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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 69/15

10.00 a.m., March 14, 1969

F. A. Southard, Acting Chairman

Executive Directors	Alternate Executive Directors
E. Asp	
W. B. Dale	
L. Escobar	R. H. Arriazu
	M. Horgan
	E. da S. Gomes
	M. A. Merican
P. Lieftinck	T. de Vries
	S. S. Marathe
	G. Huntrods
	C. Bustelo
	M. A. Sandoval
	B. de Maulde
A. Z. Saad	A. Mansour
	L. Fuenfgelt
J. O. Stone	
	S. Hattori
	N. H. Hanh
	J. Roelandts
L. A. Williams	
A. W. Yaméogo	L. M. Rajaobelina

W. L. Hebbard, Secretary
T. W. H. Eckersley, Assistant

Also Present

Asian Department: C. C. Liang, C. J. P. Weets. European Department: L. A. Whittome, Director; R. Evensen. Exchange and Trade Relations Department: H. A. Mehran, S. Mookerjee, B. Nowzad. Legal Department: A. S. Gerstein, Deputy General Counsel; N. S. N. Chari, P. R. Lachman. Middle Eastern Department: J. W. Gunter, Acting Director; A. K. El Selehdar, A. S. Gerakis, M. M. Hassanein, D. F. McCormack. Treasurer's Department: C. B. Fink, D. L. Lechliter, A. Watkins. Bureau of Statistics: J. C. Sánchiz. Technical Assistants to Executive Directors: G. Castañeda, J. M. Chona, I. A. Craik, P. M. de Raet, D. Frommel, R. Patti, H. G. Schneider, J. Skutle, J. A. Sogo, W. Stoop.

1. APPROVAL OF MINUTES

The draft minutes of Meeting 69/11 were approved.

2. YUGOSLAVIA - POSTPONEMENT OF REPURCHASE COMMITMENT

The Executive Board considered a request from Yugoslavia for postponement of a repurchase commitment, together with the staff's analysis and recommendation (EBS/69/41,2/28/69).

Mr. Lieftinck said that in 1968 Yugoslav agricultural exports, both to the Common Market and to the United Kingdom, had suffered as the result of trade restrictions and foot and mouth disease in Yugoslavia. The expectations for 1969 were better. Noting the statement on page 2 of the staff paper that net capital inflows had decreased largely as the result of an increase of $78 million in long- and medium-term loan repayments, he said that this increase was over and above the level of loan repayments for the previous year. Foreign debt repayments had amounted to $200 million in 1967, and to $278 million in 1968. For 1969 and 1970 it was estimated that the repayments would again amount to about $200 million. Thus 1968 had been a peak year for repayments; that had affected the reserve position of Yugoslavia. He warmly supported Yugoslavia's request and said that it was not unusual for the Board to be ready to extend up to five years' credit to a country which had originally agreed to a three-year repayment period. The schedule of repayments that had been discussed with the Yugoslav authorities would result in complete repayment of this particular drawing within the five-year period.

Mr. Horgan observed that Yugoslavia's total repurchase commitments would amount to $31.5 million in 1969, $80.25 million in 1970, and $5.25 million in 1971. In addition, amortization and interest payments on medium- and long-term external debts of $1,662 million would amount to $205 million in 1969 and $198 million in 1970. At the same time external reserves were only $183 million. He therefore wondered whether the Yugoslav authorities would be able to meet their commitments and at the same time comply with the schedule of repurchases. Their difficulties were largely due to circumstances outside their control and he remarked that Yugoslavia's agricultural exports met the same obstacles as Ireland's in relation to exports to the EEC. The EEC guide price for cattle was 50 per cent higher than producers' prices in Ireland, but the levies and tariffs imposed by the EEC countries more than offset this advantage. He was doubtful about the realism of the assumption on page 3 that meat exports to the EEC would make some progress in 1969.

The staff representative said that the Yugoslav authorities hoped, as a result of discussions with the EEC authorities, to increase their meat exports to the Common Market. In addition, exports to the United

Kingdom had been resumed. Since foot and mouth disease, which had contributed to the decline in exports in 1968, had been eradicated, they had grounds for hoping that meat exports would increase in 1969.

The Board considered the text of the proposed decision, which was approved.

The decision was:

Yugoslavia has requested that the repurchase commitment in connection with the purchase equivalent to $30 million on March 24, 1966 under the stand-by arrangement effective July 26, 1965 (Executive Board Decision No. 1910-(65/45), adopted July 23, 1965, as modified by Executive Board Decisions No. 2026-(66/15) and No. 2027-(66/15), adopted March 7, 1966) be discharged in eight quarterly installments equivalent to $3.75 million each beginning not later than June 23, 1969. The Fund agrees to the request (EBS/69/41, 2/28/69).

Decision No. 2698-(69/15), adopted
March 14, 1969

3. IRAN - 1968 ARTICLE XIV CONSULTATION

The Executive Board considered the staff report and proposed decision on the 1968 Article XIV consultation with Iran (SM/69/13, 1/31/69).

The Acting Director of the Middle Eastern Department provided the Board with some more recent information than that contained in the staff paper. Banking data for the last quarter of 1968 showed that expansionary forces continued to be strong, as had been expected. However, in contrast to the earlier period of the year, net foreign assets had increased. This reflected the higher level of oil exports, and a bond issue equivalent to $20 million which had been floated in the Federal Republic of Germany. Exports other than oil had risen substantially and more than what was seasonally normal. Only scattered information was available for early 1969. Exchange reserves had declined by about $14 million in the first two months of the year. Preliminary information on the budget for 1969/70 showed that it provided for some reduction in bank financing of the public sector, but it was not clear how much. There was evidence that the credit measures of recent months were beginning to slow down the growth of credit to the private sector.

Mr. Saad made the following statement:

The Iranian economy has experienced a remarkably high rate of growth in recent years. The expansion reflected mainly rising investment levels in both the public and private sectors, favorable agricultural crops and increasing receipts from the oil sector. In the past three years the growth took place under conditions of price stability and without undue pressures on external reserves. The continued rapid expansion in the current Iranian year (ending March 1969) led to pressure on the foreign exchange position, while prices have remained fairly stable so far.

The Iranian authorities are well aware of the need to reduce the pressures on resources by appropriate monetary and fiscal measures. They have already taken steps, described in the staff report, to restrict the rapid expansion of credit to the private sector from the commercial banks. These measures are expected to result in a significant reduction in commercial bank credit, without impairing the confidence of the private sector. The authorities intend to keep the monetary situation under continuous review and, if necessary, take additional measures to achieve an adequate cutback in the credit activities of the commercial banks.

The Iranian authorities are also taking measures to strengthen government finances, primarily through a curtailment in the rate of growth in current expenditures. Government revenue is increasing at a satisfactory rate mainly as a result of improved revenue collections and effective implementation of the new income tax law. The objective of fiscal policy in the coming Iranian year, beginning March 21, will be to reduce the public sector's reliance on the banking system to a level which, taking into account the expected credit expansion to the private sector, would be consistent with external balance. In implementing this policy, increasing priority will be given to development expenditures in order to achieve a high and sustainable rate of growth in line with the targets of the Fourth Development Plan. As indicated in the staff report, the authorities are prepared to make necessary adjustments in the Plan targets if excessive expansionary forces should be generated during the Plan period.

Iran's exchange and trade policies continue to be relatively liberal, and, as indicated in the staff report, the exchange system has been further liberalized in the last two years.

Mr. Lieftinck said that Iran had made great progress over the previous five years under conditions of remarkable stability. The authorities had reached a sophisticated level of economic planning which was reflected in the execution of the Third Five-Year Plan. Much of the success could of course be attributed to the large source of income from oil. One of the impressive features of the Third Five-Year Plan was the high output/capital ratio which had been achieved, in spite of the fact that much larger amounts than had been planned had been spent on infrastructure projects, probably carryovers from the Second Five-Year Plan. Even more in the private sector than in the public sector, the Iranians had invested in quickly maturing projects. In addition, a remarkably high rate of saving, both in the public and the private sectors, had been achieved; that was particularly noticeable if one considered the marginal rate of saving.

Mr. Lieftinck said that the outstanding agricultural development had been land reform. Although agriculture had not developed as rapidly as one might have hoped for, structural changes and the increased use of inputs would soon begin to have favorable results. Hitherto, land reform did not seem to have contributed much to higher production in agriculture. That could be attributed to temporary setbacks such as weather conditions. However, it now seemed that land reform had entered into a new stage in which better productivity results could be expected. He noted that, after the handing over of large tracts of agricultural land to the peasants, there was now a strong movement toward the institution of cooperatives and toward the consolidation of small farms into larger units. He asked whether this was a purely voluntary consolidation, or whether it was a reversion to the old system of land tenure. He thought that the consolidation might have unfortunate consequences unless it was under a system of joint ownership.

Mr. Lieftinck said that great progress had been made in industry and mining, mainly in the private sector. It was expected that under the new Plan the public sector would make a large contribution to industrial development, particularly in industries based on oil. The Fourth Five-Year Plan was well conceived, but the high targets were based not only on sound sectoral development programs, but also, unlike the Third Five-Year Plan, on high estimates for saving and other factors. Forecasts of saving as a percentage of GNP were higher than the level that had been achieved under the Third Five-Year Plan. If these savings targets were to be reached, it was of fundamental importance that the economy should not be subject to strong inflationary pressures. One of the explanations of the high rate of saving during the Third Plan was the price stability. Maintenance of that stability would be essential for the implementation of the Fourth Plan. Some inflationary pressures had already begun to appear during the first year of the new Plan; he was, however, confident that the authorities were fully aware of the need to suppress them, and he commended them on the measures already taken. In view of the target set for the Fourth Plan, he thought that they should attach even greater importance to controlling inflation than they might have done under other circumstances.

Mr. Lieftinck said that budgetary performance in 1968 had not been too satisfactory. However, the authorities had shown awareness of this, and had taken measures to improve the tax system and to restrain current expenditures. They had decided not to increase taxation, but to introduce a revised income tax law, and to improve the collection of existing taxes. Since the general level of taxation was relatively low, the authorities had a margin available to them in countering any excessively expansionist elements of public sector financing. He was grateful for the staff's presentation of a consolidated budget; understanding of the Iranian financial position had suffered in the past on account of separate budgets for the Plan organization and for the Government. He hoped that the Iranian authorities would see the merits of the combined presentation. The large increase in current expenditures could be attributed to the impressive rise in military and educational expenditures. Part of the current expenditures had been financed by foreign borrowing, mainly for the payment of military supplies. He wondered whether it was wise for a country with such large oil resources to borrow so much abroad. It was reasonable for the Iranians to make full use of their creditworthiness in order to obtain suppliers' credits for investment projects, but he doubted whether external borrowing for current expenditure should be commended.

Mr. Lieftinck agreed with the staff that credit expansion in 1968 might well be described as excessive, particularly in view of the carry-over from the preceding year. The total of money circulation had grown faster than the increase in the real national product. However, one factor made the increase of money less disquieting, namely, the fact that much of the increase had been represented by rising levels of quasi-money. That would not have affected the active money circulation, and inasmuch as the quasi-money represented genuine savings, would also reduce the danger of the Central Government relying too much on bank financing.

On the Iranian system of exchange management, Mr. Lieftinck made two observations. He was not clear why the authorities maintained a system of advance import deposits. Indeed, he saw disadvantage in this system because, as was stated on page 59 of Part II, there had been an alternation of stiffening and relaxing the requirements; in particular in 1968, when money expansion was already considerable, a relaxation of the import deposit requirements had added to liquidity. This was poor timing from the monetary point of view, and he asked whether there was any justification for it from any other point of view. Second, he noted that the monetary authorities had narrowed sharply the spread between the buying and selling rate for the rial, and that the loss of income which this had caused had been made up by means of a fee imposed on exchange buying. In fact, he thought that this fee might provide a greater revenue to the Government than the spread had done. He asked why the authorities had reduced the spread between the buying and selling rates. Finally, he noted that considerable restrictive elements still remained in the external trade system, and he hoped that the authorities would be able to reduce them.

Mr. Dale said that the pace of real income growth in Iran had been very high in recent years. In view of the record of price stability and good balance of payments situation, the growth rate was satisfying. Recently, however, domestic credit expansion had been high, prices had moved up somewhat, and balance of payments pressures had emerged. It appeared from page 10 of Part I that the conjunction of several factors of timing had led to the rapid increase in credit to both public and private borrowers in the second half of 1968. In the first half of the current Iranian year, credit to the public sector had been reduced slightly, but perhaps not much more than seasonally, while credit to the private sector had continued to grow quite rapidly. Subsequently, measures had been taken to raise interest rates and to limit the available reserve base of the banks. Even so, the Iranian authorities had indicated, as shown on page 11 of Part I, that the over-all level of domestic credit expansion for the current year could not be expected to be less than for the previous year. He assumed from what the staff representative had said at the beginning of the meeting that that expectation had been realized. The staff had given good advice in suggesting that both monetary and fiscal policies should be aimed at a moderate degree of disinflation, and he agreed with Mr. Lieftinck's remarks in connection with the implementation of the Fourth Five-Year Plan. That Plan was ambitious, both in terms of its targets and its assumptions as to available resources, particularly those available from oil revenues. However, the flexibility with which the authorities had indicated they would carry the Plan forward, and which they had clearly demonstrated in their implementation of successive Plans, was realistic and encouraging.

Mr. Huntrods said that the increase in real GNP over the four-year period ending March 1969 had been about 10 per cent per year; this achievement must give the Iranian authorities great cause for satisfaction. Equally important had been the success in smoothing out the waves of expansion and retrenchment which had characterized the Second Plan and the early part of the Third Plan. The key to the success was outlined on page 5 of Part II where it was noted that total domestic consumption at constant prices had grown at a less rapid rate than the GNP over the previous five years. He agreed with Mr. Lieftinck's reference to the output/capital ratio, and said that there were indications of a high degree of efficiency in investment. Price stability had also been a very noticeable feature of the period under review; few countries could claim to have kept the annual rate of increase in the cost of living index below 1 per cent over the past three years, and the slight increase in the cost of living index for the current Iranian year gave no immediate cause for alarm. The good wheat crop expected should be a factor in the envisaged reduction of food prices. The good record of price performance, the acceleration of oil production, and the discovery of new mineral deposits had contributed to the growing feeling of confidence and optimism which was reflected in the assessments which had been made of the growth potential of the Iranian economy, in particular the target of the Fourth Development Plan for an annual growth rate of 9.4 per cent in real terms. That was an ambitious target, even on the record of the previous five years. It was a matter of judgment as to whether the target should be pitched on the optimistic side or should lean toward caution. However, he believed that the staff was right to point out that the emphasis should be on a sustainable rate of growth, and sharp changes or cut-backs in development expenditures could be wasteful. The provision for annual review of the Plan should enable any required adjustment to be carried out smoothly. Apart from a further substantial increase in the already high ratio of domestic saving to GNP, the new Plan postulated heavy reliance on foreign capital in the form of a net inflow of $1.5 billion, which was four times the inflow during the Third Plan. Given the continuation of the favorable climate for foreign investment in Iran, foreign borrowing of this order was probably feasible, but the very size of the amounts involved could lead to difficulties. Moreover, a substantial increase in the ratio of payments for foreign debt servicing to foreign exchange receipts was projected; while the ratio had been 7 per cent in 1967/68, it was expected to be 17 per cent in 1972/73. This projection assumed that the receipts from the oil sector and other exports would come up to expectations.

Mr. Huntrods said that he had found in the staff report somewhat scanty information on the employment situation in Iran. He understood that statistics in this area were inadequate. Nevertheless, the data that were available gave rise to concern. If the annual average rate of population increase of 2.8 per cent between 1963/64 and 1967/68 was any guide to the population growth in earlier years, the employment opportunities which were expected to be created during the Fourth Plan might not even match the natural increase in the labor force. He asked the staff to say whether the pattern and character of private investment, with its heavy emphasis on capital-intensive processing industries, would in practice provide more than 1 million jobs. While the staff report stated on page 5 of Part I that there was practically full employment for skilled personnel, it gave little information about the over-all employment situation. If the adult literacy rate, which had been 13 per cent in 1956, could be taken as any guide to the proportion of the total labor force which could be classified as skilled personnel, there was some danger of a significant increase in the level of unemployment among unskilled adults. This would bring social problems, and at the same time the utilization of the investments would be impaired by shortages of trained managerial and technical personnel. Against this background, he noted that the allocations under the Fourth Plan of government development expenditure to health and education, although higher in absolute amount than the allocations under the Third Plan, represented only 10 per cent of total expenditures, compared to 15 per cent in the past.

In recording his support of the proposed decision, Mr. Huntrods particularly endorsed the comments in paragraph 4 warning of the possible results of according substantial protection to domestic industry. While some degree of protection might be necessary at present, continued isolation from outside competition might account in part for the relative stagnation and disappointing performance of some sectors of the economy, notably cotton textiles.

Miss Fuenfgelt congratulated the Iranian authorities on the performance of the economy and on the progress that they had made in the development of the country. The actual growth rate of 1967/68 had exceeded the forecasts by far. The growth had been achieved in a climate of almost perfect price stability, due to a large extent to a sharp rise in imports. The actual increase in imports had been 28.7 per cent, although the figure of 17 per cent, which had been expected, had seemed exaggerated at the time of the Board's previous discussion of the Iranian economy. Obvious risks to the reserves were attached to this sharp increase in imports. Although the full impact had not been felt during 1967/68, on account of a compensating inflow of official capital, there had been a reduction in reserves in the first part of 1968/69. However, she understood that this reduction was not as large as had been assumed at first. The authorities' policies to restrict credit expansion and to curtail the growth of government expenditures, in order to keep demand within limits, were appropriate, and had had some success already. The slowing down of the demand for money and of economic activity could in part be attributed to the increase in the discount rate from 5 to 7 per cent in November 1968.

Miss Fuenfgelt asked for more information on the administrative measures which were designed to limit access to central bank credit. The main field in which caution could be exercised was the budgetary sector; even if the actual revenue came up to the projected figures for 1968/69, the financing gap would be much higher than in preceding years. External borrowing needs were at a high level, and borrowing from the banking system and from the public would have to be heavy. She wondered whether the figure for external borrowing of Rls 24 billion was not excessive and ambitious, especially since there was some question whether financing from internal sources could be provided as projected. Shifting back to the contractors some of the financing of government development projects, as the authorities had indicated they might do if necessary, would simply mean deferring payments to following years, which might not be desirable. It would seem more appropriate to defer some of the projected expenditures to the following year or later.

Miss Fuenfgelt touched on the system of buying and selling rates for the rial, and said that the question of the distribution of profits from the spread in the rates seemed quite complicated. She understood from page 14 of Part I that the official selling rate for dollars against rials had been reduced several times, but that an import registration fee had been imposed, and that the proceeds of this fee had become a source of revenue for the Government. Apart from the legal question whether that amounted to a multiple currency practice, she wondered whether it was appropriate to use exchange rate differentials for fiscal purposes, or to adjust the rate in order to increase government revenues. She supported the proposed decision.

Mr. Marathe said that in many respects Iran stood apart from other developing countries. For example, per capita income was nearly $300 a year and in recent years real income had grown at the rate of about $8\frac{1}{2}$ per cent per year. This remarkable growth, and the accompanying rising levels of investment, had been secured under conditions of price stability and without undue pressure on external reserves. However, in the year ending March 1969 the balance of payments had come under some pressure. Iran had been pursuing a generally liberal payments policy, although in common with other developing countries it was judged necessary to protect domestic industry by import restrictions and import taxes. Oil, and industries based on the processing of oil, played an important part in the growth of the economy. The petroleum industry accounted for one sixth of the GNP and receipts from the oil sector accounted for about three quarters of foreign exchange earnings on current account. The petroleum industry also provided about half of the total government revenues. The production of crude oil had increased very rapidly in recent years. Indeed, the rate of growth had been faster than the rate of growth of world output, with the result that Iran's share of world output had gone up from about 5 per cent to nearly $7\frac{1}{2}$ per cent in 1967. No doubt 1967 was an exceptional year, in which production in other parts of the world had been affected by special factors, including the political conflict in the Middle East. It appeared from the staff report that foreign exchange receipts from the oil sector had increased more or less in line with the increase in the production of oil throughout the year. Although the share of oil products in total oil exports had declined sharply, the growth in earnings from the petroleum sector would depend on an increase in exports of refined products, and on the establishment of petro-chemical plants. It was in this context that the developments in the field of natural gas pipelines, and the proposals for three large petro-chemical plants, assumed significance. The recent discoveries of copper deposits was also a factor which might be of considerable importance in the future.

Mr. Marathe said that the hopeful features of the Iranian situation were not confined to the petroleum sector. Agricultural developments were also important. It would be interesting to see whether and to what extent recent increases in wheat production could be attributed to such factors as land reform and improved agricultural techniques, as well as to the climatic factors which were noted in the staff report.

Mr. Marathe said that the high and sustained rate of growth had not until recently exerted any marked pressure either on prices or on the balance of payments. During the latter part of 1967/68, however, there were some indications of an increase in liquidity, and in the year 1968/69, there had been some pressure on the foreign exchange position. The Iranian authorities recognized the need to take appropriate monetary and fiscal measures, and the staff report mentioned some of the steps which had already been taken. The authorities had also given an indication that they would consider any necessary adjustments in the targets of the Fourth Plan, if evidence emerged of excessive expansionary forces.

Mr. Marathe noted that most imports were subject to rates of import tax ranging between 30 and 80 per cent. He also noted that the incidence of import taxes amounted to 20 per cent of the value of imports in 1967/68. He assumed this was because a substantial proportion of total imports was either not subject to duty or subject to duty at rates which were lower than 30 per cent. He asked the staff which imports were subject to taxes in the 30 to 80 per cent range, and which imports were taxed lightly or not at all. He noted that the proposed decision contained a reference to the protection of domestic industry, and a suggestion that "a reassessment of the protective policy is necessary to ensure that resources are not diverted into uneconomic channels." This recommendation was more positively worded than that which appeared in the Executive Board's decision of February 1967. While there could be no two opinions about the need to ensure the most economic use of limited resources, and to exercise care in the choice of industrial investment, the present report contained no specific evidence of serious misallocation of resources.

Mr. Marathe asked the staff to explain why the suggestion was made that reassessment of protective policy was necessary. The staff paper showed that the Iranian economy had a high income elasticity of demand for imports, and that there would be close correlation between investment and imports. In spite of the fact that in recent years imports of wheat and sugar had declined, total imports had increased by nearly 80 per cent between 1964/65 and 1967/68. Imports of machinery had more than doubled during that period, and imports of base metals had increased nearly $2\frac{1}{2}$ times. One would therefore expect that a rapidly developing economy such as that of Iran would need to diversify its industrial structure with emphasis on import substitution. While such substitution should be based on comparative long-term advantage, it might still be necessary to use a certain measure of protection for domestic industry in the initial stages.

The Acting Director of the Middle Eastern Department first answered the question as to how the development of large agricultural units fitted into the general policy of limiting the holdings of agricultural land. He explained that the consolidation of land holdings in the private sector was a deliberate policy; agricultural units set up on a corporate basis were given exemption from the ceiling on land ownership. The aim was to develop in certain circumstances and certain areas large agricultural units that would function efficiently as a sort of industrial enterprise. This consolidation in some cases involved foreign investment. An attempt was being made to follow the pattern of agricultural development that had occurred in some desert regions of California. The IBRD was involved in certain of these projects.

The Acting Director of the Middle Eastern Department said that the purpose of the reduction in the spread between the buying and selling rates for the rial was to put the banks into a more competitive position in relation to the parallel market; in this, the authorities had been generally successful. At the same time there had been some liberalization of transactions, so that the general scope of the parallel market, which was illegal, had been considerably reduced. The introduction of the import registration fee had benefited the Treasury; it yielded more revenue than the previous system. On the question of employment, he acknowledged that the information was somewhat limited. The staff had had some discussion of this with the authorities, but had not attempted to make any detailed study of the relationship between employment levels and development programs. Over recent years there had been a decline in the unemployment of unskilled workers, accompanied by a continual shortage of skilled workers, but the staff was not in a position to make a judgment as to the future on whether new facilities were being created fast enough to provide sufficient employment.

Referring to the administrative measures for limiting access to central bank credit, the Acting Director of the Middle Eastern Department said that the commercial banks did not have automatic access to the central bank; therefore when they needed additional credit, their situation was discussed with the authorities of that bank. Clarifying the information he had given on movements in exchange reserves since the writing of the staff report, he said that reserves had risen somewhat in the last quarter of 1968, which was the third quarter of the Iranian year. In the current quarter reserves had declined. He expected that for the six months as a whole there would be some net loss in reserves.

The Acting Director of the Middle Eastern Department said that he did not have readily available information on the imports which were subject to import duties in the 30 to 80 per cent range. He would supply that information later. He said that while improved agricultural production could be related largely to favorable weather conditions, technical factors had played a role and were expected to be a more important aspect of rising agricultural production in coming years. On the question of protection of Iranian industry, he said that the authorities recognized that some industries which had been established in the past were operating inefficiently behind a high protective wall. While a degree of protection was undoubtedly desirable in many cases, the staff felt that the authorities went too far in maintaining the protective measures.

The staff representative from the Exchange and Trade Relations Department said that the advance deposits for imports had originally been imposed in order to restrain the rise in imports. The rates for the deposits had been adjusted from time to time to affect the composition of imports. Together with tariffs and the commercial benefit taxes, the deposits had been used as a device to encourage what the authorities considered a desirable pattern of imports. In the second half of 1967/68, both the scope and the rates of the deposits had been reduced, partly to simplify the system, and partly to counteract the incidence of the import registration fee which had been introduced in October 1967 and increased in February 1968.

Mr. Saad thanked Executive Directors for their comments. Referring to Mr. Huntrods' remarks on employment, he said that the Iranian authorities were doing their best to keep under control the problem of unemployment among skilled labor by providing new jobs and industries. The same problem faced many countries. Noting that Miss Fuenfgelt had inquired whether the authorities' actions in relation to the spread between the buying and selling rates for the rial amounted to a multiple currency practice, he said that no formal and accepted interpretation of what was a multiple currency practice existed.

The Board considered the text of the proposed decision, which was approved.

The decision was:

1. This decision is taken by the Executive Directors in concluding the 1968 consultation with Iran pursuant to Article XIV, Section 4 of the Articles of Agreement.

2. The Iranian economy has grown at a rapid rate during the last five years. Investment by both public and private sectors has continued to rise and has been sustained in the main by rising oil revenues, a high rate of domestic savings, and substantial capital inflow from abroad. However, in the second half of 1967/68 the rate of credit expansion rose sharply and, as a consequence, pressures on the balance of payments increased and foreign exchange reserves declined in 1968/69.

3. The Fund notes that it is the policy of Iran to moderate the expansion of aggregate demand without disrupting the momentum of growth. The Bank Markazi has recently taken measures designed to increase interest rates and reduce the liquidity of the commercial banks. These measures need to be supported by efforts to reduce the public sector's dependence on the banking system and the Fund urges Iran to adopt in 1969/70 fiscal policies designed to achieve a sharp curtailment of this dependence.

4. Iran continues to pursue liberal payments policies, but accords substantial protection to domestic industry through import restrictions and import taxes. A reassessment of the protective policy is necessary to ensure that resources are not diverted into uneconomic channels.

Decision No. 2699-(69/15), adopted
March 14, 1969

4. LEBANON - 1968 ARTICLE XIV CONSULTATION

The Executive Board considered the staff's report and proposed decision on the 1968 Article XIV consultation with Lebanon (SM/69/15, 2/5/69, and Cor. 1, 3/5/69).

Providing the Board with more recent information, the Acting Director of the Middle Eastern Department said that in the concluding months of 1968 the trend toward recovery in the economy had continued. The public sector had been in surplus in the last quarter of the year, and credit to the private sector had changed little. During the last months of 1968, net foreign assets of the banking system had continued to rise, and the exchange rate for the dollar had been stable at the rate of LL 3.17 to LL 3.18 per US$1. However, following the attack on Beirut Airport on December 28, some adverse economic developments had occurred. Activity had slowed down in the early months of the year, and the balance of payments had deteriorated, probably mainly on capital account. The exchange rate for the dollar had recently been about LL 3.25. He understood that official reserves had not greatly changed in the early months of 1969.

Mr. Saad made the following statement:

> In 1968 the Lebanese economy showed a substantial recovery from the recession occasioned by the successive crises of the Intra Bank failure in October 1966 and the hostilities in the Middle East in June 1967. Most sectors, apart from construction, contributed to the expansion. The monetary and fiscal policies pursued by the Lebanese authorities have been generally appropriate in view of the need to reactivate the economy. A sizable public sector deficit and a major increase in the net foreign assets of the banking system were the principal factors accounting for monetary expansion. However, the commercial banks have continued to exercise caution in their credit activities.
>
> An important factor in economic recovery has been the strong foreign demand for both goods and services. In particular, industrial exports and tourism established new records in 1968. There was also renewed capital inflow reflecting, in part, restoration of confidence in the stability of Beirut as a financial center. Consequently, despite a sharp increase in imports, the balance of payments situation remained satisfactory. The level of official reserves increased over the year and there was some depreciation of the Lebanese pound in the free foreign exchange market. Notwithstanding the difficulties encountered over the past three years, Lebanon has maintained its traditional adherence to a liberal trade and payments system.

Recognizing the importance of re-establishing and maintaining confidence in the financial system, the Lebanese authorities have pressed forward their program of banking reform vigorously. The Banking Control Commission has come into operation and the remaining unsound banks have been taken over. These measures and the creation of a deposit insurance company are calculated to increase the stability of the banking system significantly and to enhance the attractiveness of Lebanon for foreign investment.

Lebanon's exchange rate policy aims mainly at ironing out sharp fluctuations. It is also felt that, in present circumstances, intervention in the market is justified in order to prevent an undue appreciation of the pound.

Mr. de Maulde said that the development of Lebanon provided a comforting example of sound economic management in a troubled area of the world. The over-all growth of GNP in the medium term had been satisfactory and, while price performance could have been better, it had been reasonable in comparison with that of neighboring countries. The level of reserves was satisfactory, and the balance of payments results were positive, largely due to the high level of invisible receipts which flowed in from the Lebanese community throughout the world. He congratulated the Lebanese authorities on these achievements, which were all the more remarkable since the inadequacy of statistics did not provide a sound basis for the formulation of financial and economic policies. He was particularly interested in the recent measures taken in the banking field. He concurred in the recommendation in the staff appraisal to the effect that while the steps taken after the Intra Bank affair appeared "to have been in the right direction and to have helped restore a climate of confidence, it now appears desirable to give attention to developing appropriate liquidity standards for commercial banks." He hoped that the authorities would pay attention to this sound advice. He asked for comments on the possibility of improving the performance of tourism in the future.

Mr. Dale said that the Lebanese economy and financial system had weathered the Intra Bank crisis and the hostilities in the Middle East reasonably well. The recovery in 1968, except for the construction industry, had been encouraging. The balance of payments had returned to a position of strength as confidence in Beirut was re-established. Fiscal and monetary policies had been applied appropriately in order to assist the stimulation of the recovery. He hoped that the authorities would overcome the difficulties which, as the staff representative had explained, had arisen in the first months of 1969. The banking reform program, which the authorities had pressed forward with vigor, had been well received and hitherto fairly successful. It involved action on many fronts, particularly squeezing out the marginal banks, of which there had been a large number. However, further advances would have to be made in the banking field, such as prescribing appropriate liquidity ratios and other standards for the banks, and in encouraging longer-term credit institutions. He had found interesting the discussion of the Lebanese fluctuating rate, both in the consultation paper and in the departmental memorandum (DM/69/20). However, he had found it hard sometimes to understand exactly what were the objectives of policies in this area. For example, the rate had appreciated toward the end of 1967, and had depreciated during 1968 in spite of a substantial increase in reserves. He wondered whether the authorities were guided by a fully consistent set of objectives covering reserves, the balance of payments, and domestic economic activity, or whether policies in only one of these areas predominated at any one time. He supported the proposed decision.

Mr. Horgan said that it was difficult to form a judgment about current economic developments in Lebanon, and about the balance of risks which the authorities faced. Uncertainty derived from the inadequacy of statistics and from the major upheavals which had affected the economy and the financial system in recent years. He hoped that it would be possible for the Fund to provide technical assistance to improve statistics. He observed that balance of payments figures were sketchy and out of date. Nevertheless, the information that was available indicated that the balance of payments had been in surplus in 1968 and that the external position had recovered quite substantially following the strains of 1967. Tourism had recovered somewhat, and official reserves had risen sharply. In 1969 the balance of payments was expected to be in surplus again, although to a lesser extent than in 1968. Although figures on recent trends in output and employment were also inadequate, one could assume that the recovery during 1968 had not reached the stage at which domestic resources were strained. The price situation pointed to the same conclusion. Wholesale prices had not changed appreciably over the past year, and encouragement of further expansion therefore seemed desirable. The budget for 1969 called for movement from a deficit of LL 71 million in 1968 to a balanced position in 1969. Revenues and current expenditures were both expected to increase moderately, but budgeted capital expenditures had been cut back to LL 110 million in 1969 compared to about LL 200 million in the two preceding years. The caution of the authorities in relation to deficit financing could presumably be explained in terms of the law which prohibited any net borrowing from the banking system. This seemed to be an exceptionally tight requirement, and it was encouraging to note that the auhtorities intended to submit legislation permitting the Government to borrow. There were some doubts about the strength of private credit demand in 1969, and about the commercial banks' willingness to grant private credits after the recent upheavals. At the same time, a further substantial increase in claims on the banks was to be expected. It seemed clear that there was some room for government debt in the banking system. The staff's judgment that a sizable public sector deficit could be safely accommodated therefore seemed sound. He hoped that the Lebanese authorities would be able to take the necessary action promptly and thus avoid serious cutbacks in capital expenditure.

Mr. Liftinck referred to the sentence on page 12 of Part I: "As regards reserve policy, the Lebanese representatives stated that, although the Bank of Lebanon had purchased considerable amounts of gold in recent months, they were aware of the disadvantages of maintaining too high a proportion of their reserves in gold." He asked the staff where the Bank of Lebanon had purchased the gold, and what were the disadvantages of maintaining too high a proportion of reserves in gold.

The Acting Director of the Middle Eastern Department referred first to the question of tourism. He said that there was considerable scope for further development of tourism in Lebanon. Special factors had deterred tourists in 1967, and had continued to affect the level of tourist activity in 1968; however, in that year there had been a considerable recovery in the inflow of tourists from other Arab countries. Answering Mr. Dale's comment on the objectives which lay behind the exchange policy, he said that it was important to bear in mind that the Central Bank was a comparatively new institution. It had gone through some difficulties in obtaining a Governor on a permanent basis, and had suffered other staffing problems. He believed that the Bank was moving in the direction of becoming a more effective institution in the field of both monetary and exchange policy. He could not give a full answer to Mr. Lieftinck's question about the sources of Lebanese purchases of gold, although he believed that most of the gold had been bought in the United States. The disadvantages in holding too high a proportion of reserves in gold which the authorities had in mind were, first, the loss of interest income and, second, the domestic problems associated with selling gold when foreign exchange was badly needed. The sale of gold in those circumstances often caused political difficulties.

Mr. Stone asked whether he would be correct in interpreting the staff representative's last remark as implying that the presence of a reasonably substantial proportion of gold in a country's reserves could, by the pressures it might place on the authorities, induce them to take adjustment measures earlier than might otherwise have been the case.

Mr. Dale believed that the total change in Lebanese gold holdings could be accounted for by purchases from the United States. He added that he had made the comment about the management of the free exchange rate in Lebanon in the light of the generally accepted view that if a country had a fluctuating rate it had less need for reserves. Although Lebanon might be a special case which would not contradict that view, he pointed out that Lebanon had one of the highest ratios of reserves to imports of any country in the world. Perhaps one could say that the importance of capital movements and invisible transactions in the case of Lebanon made that ratio inapplicable as a desirable standard for reserves. On the other hand, the Lebanese situation might give grounds for reconsidering the accepted view on flexible rates.

The Executive Board considered the text of the proposed decision, which was approved.

The decision was:

1. This decision is taken by the Executive Directors in concluding the 1968 consultation with Lebanon pursuant to Article XIV, Section 4, of the Articles of Agreement.

2. Since late 1966 the Lebanese economy has been adversely affected by a number of developments which led to economic recession and a weakening of the external sector. However, generally appropriate financial policies and the gradual restoration of confidence have combined to bring about an economic upswing in the second half of 1967 which has continued in 1968. The balance of payments was again in substantial surplus in 1968.

3. The short-term objective of fiscal and monetary policy is to promote a continuation of economic recovery. In these circumstances and in view of the strong balance of payments position, it appears approporiate for the Government to continue to rely moderately on the banking system in financing its operations. While continuing to press forward with the program to improve banking standards, it may also be appropriate for the Bank of Lebanon to foster an expansion in credit to the private sector. The Fund welcomes the progress made on the banking reform program and urges the Lebanese authorities to take steps designed to strengthen the position of the Bank of Lebanon to carry out monetary policy more effectively.

4. Current operations of the Bank of Lebanon in the foreign exchange market are aimed at ironing out fluctuations in the market and offsetting the tendency towards undue appreciation of the Lebanese pound. While the long-term objective of exchange policy should be rate stabilization at a realistic level which would provide a basis for agreement of a new par value with the Fund, the Fund agrees that the existing flexibility of policy is desirable in present circumstances. The Fund welcomes the assurances that Lebanon's trade and payments policies will continue to be largely free of restrictions and discrimination.

Decision No. 2700-(69/15), adopted
March 14, 1969

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Directors without meeting in the period between EBM/69/14 (3/7/69) and EBM/69/15 (3/14/69).

5. UNITED KINGDOM - NONMETROPOLITAN TERRITORIES - INITIAL PAR VALUE - QATAR AND DUBAI

1. The United Kingdom has communicated the following initial par value for the Qatar/Dubai riyal, the monetary unit of the Sheikdoms of Qatar and Dubai which are nonmetropolitan territories in respect of which it has accepted the Articles of Agreement of the Fund:

0.186 621	gram of fine gold per Qatar/Dubai riyal;
166.667	Qatar/Dubai riyals per troy ounce of fine gold;
4.761 90	Qatar/Dubai riyals per U.S. dollar;
21.000 0	U.S. cents per Qatar/Dubai riyal.

2. The Fund agrees to this initial par value (SM/69/30, 3/6/69).

Decision No. 2701-(69/15), adopted
March 11, 1969

6. UNITED KINGDOM - NONMETROPOLITAN TERRITORIES - PAR VALUE - TONGA

1. The United Kingdom has proposed the following par value for the Tongan pa'anga, the monetary unit of Tonga which is a nonmetropolitan territory in respect of which it has accepted the Articles of Agreement of the Fund:

0.995 310	gram of fine gold per pa'anga;
31.250 0	pa'anga per troy ounce of fine gold;
0.892 857	pa'anga per U.S. dollar;
112.000	U.S. cents per pa'anga.

2. The Fund concurs in this proposal (SM/69/30, 3/6/69).

Decision No. 2702-(69/15), adopted
March 11, 1969

7. UNITED KINGDOM - NONMETROPOLITAN TERRITORIES - ARTICLE VIII - RESTRICTIONS ON CURRENT PAYMENTS AND TRANSFERS

The Fund does not object to the application by Gibraltar through October 31, 1969 of the restrictions on payments and transfers for current international transactions mentioned in the memorandum dated February 24, 1969 to the Managing Director from the Executive Director appointed by the United Kingdom (SM/69/31, 3/6/69).

Decision No. 2703-(69/15), adopted
March 11, 1969

8. UNITED NATIONS COMMITTEE ON DEVELOPMENT PLANNING - FOURTH AND FIFTH SESSIONS - FUND REPRESENTATION

The Executive Board approves Fund representation at the fourth and fifth sessions of the United Nations Committee on Development Planning as set forth in EBD/69/35 (3/3/69).

Adopted March 7, 1969

9. GATT - BALANCE OF PAYMENTS CONSULTATIONS - FUND REPRESENTATION AND GUIDANCE

The Executive Board approves the recommendation of the Committee on Liaison with the CONTRACTING PARTIES to the GATT and Fund representation set forth in EBD/69/40 (3/4/69) regarding the forthcoming GATT consultations with Iceland and Korea.

Decision No. 2704-(69/15), adopted
March 10, 1969

10. STAFF MEMBER - LEAVE WITHOUT PAY

The Executive Board approves the proposal contained in EBAP/69/50 (3/11/69) to grant a staff member a further period of leave without pay on special assignment.

Adopted March 13, 1969

11. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/69/32, Sup. 1 (3/10/69) and EBAP/69/51 (3/12/69) is approved.

APPROVED BY THE EXECUTIVE BOARD:
Meeting 69/26, April 18, 1969

PIERRE-PAUL SCHWEITZER
Chairman

ROGER V. ANDERSON
Acting Secretary