NOT FOR PUBLIC USE

FILES

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 70/86

10:00 a.m., September 9, 1970

P.-P. Schweitzer, Chairman

Executive Directors	Alternate Executive Directors
E. Asp	S. Jónsson
W. B. Dale	
	R. H. Arriazu
R. Johnstone	
A. Kafka	E. da S. Gomes
B. Kharmawan	M. A. Merican
	T. de Vries
B. K. Madan	
	R. H. Gilchrist
	V. Barattieri, Temporary
A. Phillips O.	M. A. Sandoval
G. Plescoff	
	A. Mansour
	L. Fuenfgelt
	G. P. C. de Kock
H. Suzuki	K. Satow
	N. H. Hanh
	J. Roelandts
	M. P. Omwony
	L. M. Rajaobelina

W. L. Hebbard, Secretary
J. A. Kay, Assistant

1. Syrian Arab Republic - Schedule of Repurchases . . . . . Page 3
2. Mexico - 1970 Article VIII Consultation . . . . . Page 3
3. Malaysia - 1970 Article VIII Consultation . . . . . Page 20
4. 1970 Regular Election of Executive Directors - Proposed Resolution . . . . . Page 30
5. Executive Board Travel . . . . . Page 31

Also Present

J. Carrière, Alternate Executive Director, IBRD. African Department: P. W.-S. Kim. Asian Department: D. S. Savkar, Director; A. Abadjis, A. G. Chandavarkar, H. Jensen, R. J. Niebuhr, S. A. Pandit, D. A. Scott, E. D. W. Spingarn, K. Suzuki. Exchange and Trade Relations Department: C. D. Finch, Deputy Director; D. K. Palmer, Deputy Director; A. Buira-Seira, I. Takamuki. The IMF Institute: P. W. Chooi, Participant. Legal Department: J. Gold, General Counsel and Director; J. G. Evans, N. S. N. Chari, A. O. Liuksila, F. Gianviti, J. V. Surr. Middle Eastern Department: J. W. Gunter, Acting Director; P. Dickie, S. H. Hitti, D. F. McCormack, D. Noursi. Research Department: J. J. Polak, Economic Counsellor and Director; D. Ridler, A. W. R. Braun. Secretary's Department: J. W. Lang, P. F. Gourley. Treasurer's Department: A. Watkins. Western Hemisphere Department: J. Del Canto, Director; J. W. Crow, V. Galbis, H. Megía, S. J. Stephens. Personal Assistant to the Managing Director: L. F. T. Smith. Technical Assistants to Executive Directors: J. M. Chona, L. de Pablo, A. Doizé, L. Halfmann, P. C. Hayward, J. L. Muchinga, C. G. Muñiz, H. Rudloff, J. Skutle, G. F. Taylor, J. R. Vallet, B. F. van Ittersum.

1. SYRIAN ARAB REPUBLIC - SCHEDULE OF REPURCHASES

The Executive Directors considered a proposal by the Syrian Arab Republic for a schedule of repurchases, together with the staff's analysis and recommendation (EBS/70/249, 9/1/70).

The Acting Director of the Middle Eastern Department corrected an error in Attachment 2.

Mr. Mansour asked that the proposal by the Syrian Arab Republic should be accepted for the reasons explained in EBS/70/249 and in the letter from the Minister of Economy and Foreign Trade annexed as Attachment 1.

Mr. Dale said that the proposal by the Syrian Arab Republic provided for repurchase within five years of the purchase; it therefore raised no particular issues and he supported the proposal.

The Executive Directors turned to the proposed decision, which was approved.

The decision was:

> The Syrian Arab Republic has proposed that repurchase in respect of the purchase equivalent to $9.5 million on September 18, 1967 under the Compensatory Financing Decision be made in four equal semiannual installments equivalent to $2,375,000 each, beginning not later than February 15, 1971 and ending not later than July 15, 1972. The Fund agrees to the proposal of the Syrian Arab Republic.

Decision No. 3134-(70/86), adopted
September 9, 1970

2. MEXICO - 1970 ARTICLE VIII CONSULTATION

The Executive Directors considered the staff report for the 1970 Article VIII consultation with Mexico (SM/70/171, 8/10/70, and Cor. 1, 8/14/70). They also had before them "Mexico - Recent Economic Developments" (SM/70/180, 8/14/70, and Cor. 1, 8/20/70).

Mr. Phillips made the following statement:

> I would like to express the appreciation of my authorities and my own to the staff for an excellent and very prompt report on the 1970 Article VIII consultation with Mexico. This provides a very useful means of reviewing recent economic developments and outlook,

as well as the effectiveness of the policies that have been followed. The Mexican authorities are in general agreement with the views expressed by the staff, and the following comments are offered in order to highlight certain aspects of Mexican economic policy which my authorities consider of importance.

1. The rate of growth of GNP for 1970 will be slightly below the one achieved in the past two years. This is the result of a deliberate policy. Both fiscal and monetary policies have been so geared as to afford the necessary leeway to face developments in the next two years, having in mind both internal developments related to a change in administration, and the anti-inflationary policies followed abroad.

2. In various sections of the report it is stated that the international reserves of the Bank of Mexico at the end of 1969 showed a decline when compared with the previous year. My authorities cannot agree with such a conclusion, but they are conscious that the discrepancies may be due to different statistical methods and to changes in the composition of the foreign assets of the Bank of Mexico. To further clarify the issue and bring figures up to date, President Díaz Ordaz in his report to the nation a few days ago stated that the gross reserves of the Bank of Mexico at the end of August 1970 amounted to $762 million, which represents an increase over the previous year and above the SDR 45 million allocated.

3. My authorities believe that stable financial conditions and adequate yields are the only means to ensure the generation of the domestic savings required to finance an increasing level of investment. However, they are conscious that in order to maintain the latter, it is necessary to obtain additional resources abroad, although it must be stressed that these foreign savings are complementary to those obtained domestically, and do not substitute each other. The consultation report and the document entitled "Recent Economic Developments in Mexico" discuss at some length the external debt situation of the country. The Mexican authorities share the concern expressed by the staff as regards the amount of public foreign debt and its servicing, but in this connection I have been asked to stress two points:

First. The public external debt that has been incurred has been used exclusively to finance investments in productive activities which will either generate their own means of payment through increased exports, substitute imports and thus save foreign exchange or assist other activities that will lead to these results. Therefore, it is considered that this debt does not necessarily create an unbearable burden on the country's resources.

Second. It is true that annual interest and amortization payments represent 22 per cent of the current account earnings, which may appear high in simplified international statistical comparisons. However, in Mexico the public sector includes many activities which in other countries form part of the private enterprise. The foreign debt incurred by these sectors is included in the Mexican public indebtedness, but may not be added to that of other countries. In addition, there is debt originally contracted by public financial entities which is later channeled to private productive activities. Therefore, I would like to emphasize that it is dangerous to give excessive weight to such statistical relations without qualifying the composition and the use of the resources obtained through external borrowing.

On pages 8 and 9 of the consultation report, the staff refers to a recent decree instructing the Secretary of Finance to authorize new public indebtedness only when it is incurred in order to finance imports for authorized investments or to repay previous debt. I would like to stress that this decree was issued in order to legally strengthen the policies which have been pursued for several years.

4. Regarding the balance of payments, the authorities of Mexico share the concern expressed by the staff in the document before us in relation to the current account deficit. Export performance last year was very satisfactory and a coordinated policy has been started to apply specific measures to increase sales abroad in the face of adverse circumstances, especially in the agricultural field. In addition, important advances have been made to diversify exports and the results can already be seen by the figures quoted on the dynamic behavior of manufactures. On the import side, emphasis is being given to the policy of import substitution and progress has already been made in the past. I am sure that, seen from the domestic efforts, one must have an optimistic outlook for the immediate future.

In the field of tourism, a most important industry for the world as a whole, Mexico is particularly well located and endowed with both cultural and natural attractions. Thus, considering the importance of this activity for the balance of payments, every effort is being made to further promote it. In this context, the staff fully describes various projects that are under way, and in some of which Mexico expects to receive the assistance of international financial organizations such as the World Bank.

Mexico, like other developing countries, is trying to reduce its current account deficit through policies that promote activities that will give rise to foreign exchange earnings. However, it is

sometimes difficult to achieve the desired results if our main markets, those of more developed countries, are restricted or protected by trade barriers and high tariffs. This is a field in which, I am sure, substantial improvements can be made for the benefit of all.

5. As the report clearly states, domestic prices in 1969 behaved according to the pattern of the previous years and rose moderately. The first half of 1970 has registered a larger increase in prices derived from nonrecurrent circumstances and developments abroad. Specifically, this is due to poor crops caused by bad weather, the increase in prices of imported goods, and the anticipation of the effects of the new Federal Labor Law and revised minimum wages. The authorities are fully aware of these factors and will continue, as in the past, to be vigilant and, as the staff states and I quote, "guard against any feedback from these price increases."

6. Turning to monetary policy, my authorities have asked me to stress that the traditional full convertibility and stable rate of exchange of the peso will be maintained. They are convinced that it is within the framework of financial stability that economic progress can best be achieved.

The Mexican financial system has been more closely integrated to the international one as the years go by. My authorities are fully aware that monetary policies need to be framed in relation to the domestic economy and, at the same time, attuned to international financial conditions. Thus, they cannot agree with the statement of the staff that there has been a deterioriation in the liquidity structure of the banking system. The measure taken last year which allows the issue of promissory notes with a higher rate of interest did not derive from a change of the liquidity preference of the public but, rather, was the result of the unwillingness of financial institutions to issue long-term obligations with a high rate of interest. These practices have since been observed in other member countries of the Fund.

7. The last paragraph on page 12 of the consultation report states that the Bank of Mexico is lacking in instruments to offset a possible capital inflow. This may be due to a possible misunderstanding. The Bank of Mexico has at its disposal all the necessary technical instruments, such as legal reserve obligations, government bonds, or even, if necessary, central bank bonds to offset such capital movements. There may be some difficulty in selling government bonds directly to the public in view of the unwillingness to allow the rate of interest on such paper to rise to present market levels. However, based on past experience, I can assure Executive Directors that Mexico's monetary authorities have all the necessary instruments and legal powers to take care of the situation, if it should arise.

8. Regarding fiscal policy, I am pleased to state that so far this year, and notwithstanding a change in administration, it has been indeed possible for both current and investment expenditures of the public sector to go according to plan, and it is intended to continue the strict control. Emphasis will be maintained in the investment-financing program for the public sector so as to ensure that spending plans are consistent with the set priorities and with the financial resources available.

The Mexican authorities fully agree with the staff on the need to increase public savings without unnecessarily reducing private ones or the confidence in Mexico's financial position that has been the result of many years of continuous efforts. They are aware of the need to undertake certain fiscal measures to increase revenues, as well as improve the operation of certain public enterprises in order to reduce operational deficits. At this time it is difficult to state specifically what measures may be taken as the fiscal program for next year is under preparation.

9. In conclusion, the last two decades have shown that the Mexican economic development has been a constant process, and that this has been the result of a favorable social and political climate, as well as adequate fiscal and monetary policies. These factors have given rise to a high level of domestic savings and have attracted foreign financial resources that have contributed to the maintenance of a high level of investment. I can assure Directors that, with the Fund's very valuable cooperation, these basic elements of Mexico's economic success will be continued.

Mr. Phillips added that he wished to re-emphasize the great appreciation of his authorities for the excellent work performed by the staff.

Mr. Kafka said that he had greatly enjoyed reading the excellent paper on the 1970 Article VIII consultation with Mexico, and that he had particularly liked the decennial retrospect, which he hoped would be included in other staff consultation reports. He was grateful for the excellent observations made by Mr. Phillips, and he wished particularly to refer to his very appropriate strictures against mechanical comparison of debt service ratios. In addition to the points which Mr. Phillips had mentioned, which ought to be taken into account in judging the Mexican debt service ratio, the excellent management of the Mexican authorities ought also to be borne in mind. They always had a pipeline filled with several hundred million dollars worth of loans precontracted; and, naturally, if it was possible to roll over a large part of the external debt, as the Mexican authorities had arranged to do, a given debt service ratio would present no danger, although the same ratio might be too high for a country that had not been able to make such satisfactory arrangements.

Continuing, Mr. Kafka expressed his general admiration for the skillful management of the economy by the Mexican authorities, which had made possible the exceptional performance of that economy over the past ten years. He was certain that the same skillfull management would continue in the new administration, with the help of Mr. Phillips himself, because the new men represented the same school of thought as their predecessors. That was true in particular of the new Minister of Finance and the new head of the Bank of Mexico, whose late Director-General had been a friend and mentor to himself and so many of his colleagues.

Mr. Kafka, continuing, remarked that Mexico had known not only how to avoid the pitfalls of bad demand management and, so far, the even worse pitfalls of cost inflation; it had also known how to direct its long-term efforts in the best direction. Mexico had been one of the first less developed countries to perceive, in the immediate postwar period, the importance of growth appropriately balanced between agriculture and industry; and it had reaped very great advantages from so doing. Indeed, in the last analysis it was that balance which had made further growth with stability possible. Mexico was again in the forefront of less developed nations in realizing the need for impressing greater competitiveness on their industries in order to maintain their growth potential. As Mr. Phillips had stated, if Mexico's efforts were to bear fruit, it was essential that the actions of other countries, particularly the more industrialized ones, should not lead to frustration of its endeavors in the commercial field. He congratulated the Mexican authorities for their excellent performance, and asked Mr. Phillips to convey to them his best wishes for the future.

Mr. Dale began by agreeing very much with a good deal of what Mr. Kafka had said, in particular about Mexico's fine reputation and the impact of that reputation on the handling of the foreign debt problem. The discussion in the staff paper, together with Mr. Phillips' interesting recapitulation, made for most absorbing reading. While it would be premature to attempt to assess any specific adaptations of policy which the new administration might be called to decide upon, two things were quite certain. One was that the success of Mexican policies, and thus of the Mexican policymakers, over the past decade had been clearly assured. The review in the staff report showed a record for which congratulations were richly deserved. The second point was the extent to which step-by-step progress of a pragmatic, administrative kind had been systematically achieved in Mexico, leading in the long run to an important improvement in policy performance. A good example of that trend was the continuing improvement in fiscal arrangements, not only in their internal coordination but also in their relationship to the current state of the economy and the allocation of resources.

Particularly striking in that respect, Mr. Dale observed, was the painstaking way in which the economy and public policy were being turned

over to the new administration. The staff had referred to that feature of Mexican economic life in particular at the bottom of page 19; but even more striking was the staff's appreciation of the sophistication and maturity with which financial policy was applied in Mexico, as described on page 8 of SM/70/171.

He had noted with a great deal of interest the focus in the staff report on the degree to which the balance of payments might in future constitute a constraint on development and economic policy, Mr. Dale remarked. On that subject he concurred broadly with the staff appraisal, but he also took comfort from the points of emphasis in Mr. Phillips' statement regarding the alertness of the authorities to the many aspects of the payments situation. He was particularly glad to see an increasing emphasis on cost competitiveness in import policy.

In conclusion, Mr. Dale remarked, it was clear that one era was ending and another was beginning in the hierarchy of financial officialdom in Mexico. It was particularly sad to note the announcement which the Chairman had recently made concerning the sudden death of Don Rodrigo Gomez. An outside observer like himself had the impression that a whole generation of able, dedicated, and successful Mexican public servants had been deeply touched by his influence, an influence that could only be characterized as one of financial statesmanship. The Executive Directors could hardly do better than to hope for the new incumbents a regime as productive as that of their predecessors in overcoming the problems that might face them.

Mr. Gilchrist said that he too had been struck by the very impressive long-term record which the Mexican authorities had achieved in the management of a rapidly growing yet stable economy. Mexico provided an admirable example of how stability could foster confidence and make possible the voluntary mobilization of domestic savings on an impressive scale. Looking ahead, Mexico might be called upon to make some difficult sacrifices during the current year. The target for a growth rate of 6 per cent might not be reached and there was a rather unwelcome indication that prices were not proving as amenable to demand management as in the past. In that connection he found Mr. Phillips' statement particularly helpful, and he sincerely hoped that the position could be held satisfactorily. He understood that the trade figures for the first six months had endorsed the staff's assessment of performance in the first four months of 1970 to the effect that there had been very little growth in exports, while the growth of imports had accelerated. In those circumstances, even allowing for weather conditions and the slowdown in activity in the United States, it might be wondered whether the projected trade deficit of $679 million for 1970 shown in Table 21 of SM/70/180 was still realistic. If so, and if the outturn on invisibles and private capital account was no better than anticipated, the already large external financing requirements might well be exceeded. In the short term it was to be hoped that that situation

would not create problems, since Mexico seemed to have access to adequate funds, although at a rather high price. If the maturity structure of the Mexican external debt was not to be distorted, considerable efforts would have to be made to expand exports of manufactured goods and to raise tourist earnings. In that connection, the authorities deserved congratulations on pursuing cautious fiscal policies with the aim of laying a sound financial base for the new administration.

He was glad to see, Mr. Gilchrist continued, that the staff and the Mexican authorities agreed that if the external burden was to be contained, further measures would be needed to increase domestic savings. The staff's judgment that the emphasis would have to be on the public sector seemed to him justified in view of the success that the authorities had achieved in the private sector. In the monetary field the stance of the authorities was sufficiently cautious. In conclusion, he would ask the staff whether the rise in the short-term interest rates in 1969 to reflect international movements had been carried through into bank lending rates for industrial investment. If so, was there any connection between the rise in interest rates and the rather slower rate of increase in private investment?

Miss Fuenfgelt remarked that it was a lucky coincidence that the agenda for the meeting had brought together two countries--Mexico and Malaysia--that were examples of what could be performed by pursuing sophisticated policies when governments and people were determined to advance their economies on a path of sound growth with relative stability.

Continuing, Miss Fuenfgelt remarked that during the past year growth in Mexico had been somewhat slower than the average; nevertheless, the dynamic forces were unbroken and there was no indication that their basic strength and soundness were in any way lessened. It was therefore not surprising that the staff and the Mexican authorities were in basic agreement in their judgment on the proper economic course for Mexico to follow. While in the coming period of development the authorities might be faced with structural problems more difficult to manage than those of the past, they seemed to be aware of the narrowing margin of maneuver for their overall economic measures, and they were certainly prepared to react promptly even to early warning indicators of any tension that might arise.

So far, the authorities had been successful in meeting the growing financial needs by prudently using all possible means of raising additional internal and external savings, Miss Fuenfgelt observed. In the present circumstances, marked as they were by a slowdown in domestic activity and the continuing tightness of international capital markets, the authorities' intention to exercise closer control over public investment while attempting to increase domestic savings was to be commended. In SM/70/171 the staff had reported an exchange of views with the Mexican

authorities on burden sharing between the private and public sectors for adapting the savings performance to investment needs. The staff had expressed the opinion that if the intention was to raise total domestic savings nearer to the requirements of domestic investment, the task of making such an adjustment would have to be undertaken mainly by the public sector, as it appeared that the Mexican authorities had already done as much as they could in encouraging a large flow of voluntary savings from the private sector. If she had understood the situation correctly, the staff's view should be seen in the light of what had been said on pages 16 and 17 of SM/70/180 regarding the chanelling of financial resources to the public sector by the regulations on reserve requirements. It would there be seen that the ratio of government securities to cash in the reserve of the commercial banks was extremely high. In 1969 deposit and savings banks had 19 per cent of their reserves in government securities and 17.4 per cent in cash. Other private banks had 25.2 per cent of their reserves in government securities and 2.3 per cent in cash. The connection between those figures and the figures given in Table 15 was not very clear, but in that table the ratio of security reserves to specified liabilities covered a range from 5 per cent to 99 per cent, while cash reserve requirements in terms of specified liabilities ran from 1 per cent to 25 per cent.

Arranging for banks to hold their minimum reserves in the form of government securities provided the Government with a relatively flexible instrument of deficit finance, Miss Fuenfgelt remarked, even if the instrument was not normally used for that purpose. However, government securities were not as independent an instrument as cash reserves, and the technique might prove to be an element of rigidity in the management of credit and banking policy if monetary restrictions were to be tightened and banks were already loaded with large amounts of government securities. It was essential to have available efficient instruments to offset the effects of capital inflows, and the composition of minimum reserves might cause some structural difficulties in that connection. It was satisfactory to learn from Mr. Phillips that in present circumstances the Bank of Mexico had sufficient technical instruments at its disposal to handle major capital inflows as well as other movements.

Considering the high ratio of public debt servicing to current account earnings, Miss Fuenfgelt wished to emphasize the sentence in the staff appraisal to the effect that, if they wished to improve the balance of payments picture, the Mexican authorities should press forward with the efforts already begun to strengthen the export performance. Taking into account the absence of excess demand, the authorities should have no difficulty in bringing about the desired shift in resources to the external sector without having recourse to undue import restrictions. She wished the Mexican authorities every success for the future.

Mr. Johnstone said that he agreed with the interesting staff appraisal on the Mexican economy. It was appropriate that attention should have been drawn in the discussions to the consistency of targets for economic growth with the sound development of the balance of payments, and to the closely related questions concerning domestic and external financial flows. Mexico had achieved a commendably high rate of growth in conditions of relative price stability. Indeed, it could be persuasively argued that the good price performance had been a major element contributing to the economic growth. Nonetheless, the staff had correctly drawn attention to the possible constraints on the growth process with respect to both domestic and foreign financing. Although serious problems had not so far arisen, the rising level of international indebtedness and the related burden of servicing it were matters that did bear watching. He accepted Mr. Phillips' point that the arithmetic on that subject should not be interpreted too simplistically; but even so he shared the staff's concern over the debt service ratio and its prospective increase in the years ahead. At EBM/69/95 (10/15/69) he had said that a well managed economy should draw on foreign savings to the maximum extent consistent with development and the use of its own resources. Mexico was a prize example of the successful operation of that process; nevertheless, the note of caution which the staff had put into its report was merited.

The success of the Mexican authorities in collecting and chaneling domestic savings was too well known to need additional comment, Mr. Johnstone observed. An appropriate and increasingly varied range of financial claims had been offered to the public; their soundness had been assured and their rates of return had been sufficiently attractive. With the incentives well attuned to the needs, and with levels of income continuing to rise, the funds to feed the process had continued to flow in; but increases in financial savings at rates well in excess of increases in money incomes could not be expected to persist forever. The staff therefore looked to the need to generate a higher rate of public savings, and he noted that that view was broadly accepted in Mexico.

Speaking of the public sector itself, Mr. Johnstone said that he was aware that Mr. Phillips was not particularly impressed by discussions of the ratio of taxation to GNP or other measures of the flow of income. Nevertheless, the tax ratio in Mexico did seem low, and the stage might well have come when moves to increase the ratio could be made without disturbing the confidence which was so essential to the continued dynamic development of the Mexican economy. Indeed, he wondered whether a widening of the income tax base and other possible changes in the tax system might not positively contribute to general confidence in the future broad development of the Mexican economy. Quite apart from the direct effect of raising public sector savings, appropriate tax measures combined with other development policies could contribute to the objective of "spreading the benefit of economic growth to the large segment of the population which had not yet fully benefited from the economic gain of the past."

The distribution of the benefits of economic growth was one topic that had not been fully covered in the report, Mr. Johnstone remarked. While he understood that comment on that subject was difficult in the absence of adequate statistical information, the interested and sympathetic outside observer would feel happier if he were able to learn something about the way in which real income had been distributed through the Mexican economy in recent years. Similarly, information on employment in the various sectors of the economy would be of real interest, as would some discussion of the unemployment situation, such as it might be. He fully shared the views that had been expressed by other Directors regarding the remarkable and consistent successes achieved by the Mexican authorities in the management of the economy. All he had wanted to say was that it would be interesting and useful if the excellent discussion of the financial side of life in Mexico could have been fleshed out with a somewhat fuller discussion of developments in real terms.

In asking Mr. Phillips to convey to his authorities his best wishes, Mr. Johnstone expressed his real sadness at the death of Don Rodrigo Gomez, a very great man whom he had had the privilege of meeting when he had visited Canada several years ago.

Mr. de Vries shared the admiration for the development of the Mexican economy over a long period which had been clearly reported by the staff and highlighted by Mr. Phillips. Mexico had indeed been characterized by a high, stable, and sustained rate of growth with greater success in maintaining relative price stability than had been achieved in many other countries. It was true that that growth had not been entirely reflected in increases in per capita income because of the relatively high rate of population growth; nevertheless, there had also been a substantial increase in per capita income.

Coming to more immediate policy matters, Mr. de Vries remarked that he had been struck by the concerted efforts of the Mexican authorities to keep expenditure in hand over a number of years and by the success that they had had in doing so. Public savings, which were important in the Mexican economy, had increased. While the increase had largely been achieved in the finances by the Federal Government, the remainder of the public sector had at least maintained its rate of savings, which was in itself an encouraging sign. The result had been that as domestic investment had risen, domestic savings had followed step over the years and that relationship had been an important element in the development of the Mexican economy.

On the prices front, Mr. de Vries considered the situation had become slightly less favorable in recent months. It was true that special factors had been in play, and it could only be hoped that the Mexican authorities would be successful in limiting the feedback effects of the price increases that had occurred; they were in any event still relatively moderate compared

to increases elsewhere in the world. In connection with the internal and external debt policy, he had been struck, like others, by the shortening in the average maturity of the debt structure. The Mexican authorities had been impressed by the current high interest rates and had concluded that perhaps they should put more emphasis on short-term financing. If interest rates did indeed turn out to have been at a temporary peak, they would be seen to have followed a wise policy. However, their chosen course of action implied that as soon as the interest rate structure became more favorable, they would have to take action and lengthen the average maturity of the foreign debt. In considering the 22 per cent ratio of foreign debt service to foreign earnings, it was necessary to take into account many factors including the possibility of rolling over foreign debt; nevertheless, as foreign resources were being put to work through increased economic activity within Mexico, in the long run exports should grow more or less pari passu with foreign borrowing, and consequently the result of increased recourse to foreign resources should not necessarily be an increase in the ratio of debt service to current foreign earnings. Naturally, if the ratio were to be kept down, the problem of further increasing the domestic savings ratio would have to be tackled. He agreed with Mr. Johnstone that in that connection some consideration could perhaps be given to a modest increase in the tax burden as a method of raising the public savings ratio. He concluded by extending his best wishes to Mr. Phillips and to his authorities.

Mr. de Kock remarked that he had had the privilege of commenting on a report on an Article VIII consultation with Mexico three times within the two years and one and a half weeks that he had been with the Fund. In the case of Mexico, the Fund had clearly achieved its ideal of regular annual consultations and SM/70/171 must indeed be, as Mr. Phillips had described it, "a very prompt report." He had again enjoyed reading the staff paper on the Mexican consultation because, first, the report itself was of a very high quality and, second, it again described a genuine success story. The report mentioned the achievement of a growth rate of 5 1/2 per cent to 6 per cent--apparently considered rather low by the Mexican authorities--financial stability, high savings ratios, restraints on public spending even in an election year, restrained credit policy, realistic interest rates, and policy coordination. It was true that the report also described certain problems in the Mexican economic situation, but the outside observer had the feeling that the authorities had the situation well under control, and that they were in a position to take further steps if necessary, election year or no.

If there was one aspect of Mexican economic policy that might cause concern, Mr. de Kock considered, it was the greater stress apparently being placed on the policy of import substitution. He sincerely hoped that the Mexican authorities would not fall into that particular trap. The experience in other countries, including his own, had shown how dangerous that course could be. In a world where technological changes took place very

rapidly, it was important to expose domestic industries to stiff international competition. While the decline over time in the ratio of imports to total production might be desirable in a country like Mexico, that decline should come about as the natural result of sound development and stabilization policies; it might indeed be counterproductive if the Mexican authorities were to attempt to force the pace by protectionist measures to stimulate the establishment of import-substituting industries. While import substitution was always so appealing on the surface, in the medium and long terms it might not be a desirable policy even for a country like Mexico.

Turning to a point of presentation, Mr. de Kock referred to section II of SM/70/180. At EBM/69/95 there had been some discussion of the nature of the financial analysis employed by the staff in SM/69/141. At that time he had said that, while he had been greatly impressed by that section of the staff report, he had missed the banking sector analysis which had become standard procedure in most consultation papers. In SM/69/141 the section in question had been almost entirely financial, with very little reference to money or banking aggregates. In SM/70/180 the staff had gone far toward meeting his request, and he expressed his appreciation that it had done so. In particular, Table 7 of SM/70/180 was most useful indeed. He would only comment that the concept of near-money or quasi-money used by the staff had been very broad indeed; it included not only near-money but also "far-money," meaning bonds, certificates, and long-term liabilities of financial institutions which in most other reports of the same nature would not be added to money or deposits to form a monetary aggregate. He therefore wondered whether in the future it would not be useful to work with three monetary aggregates instead of two: namely, money supply, money supply plus genuine near-money, and the concept employed by the staff which included all other quasi-monetary liabilities. While it was undesirable to overemphasize the importance of monetary aggregates, and the present tendency was indeed to overemphasize them, if they were to be used at all the most useful aggregates should be chosen; in the case of Mexico, his suggestion would be that an aggregate lying somewhere between the definitions used by the staff for "money" and "quasi-money" would be a useful third tool of analysis.

Mr. Arriazu remarked that, as Mr. Kafka had said, it was always a pleasure for a Latin American to take part in a discussion of a consultation report on Mexico. The remark was particularly apt on the present occasion as the staff report had raised many interesting questions, and Mr. Phillips had answered most of them. Any doubts that there might be were concentrated in three areas. The first was the size of the external debt, the second was the balance of payments, and the third was the level of public saving. It was not surprising that there was some controversy in those areas, since on all three topics there was a very abundant literature in which both the staff position and the Mexican position were defended. Personally, he was on the side of Mr. Phillips. Regarding the

external debt, there was general agreement that there must be some optimum figure; but that optimum was not so much a size as a ratio of debt either to GNP or to export receipts. The Mexican authorities had managed their external debt in a very efficient manner, and the staff data showed that the ratio of debt to GNP had been maintained constant through time. In his view that was the correct way of measuring the situation.

The balance of payments might in future cause difficulties for the Mexican authorities by becoming a constraint on development, Mr. Arriazu considered. The staff sometimes seemed to believe that the existence of a balance of payments problem implied the presence of excess demand. It was true that in 1969 Mexico had suffered from an increase in price levels accompanied by a very high increase in imports. However, as the staff had explained that the increase in the price level had been brought about by exceptional circumstances, he could not readily accept the view that there was excess demand in Mexico at the present time. It would be sad if the authorities had to reduce the rate of growth because of a balance of payments constraint. With respect to the level of public saving, it was clear that Mexico had achieved great success in increasing the flow of private svaings. In consequence, he agreed with the staff that the authorities should try to increase the level of public saving without diminishing that of private savings. He congratulated Mr. Phillips and the Mexican authorities for the success that they had achieved.

Mr. Kharmawan complimented the Mexican authorities for the splendid performance of their economy, which had grown vigorously while maintaining stability. Such a performance was not only heartening to those developing countries that had not so far achieved similar success; it was also an example for developed countries in that it showed that it was possible to maintain stable conditions while the economy continued to expand. He believed that, like others, the Mexican authorities had discovered that, apart from following responsible budgetary and monetary policies even in an election year, one of the keys to development was the management and coordination of project financing. He agreed with the staff that the Mexican authorities had succeeded in establishing a mechanism, based on cooperation between the Ministry of the Presidency and the Ministry of Finance, to provide their development efforts with the framework within which expenditures and revenues could be examined project by project and the total impact on the economy assessed. That was a system worth studying by other developing countries that had experienced problems in the field of coordinating project implementation. The Government of Indonesia was paying serious attention to the Mexican system, which had proved to be both logical and highly efficient.

Continuing, Mr. Kharmawan asked whether it was the fixed policy of the Mexican authorities to rely on licensing as the main method of import management; or whether at some future date the system would be replaced by something more indirect. In conclusion, he wished to share the expressions

of sadness already uttered by other Directors on the death of Don Rodrigo Gomez whom he had the privilege to know for many years, and who had at one time visited Indonesia. With the passing of Don Rodrigo Gomez, the world had lost a very great man and a very great international banker. His memory could best be honored by practicing the wisdom which he had spread both inside and outside Mexico.

The Director of the Western Hemisphere Department expressed his gratitude to the Directors for their generous and constructive comments on the report for the 1970 Article VIII consultation with Mexico. So far as the staff was concerned, credit was particularly due to the North American Division of the Western Hemisphere Department. He himself had been most fortunate in that for the past 12 years he had headed the Fund mission to Mexico, and for that reason he wished to join the Executive Directors in expressing his regret at the loss of Don Rodrigo Gomez. During the years that he had been visiting Mexico he had had the great good fortune to know well Don Rodrigo Gomez in his capacity as Director General of the Bank of Mexico, and had learned from him much that had been described in the consultation reports on Mexico.

Turning to the comments made by Executive Directors, the Director of the Western Hemisphere Department explained that the increase in rates on the liabilities side of the operation of the private investment banks--financieras--had indeed affected the level of interest rates charged by those banks, and that it had contributed to the slower growth in private investment, particularly in housing. Nevertheless, it had also to be borne in mind that the slower growth in private investment last year was to be expected following the exceptionally large increase in 1968 in connection with preparations for the Olympic Games. So far as the trade balance was concerned, the figures given in Table 21 for the projected deficit were Mexican estimates; he regretted that he had to agree with Mr. Gilchrist that the outlook foreshadowed a greater deterioration than the one that the staff had indicated, since in the first six months of 1970 exports had risen by only 3 per cent while imports had increased by 14 per cent. That seemed to indicate that the slowdown in economic activity had not led to the decline in the rate of increase in imports that the authorities had expected. In reply to Mr. Kharmawan, the Director of the Western Hemisphere Department explained that the Mexican authorities relied heavily on import licenses, but that they did follow a fairly liberal policy insofar as capital goods imports were concerned while being fairly restrictive on imports of consumer goods. It was true that Mexico relied more heavily on licensing than on tariff measures compared with certain other countries; the equivalent ad valorem average tariff incidence was about 10 per cent in Mexico, a figure that was low for a developing country.

Concluding his remarks, the Director of the Western Hemisphere Department referred to the full and frank dialogue that the Fund had been

having with the Mexican authorities over a number of years, and paid particular tribute to Mr. Phillips for his contribution to the consultations between the Fund and Mexico. It was not always easy to conduct such full consultation with a country that was a large creditor of the Fund. It was particularly pleasant that the Mexican authorities took the consultations so seriously, and Mr. Phillips had been unusually kind and helpful to Fund missions on their visits to Mexico.

The staff representative from the Western Hemisphere Department, replying to Mr. de Kock's observation on the breakdown of liabilities of the banking system in Mexico, explained that the staff had had some difficulty in classifying those liabilities. A considerable portion was collected together under a heading entitled "Other Obligations" which covered a range of instruments, some of which could be cashed on demand at par, and some of which could not. There was no easy way of arranging them in order of liquidity at the present time.

Mr. Phillips thanked the Executive Directors for their very kind references to Don Rodrigo Gomez, who had been his close friend and leader of Mexico's finances. He would transmit them to his authorities and informally convey similar expressions to Mrs. Gomez.

Dealing with the comments on the consultation report, Mr. Phillips reminded the Executive Directors that as he had already explained in his statement, there would be a decrease in the rate of GNP in 1970. In 1969 the average rate of the past decade had been maintained at about 7.2 per cent, and the expected reduction in 1970 had been the deliberate result of policies followed by the Mexican authorities. Each change of administration had in the past brought about a relative upsurge of current expenditure, which had led to considerable problems. On the present occasion, however, deliberate action had been taken to prevent those pressures; it expected that Mexico would resume its normal rate of growth shortly after the new administration took office.

Continuing, Mr. Phillips remarked that the three basic problems facing Mexico on which the Executive Directors had commented were fully recognized by his authorities as deserving their complete attention in the future. For instance, the President of Mexico in his speech to the nation some days previously had referred to the fiscal situation. The Mexican authorities were aware of the need to undertake certain fiscal measures not only to increase public savings but also to obtain a better distribution of income. However, while that was an objective, such things could not be achieved very rapidly or suddenly. Meanwhile, the authorities were doing what they could to improve infrastructure, education, and health services.

With reference to the debt problem, Mr. Phillips stated that his authorities entirely agreed that it was a matter of concern, and they

were looking into it. However, he wished to stress that the problem for Mexico in that field was not only one of demand but rather one of supply; too many offers were being made to Mexico at the present time. He was sure that the Mexican authorities were fully aware of the changes in maturities; they would take the necessary action when the situation improved and allowed them to obtain a longer-term debt structure.

Commenting on the balance of payments position, Mr. Phillips agreed that the export situation had not been as buoyant as in 1969, a year in which Mexican exports had risen by 16 per cent. However, in 1969 the authorities and the staff had forecast an increase of only 6 per cent, and it was to be hoped that the results for 1970 would again prove better than expected. Every effort was being made to increase exports, especially of manufactures; he had already dealt with tourism in his opening remarks. The upsurge in imports during the first half of 1970 had been due to non-recurrent circumstances and to the fact that 1970 was a year of change in the administration. Many public sector capital goods that would normally have been imported over the year as a whole had in fact been imported in the first half, including a substantial amount of equipment for the subway system. It was expected that the rate of increase of imports would be substantially lower in the second half of the year, so that the overall result for 1970 would not be very disturbing. So far as import substitution was concerned, he could assure his colleagues that the authorities were following a new pricing system in order to expose Mexican industry to foreign competition. It was hoped that in that way they would succeed in making Mexican products more competitive without an overdose of protection. Import licensing was of course one way of controlling imports, but its other use was to provide statistical data. He also wished to stress that the licensing system had been liberalized in the recent past through the use of open licenses. The licensing system was administered by government committees composed mainly of representatives of the industrial sectors concerned; there was thus proper coordination between the controllers and the controlled.

In conclusion, while the Mexican authorities considered that there were many problems still to be solved, they did not think them insoluble, particularly with the assistance and cooperation of the IMF and other international institutions, Mr. Phillips remarked. A committee headed by Professor Kindelberger had recently stated, inter alia, that a country would be doing well if it attained a steady growth rate of 6 per cent or 7 per cent and devoted 20 per cent of GNP to savings. Mexico, he thought, met those standards.

The Executive Directors concluded their discussion of the report for the 1970 Article VIII consultation with Mexico.

3. MALAYSIA - 1970 ARTICLE VIII CONSULTATION

The Executive Directors considered the staff report for the 1970 Article VIII consultation with Malaysia (SM/70/169, 8 0/70). They also had before them "Malaysia - Recent Economic Developments" (SM/70/170, 8/10/70).

Mr. Merican made the following statement:

I would like first to congratulate the staff for its well-balanced appraisal and very good account of recent Malaysian economic developments.

Malaysian economic developments continued to be generally favorable. The economy grew at an impressive rate of 9.2 per cent in 1969. This compares favorably with the rates of 4.1 per cent in 1967 and 5.6 per cent in 1968, or the average annual rate of 6.2 per cent achieved for the period 1961 to 1969. Although export product prices have not remained as favorable as in 1969, the rate of GNP growth in 1970 is still expected to be around 6 to 7 per cent. This satisfactory growth performance is associated with continued domestic price stability which has prevailed for more than a decade. There were relatively small adjustments in wage rates in the private sector, and the larger but long-delayed adjustments in government wage rates arising from the report of a special salaries commission. On the wages front, no major disputes resulting in strikes occurred during the past year, nor are any currently expected. Although, as pointed out in the staff report, wage earnings probably declined as a percentage share of total income in 1969, they are on a rising absolute trend. It may be noted that the large number of small rubber holders benefitted considerably from the high price of rubber which prevailed during that year. The sharp improvement in the balance of payments position that occurred in 1969 led total reserves to increase by US$173 million to reach US$807 million at the end of 1969, or the equivalent of more than 8 months of total imports. At the end of June 1970, reserves had remained at about the same level as at the beginning of the year.

As is also indicated in the staff report, the less favorable aspects of Malaysian developments in 1969 were stagnation in investment and increasing unemployment, particularly among the young and in the urban areas. The stagnation in private investment was associated with the civil disturbances that erupted in May 1969 which made investors hesitate from proceeding with their plans for a time. It is gratifying to note, as pointed out by the staff, the definite revival of private investment activity which is also evidenced by the rapid increase in imports of machinery and equipment in the first half of 1970 and the steady upward trend in bank lending to the private sector as well as the findings of a recent survey of investors'

intentions. I should add that the uncertainties arising from the May 1969 commotion has now been overcome to such an extent that it has recently been announced that parliamentary rule will be re-established and parliament reconvened in February 1971. Meanwhile the slight and unplanned decline in public sector investment in 1969 is also to be reversed as project implementation problems are overcome and in the light of the more favorable financial situation which has enabled the authorities to adopt a more liberal attitude in approving project proposals and to aim for a 10 per cent increase in investment expenditure.

The increasing concern over rising unemployment has led to various policy responses. In its "new economic policy" the Government has placed greater emphasis on industrial development with heavier weights attached to the promotion of labor intensive industries. It is hoped that the manufacturing sector, the output of which has been growing at the rate of 10 to 12 per cent per annum, will expand more rapidly with the development of agro-based and timber processing industries as well as factories meeting not only domestic demands but also some export possibilities. In terms of employment, it is an irony of the situation that the most important rubber industry which is rapidly increasing its production should also be employing less and less labor. Consequently the migration from the rural to the urban areas may only be slowed down with the opening of more new lands and the promotion of other crops, including palm oil. The formulation of the Second Malaysia Plan (1971-75) is placing greater emphasis on the need to generate more employment, while at the same time trying to promote faster and more balanced economic growth not only as between sectors but also as between communities in this multiracial nation.

Given Malaysia's current and prospective dependence on the exports of at least three primary products--rubber, tin, and palm oil--she must obviously be concerned with international actions and measures which affect the prices and export possibilities of these and other products. Of crucial importance to her economic and financial stability is the prospective fluctuations in the price of rubber, which reacts sharply to changing levels of world economic activity. In the case of rubber, the difficulties caused by marked recent fluctuations in price--from the low of just over 40 Malaysian cents per pound in February 1968 to a peak of 85 Malaysian cents per pound in August 1969, compared with the current low of about 52 Malaysian cents per pound--had been accentuated by what are considered to be ill-timed announcements or news of changes in GSA stockpile targets and intentions. Given the sensitivity of rubber price to changes in stockpile objectives and sales policy, the disproportionate damage that would be caused to major rubber producing countries compared with the limited financial benefits which may accrue

to the U.S. budget, and the apparent subjectivity in the determination of security commodity stockpile needs, it is to be hoped that further careful and sympathetic consideration be given to this question. I would like at the same time to welcome the GSA August 19 announcement that it was witholding rubber sales for the month of September 1970 due to current unfavorable market conditions, and also the earlier consultations held by the U.S. with the four rubber producing countries jointly, as very welcome developments in international cooperative efforts in this field.

The staff report has also elaborated the views of the Malaysian authorities relating to the Fourth International Tin Agreement and the possibility of using the Fund buffer stock facility as a means of financing a part of national contributions to the international buffer stock. While the staff report has noted the regret expressed by Malaysian authorities that consumer countries (with one notable exception) would still not participate in sharing the financial burden of the buffer stock scheme (SM/70/169, p. 2, para. 3), I should add that it is very much to be hoped that all major tin consuming countries will this time participate in this important commodity agreement. In connection with the Fund buffer stock financing facility, it seems to me necessary that appropriate procedures and sufficiently flexible attitudes be adopted by the Fund if this facility is to be meaningful. This matter will no doubt be further considered when the separate paper referred to by the staff is discussed in the Board.

The Malaysian authorities are in general agreement with the staff appraisal relating to the overall fiscal and monetary situation. While the sharp increase in security spending has not given rise to serious financial issues so far, a more successful implementation of the public sector development program, when associated with the higher level of security expenditure, will necessitate a review of tax revenue prospects and strategy. Additional ways of tapping available saving in the economy through increased domestic borrowing are also being explored. I would like to record the Malaysian authorities' gratitude for the many occasions when technical assistance has been provided by the Fund, and particularly in the field of fiscal policy.

As in the past, I should mention that Malaysia has no restrictions on payments and transfers for current international transactions, and to emphasize the importance attached by the Malaysian authorities to continuing financial stability and unrestricted trade and payments.

Mr. Dale remarked that it was clear that in nearly all respects the past year or so had been a rather satisfying period for Malaysia. Moreover, the Malaysian authorities had dealt with their policy problems in

a skillful manner, and the problems that they had faced last year or were likely to face in the current year were not such as to cause undue concern from the viewpoint of the Fund's area of competence. He had noted the critical comments both in the staff report and in Mr. Merican's statement concerning the rubber stockpile policy of the General Services Administration of the U.S. Government. Executive Directors would observe that the sales of rubber had recently been discontinued, and he had reason to believe that that action was at least in part a response to the concern expressed by the Malaysian authorities through the Fund. Perhaps that topic could also appropriately be taken up on the occasion of the U.S. consultation discussions with the staff which would be held toward the end of 1970.

In conclusion, Mr. Dale concurred with the staff appraisal, in particular as it related to the fiscal implications of the faster pace of investment foreseen in the Second Plan.

Mr. Gilchrist said that Malaysia's economic policies had certainly been well conceived and that the economy was performing in a satisfactory manner, despite the rather marked fluctuations in rubber and tin prices. As was usually the case, those fluctuations had tended to be outside the authorities' control, and the Government was to be congratulated on the way in which it had tried to insulate the economy from their rather arbitrary effects.

Continuing, Mr. Gilchrist hoped that the future would be more certain, now that there were prospects of a buffer stock for tin and the U.S. authorities were cooperating to a greater extent in connection with the disposal of rubber stocks. The main problem currently facing the Malaysian authorities seemed to be that of stimulating further economic development. While private sector investments seemed to have revived satisfactorily following the May disturbances, public sector spending had been rather too static. It was particularly important that the program of agricultural and industrial development in the depressed areas should be actively pursued if the unemployment problem was to be contained. He noted that the staff considered that the rate of unemployment had risen considerably since 1968 when it had been 7 per cent, with three quarters concentrated in the 15-24 age group. He was therefore particularly glad to learn from Mr. Merican that the authorities intended to make a 10 per cent increase in public sector investment, and that preference was to be given to labor intensive industries and agriculture.

Because of the high average price of rubber and the low level of public sector capital spending, Mr. Gilchrist observed, neither the balance of payments nor the fiscal situation had posed any constraints. Indeed, the balance of payments had been decidedly favorable in 1969, and the relatively high level of reserves seemed likely to be maintained

On the fiscal side, Mr. Gilchrist saw no immediate constraint despite higher military expenditures. The staff had, however, stressed the need to raise public sector saving in the longer term. He understood the political problems that new taxes involved; but if development was to go ahead and price stability to be maintained, some means would clearly have to be found to stimulate saving. The level of credit expansion looked like being similar in 1970 to what it had been in 1969, although for different reasons. In 1969 the banking system had acquired substantial foreign assets and made few domestic loans, whereas the opposite was likely to be true in 1970. In the longer term, a more active involvement in lending to industry might well be beneficial. He was slightly less enthusiastic about selective credit controls.

Mr. Madan remarked that the continued high growth rate in 1969 had been marked by the financial and price stability that had lasted for over a decade, and he wished to congratulate the Malaysian authorities on that splendid result. Malaysia was, like Mexico, an outstanding example of a developing country that had successfully combined growth with stability. The credit for such a performance should certainly go in part to the unprecedented buoyancy of world market conditions, with sustained economic activity in a number of major economies, and high and rising levels of international trade. Nevertheless, there had been vagaries in the market for primary product exports, notably rubber, and he had been most interested by the information given by Mr. Dale regarding the responsiveness of his authorities in those circumstances.

The weak spots in the economy, Mr. Madan considered, lay in the lag in private investments, and the excessive dependence on a few traditional lines of production. Moreover, there was a need to adapt the institutional framework and to correct the scarcity of managerial ability and skilled manpower that was hampering growth in the manufacturing sector. The Second Plan rightly laid stress on production and exports, both directly through investment in the private sector and indirectly through investment in the public sector. With the rather severe unemployment situation in a multiracial society, policy was being appropriately oriented toward labor intensive industries and projects.

Notwithstanding Malaysia's good management in the face of its several problems, its situation illustrated both the need for primary producing countries to have equal access to the markets of developed countries, and the desirability of the stabilization of prices of primary products, Mr. Madan remarked. The example of Malaysia brought to the fore the role that the Fund could and should play in the area of primary commodities. He therefore looked forward with interest to the development of the Fund's policy in relation to the problem of buffer stock financing, and he hoped that that policy would be appropriately flexible and take due note of the characteristics of the market for each commodity, Mr. Madan continued.

Turning to fiscal matters, Mr. Madan said that although the fiscal situation had contributed significantly to the general outcome in terms of price stability and was not likely to represent any major problem in the foreseeable future, there was merit in the staff's suggestion that the authorities should start to evolve a new tax strategy forthwith, to make it less difficult to expand the tax base at a time when the need to mobilize resources might be more pressing. Monetary policy had hitherto been appropriately adjusted to bring about a revival of the private investment effort. There appeared to be some scope for a rather more active use of the interest rate instrument and for participation by commercial banks in long-term lending to industry without disregarding normal commercial banking functions. Malaysia's trade and payments system continued to be reasonably liberal.

In conclusion, Mr. Madan conveyed his best wishes to the Malaysian authorities for the further progress of the economy.

Mr. Satow commented that the Malaysian economy had enjoyed another year of high prosperity. In 1969 GNP had risen by 9.2 per cent, reflecting an increase in the value of exports by about 22 per cent in that year. A smaller increase was however anticipated for 1970, owing to the fall in rubber prices. Domestic prices had been remarkably stable during 1969 and total reserves stood at eight months of total imports. The performance of the economy was particularly impressive when the adverse effect of the May disturbances on investment and production in certain parts of the country was taken into account.

While the Malaysian authorities were to be congratulated for their general management of the economy, Mr. Satow remarked that Malaysia's prosperity was very dependent on the demand for its basic export commodities, especially rubber and tin. Any unexpected price fluctuation would have a serious effect on the balance of payments. As the staff had recognized, Malaysian policies and practices had been skillfully designed to deal with that difficult problem. He himself had been particularly interested in the rubber planting program that had been launched in the mid-1950's and had since considerably reduced the unit cost of production. Promotional measures had increased the production of rice to such an extent that West Malaysia was now nearly self-sufficient in that commodity. Furthermore, Malaysia was presently the world's largest producer and exporter of palm oil. Various steps had also been taken to boost exports of nontraditional goods. He hoped that progress could be made toward avoiding undue price fluctuations in such commodities as rubber and tin through cooperative efforts among the interested countries.

Fiscal and monetary policy, Mr. Satow considered, had continued to be sound, as was shown by the price stability that had lasted for more than a decade. Even the 1970 budget, which was likely to contain the largest deficit in Malaysia's fiscal history, did not appear to raise any serious

issues if only because expenditure was lagging behind estimates. Nevertheless, with the liklihood of a substantial increase in development expenditures and the need to tackle the chronic unemployment problem, the authorities were likely to face fiscal problems in the near future, especially in 1971 when the Second Plan began. He agreed with the staff that a new tax strategy should be initiated at an early stage; in that context it was satisfactory to note that the authorities were studying the recent recommendations of the Fund's fiscal mission and that they were prepared to take action if necessary. In conclusion, he agreed with the staff appraisal and wished the authorities continued success.

Miss Fuenfgelt considered that the most impressive features of the actions by the Malaysian authorities were the realism and caution with which they put up their programs and forecasts. Indeed, forecasts were often on the cautious side; the Government, for instance, appeared to have been overcautious in taking advantage of the favorable revenue situation stemming from the high export price of rubber. With hindsight, it might be said that development projects could have been executed considerably faster in 1969 without producing any overexpansion or impairing financial stability. The degree of price stability had indeed been extraordinary by any standard. The price decline in 1969 indicated that there was in fact leeway for further expansion. Nevertheless, the growth of GNP at 9 per cent had been greater in 1969 than at almost any other period of the past decade. For 1970 there were expectations of further growth, and it was good to learn that the Government intended to step up its development efforts, that the problems of project implementation were being overcome, and that the authorities were confident that the 1970 target for development expenditure would be met. The target for bank financing of government expenditure seemed likely to be realistic and there was no cause for major concern about financial stability even if some deficit financing became necessary. Development efforts were needed particularly in connection with the diversification of the economy, with special attention to export products, and to finding a solution of the problem of high structural unemployment.

Malaysia was heavily dependent on conditions abroad, Miss Fuenfgelt continued, and a more balanced spectrum of export products would contribute to achieving overall growth in the domestic economy. She had read with satisfaction that West Malaysia was progressing toward self-sufficiency in rice. The unemployment problem had become more pressing in the last year and the Second Plan rightly put great emphasis on providing employment, especially for young people. It was a strange phenomenon that the unemployment rates were higher among persons with secondary education than they were among persons with no education at all or with university education. She would appreciate some comment on that unusual situation.

Continuing, Miss Fuenfgelt referred to page 25 of SM/70/170 and remarked that it was encouraging that the authorities intended to remove

the bottlenecks which still existed in the utilization of foreign loans. In particular, she congratulated the Malaysian authorities for their intention to relax the conditions relating to foreign equity participation in the establishment of industries. In connection with the International Tin Agreement and the financing of some of the contributions through the new facility created in the Fund, she was looking forward to the paper announced by the staff.

Mr. Johnstone joined other Directors in expressing satisfaction at the many encouraging features of Malaysia's economic policies and development. He had been particularly interested in reading the discussion of Malaysia's commodity problems, especially those related to rubber. It was entirely appropriate that the matter had been frankly entered into during the discussions between the Malaysian authorities and the Fund mission. He was most gratified that the U.S. rubber stock disposal policy had undergone a helpful change and he welcomed Mr. Dale's suggestion that the topic could be taken up during the next consultation with the United States. Mr. Merican himself had been a particularly vigorous proponent of an effective evolution of the Fund in that direction, and he must have been very satisfied by recent events.

Mr. Omwony remarked that he had found the staff report for the consultation with Malaysia fascinating, if only because it revealed a level of domestic savings hardly seen elsewhere, let alone in the developing countries. Another unusual feature of the report was the fact that the authorities were concerned, not about prices rising but about the failure of prices to rise at all. Nor was it usual to read that there had been no wage disputes during the past year.

Even more significant, Mr. Omwony considered, was the success with which the authorities had skillfully mobilized domestic savings and raised domestic capital for development. As could be seen from Table 10 of SM/70/170, the authorities had been able to finance a substantial proportion of the budget deficit by borrowing in the domestic market. Monetary developments had been even more successful. In particular, he had been impressed by the statutory cash reserve requirement which made it obligatory on the part of the commercial banks to hold at least 50 per cent of their savings deposits first in housing loans to individuals and mortgage institutions, and second in federal and state securities, while maintaining a liquidity ratio of 20 per cent against total deposit liabilities. Not many developing countries used their monetary instruments as effectively as Malaysia.

Turning to the question of buffer stock financing, Mr. Omwony said that he shared the authorities' disappointment and that, like other Directors, he was looking forward to the discussion that the Board would be having on that issue. Meanwhile, he had not found the staff reaction to the authorities' concern quite satisfactory, especially if the promised

paper was that recently circulated on the role of Fund missions in the discussion of commodity policies. He reminded the Executive Directors that 70 per cent of the Fund's membership consisted of primary producing countries which had turned to the Fund because they were convinced that the institution had the capacity to assist them in that field. It would therefore be unfortunate if the Fund came down in favor of members making less use of a facility upon which agreement had been reached than they might otherwise do. Naturally, he agreed with his colleagues that the whole matter could well be discussed at a later date. In conclusion, he extended his best wishes to the Malaysian authorities.

Mr. de Vries observed that the economy of Malaysia had been characterized by rapid economic growth over the past few years, although, as in Mexico, the impact on the growth of per capita income had been lessened by a 3 per cent per annum increase in population. Malaysia was also characterized by a really remarkable degree of price stability: at the beginning of 1970 prices had been no more than 8 per cent above those of 1959. The most important problem facing the Malaysian authorities, as those authorities were very well aware, was unemployment, especially as so large a proportion was concentrated in the 15-24 year age group. He was happy to hear from Mr. Merican that the Second Plan would give special attention to that problem.

In the field of government finance, Mr. de Vries commented, the situation was favorable in the sense that the need for a relatively sharp increase in security expenditure had not disturbed the balance of the country's finances. On the other hand, that very balance seemed to owe its existence largely to the failure of development expenditure to keep pace with the forecasts. Hence, if development expenditure was to return to the desired rate, some tax measures might be necessary. In that connection, the suggestion by the staff that the tax structure should be modernized and new taxes introduced on an experimental basis at very low rates could well receive the attention of the authorities. The staff had made another suggestion regarding the need for additional efforts to persuade the commercial banks to play a more active role in term lending to industry; on page 8 of SM/70/169 the staff had said that the authorities welcomed those suggestions for study. He wondered whether there were any plans to help the authorities in that particular field by making more concrete suggestions than those contained in the rather short reference he had mentioned.

Continuing, Mr. de Vries welcomed the frank discussion which the Malaysian authorities had had on the subject of the rubber market with the staff mission, together with Mr. Dale's comments and other indications that seemed to indicate that the various authorities had become aware of the problem, whose seriousness would be somewhat diminished accordingly. He had also been gratified to read that the agreement with the U.K. authorities on the exchange rate guarantee on Malaysia's sterling balances was working satisfactorily.

The staff representative from the Exchange and Trade Relations Department commented on three topics raised by Executive Directors. First, the Malaysian authorities in discussing the question of unemployment, made the point that as Malaysia was mainly a primary producing country, when activity increased, it was the primary sector that created employment. On the other hand, when people had received some education, they were not attracted to moving into the more rural parts of the country, which included the rubber plantations. Admittedly, that was only a partial answer, as technological changes were taking place even there. Second, in reply to Mr. Omwony's remarks about the mission's reaction to the authorities' concern regarding the buffer stock scheme for tin, the staff was not referring to SM/70/186 (8/24/70), which was a general treatment of commodity problems, but a paper that was to be issued shortly analyzing the new Tin Agreement and setting forth certain staff views as to the conformity of that Agreement with the desiderata for Fund financing. Third, in reply to Mr. de Vries' question about further action by the Fund in support of the Malaysian authorities, he could only say that so far there had been no request. The discussion had been rather more extensive than was reported in SM/70/169 and, if further assistance were requested, he believed that the staff would be happy to respond.

Mr. Merican expressed his appreciation for the Fund's increasing attention to commodity problems. He was most grateful for that evolution of policy, partly because of Malaysia's continuing dependence on commodities, particularly rubber and tin. He also wished to express his appreciation to the U.S. authorities for the way in which they had responded to the changing market situation for rubber. With reference to the proposed tin buffer stock, he hoped that the major consuming countries that were not members of the International Tin Agreement would participate. More generally, he hoped that cooperative international action could be taken to prevent sharp fluctuations in the prices of rubber and tin.

Turning to the more narrowly Malaysian domestic situation, Mr. Merican said that he had noted the comments by several Executive Directors on the need to raise public sector savings. Measures to increase revenue had been examined by the Malaysian authorities for several years. The need for those measures had arisen from the fact that the earlier tax system had been geared to the activities of an export economy, so that revenues depended very largely on export levies and import duties. With the decline in importance of export levies not only in percentage terms but in absolute terms and the slow growth in import duties, the need continually to increase tax rates had become a major difficult. In that respect, he called attention to page 26 of SM/70/170, where the staff had explained that the increase in the Federal Government's domestic current revenue during the 7-year period under review had amounted to an annual average of 10 per cent, considerably in excess of the annual average rate of GNP growth (7 per cent) and slightly in excess of the average annual rate of increase of current government expenditures (9 per cent) in the same period. In

1969, moreover, the domestic revenue had been 18.4 per cent of GNP. Nevertheless, it was true that the authorities would have to look into the prospects for increasing tax revenues, and they were certainly paying careful attention to the report prepared by the Fund's Fiscal Affairs Department.

As several Directors had pointed out, Mr. Merican continued, the central problem for Malaysia was its increasing unemployment. Even though GNP was increasing satisfactorily, substantial concern over unemployment had been generated inside Malaysia, and the Second Plan would be paying more and more attention to that topic than had been paid in the past.

Commenting on the decline in prices for 1969, Mr. Merican explained that that decline might be attributed to the fall in the price of rice, while other commodities had remained fairly stable. Nevertheless, it was still reasonable to argue that the price stability in Malaysia was an indication that there was room for more vigorous domestic expansion. In conclusion, he thanked the Executive Directors for their instructive comments, which he would convey to the Malaysian authorities.

The Executive Directors concluded their discussion of the report for the 1970 Article VIII consultation with Malaysia.

4. 1970 REGULAR ELECTION OF EXECUTIVE DIRECTORS - PROPOSED RESOLUTION

The Chairman said that it was not necessary to extend the date for voting or to make other arrangements with respect to the rules for the 1970 regular election of Executive Directors.

In reply to Mr. Suzuki, the Chairman explained that the result of the vote by the Governors on the resolution on the rules for the 1970 regular election would be distributed early on Friday, September 11.

Mr. Plescoff inquired whether, if the Governors wished to change their minds, they could do so in Copenhagen.

The General Counsel explained that once the voting closed and the decision was recorded, the resolution had been adopted by the Governors. However, as with any decision of the Fund, whether it be taken by the Board of Governors or the Executive Directors, a new decision could be taken for whatever reason seemed appropriate in substitution for the former decision by the same majority and by exactly the same procedure. Such action could certainly be taken in Copenhagen; any Governor could bring forward a motion to that effect.

In reply to Mr. de Vries, the General Counsel confirmed that the decision taken as a result of the present vote by mail would stand, unless it was overruled by a new decision taken by an 80 per cent majority.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Directors without meeting in the period between EBM/70/85 (9/4/70) and EBM/70/86 (9/9/70).

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/70/171 (9/3/70), EBAP/70/174 (9/4/70), EBAP/70/175 (9/4/70), and EBAP/70/176 (9/4/70) is approved.

APPROVED BY THE EXECUTIVE BOARD:
Meeting 70/101, November 23, 1970

PIERRE-PAUL SCHWEITZER
Chairman

W. LAWRENCE HEBBARD
Secretary