bank of Korea Representative in New York; Sangjin Chyun, First Secretary, Korean Embassy. Asian Department: D. S. Savkar, Director; H. C. Murphy, Deputy Director; A. Abadjis, M. Gumbart, B. H. Kay. European Department: G. Ferras, Director. Exchange Restrictions Department: I. S. Friedman, Director; W. L. Hebbard, J. A. Kirkwood, W. J. R. Woodley. Legal Department: J. E. S. Fawcett, General Counsel; J. Gold, Deputy General Counsel; J. G. Evans, A. S. Gerstein, G. Nicoletopoulos. Middle Eastern Department: J. W. Gunter, Deputy Director. Research and Statistics Department: W. H. Taylor. Office of the Treasurer: R. Kroc. Western Hemisphere Department: J. Del Canto, Director; G. A. Costanzo, Deputy Director; M. Diaz-Godoy, J. Gonzalez del Valle, E. W. Robichek. D. H. F. Somerset, Personal Assistant to the Managing Director. G. Williams, Special Representative to UN. J. Reid, Information Officer. Technical Assistants to Executive Directors: R. M. Mays-Smith, R. Wilson.

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1. Approval of Minutes

The draft minutes of Meetings 60/5 and 60/6 were approved.

2. 1959 Consultations - Korea

The Executive Board took up the report and recommendations of the staff on the 1959 Article XIV consultations with Korea (SM/60/5, 2/11/60, Cor. 1, 3/8/60, Sup. 1, 2/26/60, and Sup. 2, 3/9/60). Mr. Won H. Chung, Bank of Korea Representative in New York, and Mr. Sangjin Chyun, First Secretary of the Embassy of Korea in Washington, were present.

The Director of the Exchange Restrictions Department said the staff understood that the special tourist rate, which had been mentioned in the report, had not yet been put into effect. The staff had also received some additional statistical information, but this would not change its analysis and conclusions.

Mr. Toussaint said he had little to add to the staff's very clear analysis of recent developments in Korea. The report presented an adequate and quite impressive picture of the difficult tasks which continue to confront the Korean authorities in the economic and financial fields. It was true that the reconstruction of the economy after the Korean War could now be considered as substantially completed. But the Government still faced formidable problems in its endeavor to restore and maintain conditions of internal and external stability. The combined requirements of heavy defense expenditures, reasonable economic development and increasing consumption from a growing population were very great indeed. Furthermore, the gradual reduction of foreign assistance, on which Korea had been heavily dependent in recent years, substantially added to the difficulty of balancing aggregate demand with available resources. In the circumstances he thought that the authorities had to be commended for having brought about, through appropriate budgetary and credit policies, a noticeable lessening of the inflationary conditions which prevailed up to 1957 and for having, at the same time, achieved considerable progress in raising output and developing the economy. This progress was well reflected in the statistical tables reproduced in the appendix to Part II of the staff report. He was confident that the importance of a continued vigorous pursuit of financial stabilization, as well as of production increase, was fully understood by the Korean authorities.

As far as the external side of the economy was concerned Mr. Toussaint wished to recall that the official rate of the hwan was recently adjusted from 500 to 650 hwan per dollar. This adjustment was made in order to take into account the rise in internal prices which had occurred since September 1955 when the original official rate of 500 hwan per dollar had been established. The Board was also aware that the Korean multiple rate system had become more complex in recent months. This development appeared to have been largely a result of the efforts which had been made to balance external payments in the new environment created by the decline in foreign aid. The Korean authorities had indicated that, although they considered it difficult to simplify the exchange system in a short time under the present changing circumstances, it was their stated policy to establish a single exchange rate in due time.

The Chairman thanked Mr. Toussaint for his statement.

Mr. Southard agreed with Mr. Toussaint that there was much in the staff report which called for commendation. The task confronting the Korean Government of dealing with the twin problems of stabilization and development was a very formidable one. There was not only the need to overcome difficulties created by the war but the need to carry on development and to attain financial stability. There was reason for satisfaction, in which the Fund could well share, that the Korean authorities had sought to deal with their problems through fiscal and monetary means rather than more direct controls. As the staff report indicated, these efforts had met with considerable, although far from complete, success. Fiscal expenditures had developed outside the general budget calling for some inflationary financing, and there had been a sufficient increase in prices to call for further efforts to control credit expansion. With respect to the Government's debt management policy, he had noted the statement in the report that the issuance of debentures by the Korean Agricultural Bank and the Korean Reconstruction Bank in an amount of hwan 10 billion each was considered noninflationary by the Government and that the staff tended to disagree with this view (SM/60/5, Part I, pp. 8 and 20, 2/11/60). It might well be that the actual outturn would be a little more disturbing than when the staff discussed this matter with the Korean representatives for there was evidence that the Bank of Korea had been granting rediscounts at a special 5 per cent rate to the five larger commercial banks which had taken over about hwan 5 billion of the debentures of the Korean Reconstruction Bank.

Another problem mentioned by the staff which Mr. Southard thought worthy of emphasis was Korea's need to increase its earnings on the balance of payments side. It would be a difficult task to find a way to reduce the country's reliance on foreign aid, and efforts would have to be made to export more of the products Korea had, particularly rice where the high price created an almost complete barrier. By October last year Korea had sold a small quantity of rice to the Ryukyus, but it might well be that at the price of \$155 per ton even this small market could not be counted on. Rice from Burma and California was available for around \$120 per ton. The premium margin which consumers might be willing to pay for Korean rice obviously had its limits. With a spread as large as this, it seemed clear that Korea would have difficulty in selling its rice even to Japan, should that market open up again. Undoubtedly, the question of price would be crucial to the problem of increasing export earnings.

With respect to the exchange system, Mr. Southard said he had little to add except to express concern about the extreme complexity described on pages 14-17 of Part I of the staff report. It seemed clear from the experience of many countries that the problem of dealing with import pressures and the needs of exporters could not be adequately handled by working out special rates of exchange for large numbers of importers and exporters. He agreed with the staff that it was urgent for Korea to tackle the task of simplifying its exchange system with a view to unifying the rate structure at a realistic level. The recent revision of the official rate to 650 hwan per U.S. dollar was a step in the right direction, but the existence of import rates ranging upwards of hwan 1000 per dollar, the consideration of a special rate for tourists, and the recent introduction of a retention quota system were all familiar evidences of the lack of adequacy in the present rate structure. The stress the staff had given this point both in its paper of February 18, 1960 (EBS/60/15) and in the present report, seemed justified, and he was

in full agreement with their views. In concluding, however, Mr. Southard wished to reiterate that in many respects the Korean authorities deserved to be commended on the general outturn of economic developments in the past year.

Mr. Guth felt that the staff had submitted a very good report which clearly brought out the twin problems, mentioned by Mr. Southard, of stabilization and development and their interdependence. It also showed that the serious efforts of the Korean authorities to stabilize the economy had had a number of encouraging results. He commended the authorities on the policies they had pursued so far, and he wished them further success in the future. It went without saying that considerable efforts were still necessary, both in the monetary and fiscal field, to achieve stable growth. So far as fiscal policy was concerned Mr. Guth felt that a simplification of the budget structure, i. e., incorporation of the various special accounts into the ordinary budget, was desirable. The recent policy decision to make government enterprises self-sustaining was to be welcomed.

With respect to the country's need for economic development, Mr. Guth noted that the staff had urged the Koreans to increase production. While he would agree that this was necessary, Mr. Guth thought one should add that the basic need was for economic development along sound and productive lines. The present evidences of some non-productive investments, creation of excess capacities, etc., should be corrected. Therefore, the elaboration of a long-term development plan which the staff report mentioned (SM/60/5, Part I, p. 11, 2/11/60) was to be welcomed. Moreover, the decline in U. S. aid meant that greater efforts would have to be made to mobilize internal resources and to increase savings. Insofar as the need to stimulate savings was concerned, the main point was to restore confidence and eliminate the present uncertainties which gave rise to wasteful speculation. It was to be recognized, of course, that internal capital could not do the whole job alone and for this reason the efforts to attract foreign capital, as exemplified in the new Foreign Investment Encouragement Law, were on the right lines. Here again, however, the creation of a general climate of confidence was the decisive task. So far as the balance of payments situation was concerned Mr. Guth wished to associate himself with Mr. Southard's view that the country had to find some way to increase its export earnings. Apart from the necessary efforts to increase productivity, Korea might find it useful in this respect to undertake some market research with a view to developing wider markets for its exports. Mr. Guth also thought the long-term Export Promotion Plan, which the authorities were drafting (*ibid.*, p. 14), should be useful. He would have thought that it should be worked out in connection with the long-term development program since the two obviously went together.

As regards the exchange system, Mr. Guth said he had nothing to add to the staff analysis which had pointed out very clearly the dangers and shortcomings in the present system which was the result of "attempts to solve difficult problems on an ad hoc basis" (*ibid.*, p. 15). He fully agreed with the revised recommendations. He hoped the Korean authorities would tackle this problem in the same way that they had faced up to their other problems.

Mr. MacGillivray associated himself with the tribute to the staff for its very good report and also joined in the congratulations to the Korean authorities on what they had been able to achieve so far. But, while congratulations were due for having reduced inflation, it was clear that the current situation was still precarious and that there was

much to be done before the economy would be on even keel. The prospect of a decline in U. S. aid emphasized the need for budgetary restraint and, as Mr. Guth had said, the need for savings and, above all, confidence. More fundamental efforts were also called for to improve export earnings.

On the external side, Mr. MacGillivray agreed with Mr. Southard that the problems were formidable. While he had sympathy with the Koreans in their difficulties, he would agree that the present exchange system was not only contrary to the Fund's principles but also to Korea's own interests. He was therefore particularly concerned to read the statement in the report that "at present, no steps for simplification of the system were under active consideration" (*ibid.*, p. 16). It was difficult to see how the Korean authorities, who appeared to recognize the shortcomings of the system and indeed had indicated that it was their policy to establish a unified rate in the future, could justify this negative attitude. It could not be pretended that the new official rate was satisfactory. The Korean Government was doubtless aware that the Fund had been increasingly reluctant to approve changes in exchange systems which introduced, maintained or extended the use of multiple currency practices. It was therefore to be hoped that the Korean authorities would bear this aspect seriously in mind and give further consideration to the necessity for early action toward simplifying the system on the basis of a unified and realistic exchange rate. In conclusion, Mr. MacGillivray said he agreed with the staff's revised recommendations subject to one amendment which he would propose later.

The discussion turned to the text of the draft decision recommended by the staff. With respect to paragraph 2, Mr. Guth suggested in the context of his earlier remarks that the penultimate sentence be changed to read: "Since the need for increased production and development is urgent, efforts should be made to mobilize internal resources for development to a greater extent."

Mr. Toussaint, while agreeing that something could be done in this respect, emphasized that Korea would still have to rely substantially on external aid. Mr. Guth recalled that he had already indicated that Korea's internal resources could not do the entire job, but he felt that some internal efforts should be made if Korea wished to attract foreign capital as envisaged in the new law to encourage foreign investment. In the light of this explanation, Mr. Toussaint had no difficulty with Mr. Guth's suggested revision, and the other Directors agreed to the proposal.

In the discussion of paragraph 3, Mr. Tann thought it unnecessary for the Fund to "urge" the Korean authorities to continue to apply budgetary and credit policies in order to achieve monetary stability since they had indicated that they would continue such policies. Mr. Toussaint suggested that the Fund should welcome this indication of the Korean authorities and the other Directors agreed.

With respect to the revised paragraph 5 (*ibid.*, Sup. 2), Mr. MacGillivray, in line with his earlier remarks, said he would prefer to have the Fund urge that "early" steps be taken toward the simplification of the exchange system, as the staff had suggested in its first revision (*ibid.*, Sup. 1).

Mr. Toussaint said he hoped the Board would accept the latest text submitted by the staff (*ibid.*, Sup. 2) which seemed appropriate as it did not approve the new complexities

in the exchange system and urged Korea to take steps toward simplification. After some further discussion, Mr. MacGillivray withdrew his proposal and the other Directors agreed to accept the text put forward by the staff.

Mr. Toussaint said he thought it was not necessary to say explicitly, as was stated in paragraph 5, that the future unification of rates should be at a realistic level, as this was obvious. Since the proposed language was the standard text used in the cases where the Fund recommended unification to members with multiple rate systems, he was prepared, although somewhat reluctantly, to go along with the language proposed.

The decision was:

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

2. Production continued to expand in 1958 and 1959, especially in agriculture. Two successive bumper crops were harvested, and a surplus of rice available for export was achieved in 1959 for the first time since the Korean War. The defense burden remains large, and there is a shortage of resources for development. The country continues to rely heavily on U.S. aid, which is declining. Since the need for increased production and development is urgent, efforts should be made to mobilize internal resources for development to a greater extent. The Fund notes that a long-term industrial development plan is now being formulated.

3. Korea continued in 1958 and 1959 to pursue financial stabilization policies directed toward preventing a recurrence of the inflationary conditions prevailing before 1957. By 1959, the budgetary deficit had been nearly eliminated, and during the year, private credit expansion was checked. After a large increase in 1958 and the early months of 1959, money supply has since been kept fairly stable. However, prices, except for grains, have increased again in 1959. The Fund welcomes the indication of the Korean authorities that they will continue to apply budgetary and credit policies so as to achieve monetary stability.

4. The balance of payments of Korea is heavily dependent on foreign aid; merchandise exports amount to only a small proportion of total imports. Preliminary balance of payments estimates for 1959 indicate that exports will be slightly higher than in 1958, and although foreign aid was lower, international reserves are expected to increase. As a further decline in foreign aid receipts is expected in 1960, it is necessary that the Korean authorities make every effort to expand exports.

5. Since Korea departed from a unitary rate for foreign transactions in 1957, the exchange rate structure has become increasingly complicated. It was further complicated by the addition in 1959 of a retention quota scheme. The Fund would stress that measures which are likely to increase further the complexity of the exchange rate structure should be avoided. The Fund has taken note of the recent revision of the official rate for the hwan from 500 hwan per U.S. dollar to 650 hwan per U.S. dollar, to which the Fund has not objected. However, this change does not reduce the complexity of the exchange system, and there is need for further improvement

with a view to unifying the rate structure at a realistic level. The Fund urges that steps should be taken toward the simplification of the exchange system. The Fund will remain in consultation with Korea on these matters.

6. In concluding the 1959 consultations, the Fund has no other comments to make on the transitional arrangements maintained by Korea.

3. Repurchase Obligation - Cuba

The Executive Board took up a request from Cuba for deferment of the repurchase schedule agreed by the Fund on April 13, 1959 (EBM/59/10, Item 2), and considered the staff's analysis and recommendation that the Fund agree to the proposal (EBS/60/23, 3/8/60).

Mr. Hazera noted that the repurchase commitment in question arose from a drawing in September 1958 which Cuba undertook to repay within six months. At Cuba's request the discharge of the repurchase was deferred in March 1959 and in April of that year the Board approved a request to change the commitment into a fixed repurchase schedule calling for payments beginning on March 12, 1960. Since last April, Cuba's exchange and reserve situation had deteriorated despite the measures taken, and for this reason the authorities had now requested a further postponement, but repurchase would still be completed within a period of five years from the drawing. During the period of the deferment it was to be hoped that the measures the authorities were taking would enable Cuba to return to a better level of reserves.

Mr. Southard said he was prepared to accept the staff's recommendation on the basis of the considerations set out in the staff paper. However, he wished to make clear that his acceptance did not in any way indicate that he saw evidence that the Cuban authorities had taken measures during the past year which would restore confidence or make a beginning toward solving their problems.

Mr. van der Valk observed that the present request was the second one for postponement of the entire schedule of repurchases. The Board's agreement to the request would change the original six months' drawing into a purchase for five years despite the fact that different criteria applied in the Fund's consideration of seasonal and longer-term drawings. In these circumstances he had doubts about postponing the entire schedule of repurchases and suggested that the Board agree at this time to the deferment of only the first payment. In the meantime a mission could be sent to Cuba to study the problem of postponing the other four payments, especially as there was reason to discuss the exchange situation reported in a recent staff paper (SM/60/10, 2/19/60).

The Chairman explained that because of the time factor the question of a mission, which would have to be taken up with the Government, was being considered separately. Meanwhile, the Fund should be as helpful as possible, on the basis of its general policies, on the subject of repurchase.

Mr. Hazera stated that the Cuban authorities had indicated to him that they were ready and willing to consult with the Fund, but because of the time factor they had not

been able to arrange for this before making the present request. He thought it should be noted that during the past year the Cuban authorities had done nothing to indicate a desire on their part to ignore their obligations under the Fund Agreement, and he trusted that their willingness to have further consultations could be considered additional evidence of intention to meet their Fund obligations.

Mr. van der Valk said that, in view of the possibility of an early mission, the postponement of only the first payment in the repurchase schedule seemed all the more desirable.

The Chairman said there were distinct advantages to keeping the two matters of repurchase and exchange practices separate. The exchange action approved by the Fund until the end of June 1960 would be the subject of separate consideration before that date. In due course, the Cuban authorities would be approached, in accordance with the standard procedure, with respect to a consultation, and there seemed to be no reason to doubt that a consultation could be held at an appropriate date.

The decision was:

The Government of Cuba has requested postponement of a repurchase commitment calling for five semiannual payments of \$5 million each, beginning on March 12, 1960 (EBM/59/10, April 13, 1959). The Government of Cuba proposes to discharge the \$25 million repurchase commitment by five semiannual payments of \$5 million each, beginning on September 12, 1961. The Fund agrees to the proposal.

4. International Meetings

a. *Economic Commission for Latin America.* In the absence of a request by any Director for formal consideration in the time specified, the following decision was taken on March 4, 1960 and recorded (EBD/60/31, 3/1/60):

The Executive Board approved Fund representation at the Seventh Session of the Committee of the Whole of the Economic Commission for Latin America as set forth in EBD/60/31 (3/1/60).

b. *Economic Commission for Europe.* In the absence of a request by any Director for formal consideration in the time specified, the following decision was taken on March 10, 1960 and recorded (EBD/60/33, 3/7/60):

The Executive Board approved Fund representation at the 15th Session of the Economic Commission for Europe as set forth in EBD/60/33 (3/7/60).

c. *GATT - Committee III on Expansion of Trade.* In the absence of a request by any Director for formal consideration in the time specified, the following decision was taken on March 10, 1960 and recorded (EBD/60/34, 3/8/60):

The Fund will not send a representative to the meeting of Committee III on Expansion of Trade beginning on March 14, 1960, and the letter set forth in EBD/60/34 (3/8/60) shall be sent.

5. Executive Board Travel

No objection having been expressed in the time specified to travel by an Executive Director as set forth in EBAP/60/22 (3/7/60), the Executive Board's approval is recorded.

APPROVED BY THE EXECUTIVE BOARD:

Meeting 60/14, April 6, 1960

PER JACOBSSON

Chairman

ROMAN L. HORNE

Secretary