February 11, 2003
Approval: 2/19/03

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 02/120

10:00 a.m., December 9, 2002

Contents

Executive Board Attendance

S. Sugisaki, Acting Chair

Executive Directors	Alternate Executive Directors
S.M. Al-Turki	A.A. Al-Nassar, Temporary
	L. Rutayisire
I.E. Bennett	
M.J. Callaghan	W.-D. Cho, Temporary
F. Zurbrügg	T. Skurzewski, Temporary
K. Bischofberger	
	F. Manno, Temporary
	A. Lanza, Temporary
S. Indrawati	
Y.V. Reddy	
	J. Prader
	J. Jonáš, Temporary
Ó. Ísleifsson	B. Andersen
	M. Lundsager
	P.A. Dohlman, Temporary
	S. Boitreaud
	A. Requin, Temporary
A. Mirakhor	
	A. Lushin
H. Oyarzábal	
	M.A. Brooke
	N. Joicey, Temporary
	A.A. Tombini, Temporary
	P. Ngumbullu
A.S. Shaalan	
Wei Benhua	Wang X.
	Y.G. Yakusha
K. Yagi	T. Miyoshi, Temporary
	C.E. Pereyra, Temporary

S.J. Anjaria, Secretary
A.S. Linde, Acting Secretary
H. Mooney, Assistant
O. Vongthieres, Assistant

Also Present
African Department: N. Kirmani. Asia and Pacific Department: W.S. Tseng, Deputy Director; T. Elson, D. Iakova, W. Lee, S. Lizondo, S. Nolan, E. Parrado, A. Senhadji. External Relations Department: G. Bhatt, C. Lotze. International Capital Markets Department: A. Bertuch-Samuels, B. Drees. Legal Department: P. De Boeck, H. Elizalde. Monetary and Exchange Affairs Department: S. Ishii, P. Kupiec, M. O'Brien, P. Schellekens, L. Teo. Policy Development and Review Department: T. Geithner, Director; S. Brown, S. Kashiwagi,A. MacArthur, M. Mlachila. Research Department: R. Benelli. Secretary's Department: L. Hubloue, P. Ramlogan. Statistics Department: T. Fontaine, C. Sisson. Treasurer's Department: E. Brau, Treasurer; B. Christensen, Deputy Treasurer; M.G. Kuhn, Deputy Treasurer; B.S. Newman, Deputy Treasurer; E. Carmetti, J. Gavino, L. Jaramillo, H. Hatanpaa, P. Ross, H. Trines. Western Hemisphere Department: A. Belaisch, A. M. Jul. Office of the Managing Director: V. Read, Personal Assistant; A. Tweedie. Advisors to Executive Directors: M.A. Ahmed, S.A. Bakhache, J.A. Costa, S.S. Farid, F. Haupt, K. Kanagasabapathy, D. Lewis-Bynoe, J. Mafararikwa, M.F. Melhem, L. Palei, H.E. Phang, S. Rouai. Assistants to Executive Directors: M. Abbing, A. Alber, V. Bhaskar, J.G. Borpujari, Cao L., N.J. Davidson, M. Di Maio, N. Epstein, C.J. Faircloth, C. Gust, C. Harzer, H.-H. Jang, C. Josz, T.-M. Kudiwu, J.K. Kwakye, A. Maciá, B.T. Mamba, M. Marques, P. Moreno, K.S. Oo, E. Pinto Moreira, T. Segara, A. Stuart, S. Vtyurina, D.B. Waluyo, N. Watanabe, N. Yeritsyan.

1. TWELFTH GENERAL REVIEW OF QUOTAS—DRAFT REPORT TO THE BOARD OF GOVERNORS AND PROPOSED RESOLUTION

Document: Twelfth General Review of Quotas—Draft Report of Executive Directors to the Board of Governors (SM/02/355, 11/18/02)

Staff: Brau, TRE; Trines, TRE

Length: 1 hour, 45 minutes

Mr. Padoan and Mr. Bossone submitted the following statement:

At the outset, we would like to take this opportunity to thank the staff for their efforts and the high-quality work done, throughout this quota review exercise, on the various sensitive and difficult related issues.

Since the second half of the 1990s, world economic events have induced the international financial community to engage itself in reconsidering the very architecture of the international financial system, with a view to making it stronger, more efficient, and better able to cope with the needs of a globalizing economic environment.

The role and the size of the Fund, the adequacy of the Fund's resources, the distribution of quotas among Fund membership, and the governance and representation within the Fund lay at the foundations of the international economic cooperation which is needed in an increasingly interdependent world economy, and of which the Fund is the epitome.

As noted by the staff, the discussion of the above issues has taken place at a time of uncertain economic circumstances, with uneven growth and progress in adjustment among economic regions and countries, high volatility of capital flows, and continued vulnerability of individual countries to financial crises. The surrounding uncertainty—which we see as an inherent feature of the global and unequal world we now live in—has made that discussion very complex, indeed; one in which the interests of individual countries may often conflict with one another and where the search for solutions does not point to unambiguous and straightforward answers.

Different views of the world coexist, each pointing to different solutions. And although much progress has been accomplished in advancing the discussion, and above all in clarifying many of its underlying core elements, Fund members are still several steps away from arriving at a consensus on major questions. One for all: they do not yet quite agree on whether or not the Fund is large enough for today's world economy. And this is clearly a key question in trying to determine the need for a quota increase.

One way of looking at this question is to assume that, in a world of large capital mobility, more Fund resources prompt higher moral hazard from both debtors and creditors. Clearly, if that were the case, the Fund should be redesigned in ways that would limit its role in crises, or that would constrain access to its resources by members. As a result, the optimal size of the Fund would automatically adjust downward.

Along the same lines, the introduction of new policies such as an effective mechanism for sovereign debt restructuring, more rigorous access limits, and greater private sector involvement in crisis prevention and resolution—once internalized by market participants—might reduce the future demand for Fund resources, thereby justifying a smaller Fund.

On the other hand, if financial globalization bears the fruit of its own fragility (the phenomenon Prof. Calvo refers to in Globalization Hazard), one may draw the conclusion, or at least raise the reasonable doubt, that the Fund is not funded enough to be able to meet its potential obligations.

This Chair has not come to a definitive view on these important aspects. Yet, if there is any clear indication to us, it is that over the last two decades the size of financial crises, as well as their probability and cross-probability of occurrence, have all increased, leading to growing Fund commitments. It is difficult to imagine that this is the result of some Fund-driven moral hazard phenomenon. It is perhaps more sensible to argue that something has changed in the world economy that has required a more intensive use of Fund resources. The fact that the Fund size-to-global GDP ratio has declined over the years from its historical level should, in our view, be considered against the judgment that in the new global world the desired ratio should be above that historical level.

In light of these considerations, we have consistently expressed in past occasions our intention not to preclude the idea of arriving at a consensus on the need to augment Fund resources—provided that individual quotas reflect primarily the members' contribution capacity.

For this reason and for the reasons indicated by the staff in paragraph 21 of the draft report, we can support the recommendation for an extension of the current review with a view to reaching a final decision on a quota increase during the Twelfth Review immediately after the 2003 Annual Meetings. To the extent that a number of current world economies' uncertainties could be resolved in the period ahead and that the Fund were to arrive at defining clear policies on access, private sector involvement, and sovereign debt restructuring, greater consensus could emerge on the quota decision.

Ms. Lundsager and Mr. Baukol submitted the following statement:

The Board has discussed in detail the issues surrounding the consideration of a quota increase as part of the 12th General Review. In our view, the current staff paper does not adequately reflect the results of the discussions, and it delves into issues not fully related to the 12th review. The Fund's resource base is more than comfortable, with about SDR 52 billion ($69 billion) in one-year forward commitment capacity from own resources. For reasons that will not be repeated, there is no need for a quota increase at this time. Board discussions have indicated that the Board is very far from the required 85 percent majority in favor of a quota increase.

The question now is whether the Board should recommend completion of the 12th review with no quota increase or extension of the review with no decision. We strongly favor completion of the 12th General Review:

- As noted, the Fund's resource base is comfortable. In our view, it is not even a close call as to whether a quota increase is needed at this time.

- If a serious shock hits the world economy that would require rapid action on quotas, the Executive Board can initiate the 13th General Review of Quotas immediately. Thus, leaving open the 12th General Review has no beneficial impact in practice.

In fact, leaving the review open would have negative implications. Failure to complete the review would give the misleading impression to the public and markets that:

- The Fund's resource base is inadequate to address possible demands on the Fund, and the Fund's Board may be close to agreement on a quota increase.

- The Fund is concerned about possible new crises in the world economy and judges that prospects for large new lending programs are significant.

The staff proposes a work plan to continue the discussion, but this would only waste the time of the Board and staff in rehashing the debates of the last year. The staff suggests that more time is needed to maintain momentum and resolve various issues in order to achieve the broad support necessary to propose a change in quotas. This argument is erroneous, as issues relevant to the 12th review have been discussed in detail.

In light of these considerations, we do not support the proposed recommendation in the staff report. Instead we support conclusion of the 12th Review and suggest that the Board approve the following alternative decision and report to be sent to the Board of Governors. (Staff technical corrections to the draft decision and report are welcome.)

Proposed Decision for Executive Board

In light of the above considerations, it is proposed that the Executive Board adopt a decision submitting to the Board of Governors:

1. a report on the status of the 12th review of quotas; and

2. a draft resolution whereby the Board of Governors would note the report of the Executive Board and resolve to complete the 12th review with no increase in quotas.

The following draft decision is proposed for adoption by the Executive Board:

1. The Executive Board approves the report annexed hereto, entitled *Twelfth General Review of Quotas—Report of the Executive Board to the Board of Governors*, for transmission to the Board of Governors.

2. The Board of Governors is requested to vote without meeting, pursuant to Section 13 of the By-Laws, on the draft Resolution attached to that report.

3. The Secretary is directed to send each member of the Fund by rapid mans of communication on or before December [ ], 2002, the Report *Twelfth General Review of Quotas—Report of the Executive Board to the Board of Governors* set forth in the Annex and the draft Resolution attached to that Report.

4. To be valid, votes must be cast by Governors or Alternate Governors by rapid means of communication on or after December [ ], 2002 and must be received at the seat of the Fund on or before January [ ], 2003. Votes received after that date will not be counted.

5. The effective date of the Resolution of the Board of Governors shall be January [ ] 2003, the last day allowed for voting.

6. All votes cast pursuant to this decision shall be held in the custody of the Secretary until counted, and all proceedings with respect thereto shall be confidential until the Executive Board determines the result of the vote.

7. The Secretary is authorized to take such further action as he shall deem appropriate in order to carry out the purposes of this decision.

**Twelfth General Review of Quotas—
Report of the Executive Board to the Board of Governors**

Article III, Section 2(a) of the Articles of Agreement provides that "the Board of Governors shall at intervals of not more than five years conduct a general review, and if it deems it appropriate propose an adjustment, of quotas of members." The five-year period for the Twelfth Review will end on January 30, 2003. The Executive Board has established a Committee of the Whole in accordance with Rule D-3. The Board has discussed in depth the issues regarding the adequacy of the Fund's resource base and the possible need for a quota increase. In response to the Interim Committee's request for the Executive Board to review quota formulas after the completion of the Eleventh General Review, progress has also been made on possible changes to quota formulas that would help achieve a quota distribution that better reflects the relative economic position of member countries, although other means, e.g., increases in basic votes, have also been raised to change the governance structure of the Fund. The discussions of the Executive Board indicate that there is not the necessary broad support among Executive Directors for a recommendation to increase quotas. The Fund's current liquidity position appears adequate, barring unforeseen developments that could result in large new demands for Fund resources.

In view of the foregoing considerations, the Executive Board proposes that the Board of Governors decide to complete the Twelfth Review of Quotas with no increase in quotas. It is recommended that the Board of Governors adopt the resolution set out in the attachment to this report.

Proposed Resolution of the Board of Governors

RESOLVED

That the Board of Governors, having noted the report of the Executive Board entitled *Twelfth General Review of Quotas—Report of the Executive Board to the Board of Governors*, hereby resolves to complete the Twelfth Review of Quotas with no increase in quotas.

Mr. Bennett submitted the following statement:

The Executive Board has examined the need for a quota increase under the 12th Review of Quotas at length over the past two years, and my views on the underlying issues of consideration have not changed. In particular, with a one-year forward commitment capacity of about SDR 52 billion, there is little question that the Fund's current resources are adequate to promote international financial stability in an effective and efficient manner.

While judgments regarding the optimal size of the Fund's resource base are likely to continue to clash, largely as a result of differing views on the appropriate financial role the Fund is to play in the period ahead, there are nevertheless certain practical considerations that are relevant to the specific question of whether or not the current review should be extended. In particular:

- One should not lose sight of the fact that, despite extensive discussions, the Board's support for a quota remains well below the required 85 percent majority. It is therefore not clear what "momentum" the staff hopes to preserve through an extension, and we share concerns that continued work may constitute an unnecessary burden for the staff and this Board;

- The staff recommends extending the review period until after the 2003 Annual Meetings to allow more time to clarify likely trends in the world economy, but quota increases should be based on longer-term considerations, not cyclical factors; and

- If developments warrant revisiting the adequacy of IMF resources, then the Thirteenth Review could and should be launched immediately.

In light of these considerations, I favor completing the 12th Review, and support the alternative decision and report to the Board of Governors appended to Ms. Lundsager's and Mr. Baukol's preliminary statement (subject of course to technical corrections by the staff). I would, however, like to reiterate this Chair's continued support for making quotas more reflective of developments in the global economy and exploring options to address serious instances of countries which are "out of line". This work, however, can continue outside of any quota review and could be taken up in the context of the forthcoming discussions on the quota formula.

Mr. Yagi and Mr. Miyoshi submitted the following statement:

We thank the staff for the paper, which reflects appropriately and summarises concisely the Executive Board's discussion on quotas so far.

This chair supports the extension of the current Twelfth General Review. Admittedly no consensus exists for a quota increase at this moment but, as the staff points out, such issues as the need for a quota increase and ways to improve the distribution of quotas have not yet been thoroughly discussed by the Executive Board. It is therefore premature to conclude the current review at this point.

This chair is of the view that a quota increase is urgently needed in order for the Fund to fulfil its important responsibility to ensure the stability of the international financial system. In light of the increased size and volatility of international capital flows, the resulting greater need for large arrangements to help members resolve financial crises, and the greater risk that the Fund could find itself short of liquidity, the costs of having a Fund that is unable to meet its responsibilities far exceed the costs of having a Fund that may have a large commitment capacity that does not need to be utilized.

The arguments against a quota increase are far from convincing. Given the increased uncertainty surrounding the world economy and financial markets, this chair agrees with the staff's observation that we need to allow more time to monitor the trends in the world economy and to review developments affecting the current large users of Fund resources.

We also believe that the Executive Board must discuss the distribution of quotas as completely as possible under the current General Review. In particular, the review of quota formulas is an issue that was assigned to the Board by the Interim Committee in 1997, at the time of the Eleventh General Review. It is not appropriate to conclude the Twelfth General Review without sufficient discussion on this important issue. In addition, as the staff argues, it would be worth examining the possibility of ad hoc quota increases for members whose actual quota shares are seriously out of line, even in the absence of a general quota increase.

Although we believe that a quota increase should have been decided upon by the current deadline, we support the proposed decision in view of the insufficient discussion by the Executive Board so far. We can also go along with the staff's proposal with regard to the length of the extended period, in order to have enough time to discuss the issue thoroughly but at the same time make a decision on a quota increase as soon as possible.

Mr. Shaalan and Mrs. Farid submitted the following statement:

Despite the lack of Board agreement on a quota increase at this stage of the Twelfth General Review of Quotas, we are of the view that there may still be scope to build on the momentum achieved in Board discussions over the past year. Accordingly, we would support the extension of the current review with a view to reaching a final decision on the Twelfth Review immediately after the 2003 Annual Meetings.

We believe that this is an appropriate course of action in view of the high degree of uncertainty surrounding global prospects at this juncture. This uncertainty is arising, not only from the persistent weakness of the global economy and the potential for further financial market instability in a number of large countries, but also from the recent rise in global political tensions which could potentially have serious repercussions on the global economy in the period ahead. Furthermore, an extension would also allow for a careful assessment of the likely impact of new Fund policies on the Fund's resource base, including possible changes in the CCL, as well as allow further deliberations on the proper role of the Fund in the world economy. For all these reasons, we feel that it may be premature to conclude the Twelfth

Review at this time. The proposed extension would permit us to conclude the review on a firmer basis than is the case at present with all the current uncertainties.

Mr. Portugal submitted the following statement:

I thank the staff and management for the paper and for the constructive approach that it is suggested to the topic, with which I agree.

It is unfortunate that the Executive Board could not yet reach a consensus neither on the changes in the quota formulas, a task it had been requested to agree upon promptly more than five years ago by the then Interim Committee, nor on a possible general quota increase. For an institution that prides itself on operating through consensus building, it is particularly embarrassing not to reach consensus on such basic and important issues.

Since the wave of capital account crises of the past decade, substantial progress has been made by the membership, especially the crisis-hit and the more vulnerable member countries to prevent new financial crises. There has been a substantial improvement in macroeconomic policy making and management, with a general move towards floating or more flexible exchange rate regimes and a strengthening of fiscal policies. Countries accepted and began implementing international codes and standards in a number of areas, including when not all of them had participated in drafting those standards, opened their financial sectors to international scrutiny by voluntarily participating in the Fund Financial Sector Assessment Program, and joined the Fund's SDDS making substantial strides in transparency of their economic policies and economic data.

This substantial progress on those tasks that were up to individual countries to implement is contrasted with the slow progress on initiatives on which it is up to the international community as a group to deliver. The issue of the size of the Fund and the quota formulas is an example. As a result of such slow progress, some emerging market countries are already accumulating sizeable international reserves to self-insure themselves against crises. Obviously, if too many developing countries try to accumulate reserves by running current account surpluses in addition to this being costly and inefficient for these countries themselves, it would also be inadequate from an international perspective and could contribute to deflationary trends in the global economy.

Many Executive Directors representing developing countries have argued during the past discussions that the deeper economic integration in trade and finance worldwide, the greater volatility of international private capital flows, the increased synchronicity of economic cycles across member countries, and the difficulties in predicting the demand for Fund resources would recommend a general quota increase, especially considering that the costs associated with a possible shortfall or excess of resources are highly asymmetric. Unfortunately we were not able to convince our industrial countries' colleagues.

Similarly, many developing countries have been advocating for years a change in the current quota formulas that are too numerous, opaque, unduly complex, and contain variables that are difficult to relate to the functions of quotas. As a result of this situation, the aggregate quota share of developing countries has been falling, while individual quota shares of some fast growing or large emerging markets do not reflect anymore their relative position in the world economy. In addition to its implications in terms of access, this has raised concerns relating to the participation of developing countries in the decision-making processes of the Fund.

These issues concerning the size and the distribution of quotas are an essential part of the new international financial architecture that the membership is trying to design since the 1990s financial crises. These issues will not go away. If we have not been able yet to reach a consensus, it seems that the best alternative is to continue discussing. The other alternative would be to go for a split vote at the Board, which I strongly believe we should avoid. This is why the proposals presented by the staff and management seem to me as the only way out at this time.

I am in favor, therefore, of postponing the conclusion of the 12th General Review of Quotas until immediately after the next Annual Meetings. Ideally, we should reach a consensus on a general quota increase that could increase the aggregate participation of developing countries in the Fund. At a minimum, I believe we should try to agree on a new quota formula, independently of using it for a general increase. Agreeing on a quota formula separate from a general quota increase might be easier since the implications of the new formula would not be immediate. Thus, in addition to what the staff has proposed, I suggest that we continue working on the new quota formula issue. If a new quota formula is agreed upon, our chair could also consider the issue of selective quota increases.

Mr. Le Fort and Mr. Pereyra submitted the following statement:

We thank the staff for a well-written paper that adequately summarizes the discussions held at the Executive Board on this 12th quota review. Over the last two years, we have maintained that quotas should better reflect members' relative economic size as well as their potential need for Fund resources. In particular, the current quota structure does not reflect the emerging and developing countries' increasing role in the global economy and their greater exposure to volatilities in trade and in private capital flows. We have, therefore, supported a simple and transparent quota formula that would be consistent with this principle, and remain open to exploring ways to address individual cases of significant out-of-lineness and to considering the role of basic votes as a means to strengthen the representation of developing countries in the Fund's governance structure.

Directors have also discussed the adequacy of the Fund's resource base in the current global environment, characterized by large and volatile international capital flows, and a significant sensitivity of investor confidence to global and regional disturbances that may affect risk conditions in emerging markets. In addition to further developing surveillance operations and encouraging macroeconomic stabilization, prudential policies, and structural reform, we believe the Fund must set out to ensure the availability of sufficient financing for crisis prevention and stand ready to provide the necessary liquidity support for crisis resolution.

We have also supported a forward-looking approach to forecast credit demand—the Fund's Forward Commitment Capacity (FCC)—in order for the Fund to be in a position to respond to balance of payments crises. However, uncertainties that cloud the forecasting of financing requirements are particularly significant in current global capital market conditions. This has increased the "premium on prudence" in assessing the adequacy of the Fund's resource base, given the asymmetry of costs, i.e., a shortfall of Fund resources would generate far greater costs for the world financial system than those that would arise from a higher quota base.

We concur that, in order to ensure the Fund's ability to provide contingent and precautionary arrangements, as well as financial assistance in the case of countries experiencing an external crisis, safeguarding the Fund's resources entails minimizing moral hazard. However, under the conditions prevailing in international markets, including greater capital account openness and integration, the Fund is unlikely to fulfill its role of promoting financial stability by seeking to tackle moral hazard in its credit operations by limiting the overall size of its resources. In this regard, we have difficulty in reconciling the increased occurrence of capital account driven crises crisis in the membership with the moral hazard that could be imputed to members' potential access to conditional Fund resources.

The alternative mechanisms that may theoretically serve to justify a smaller Fund, by fostering a more predictable private sector involvement in crisis prevention and resolution, have not been internalized by market participants, potentially entail a protracted period of uncertainty, and can result in an alarming destruction of wealth and prosperity attributable to a more disorderly adjustment in the crisis affected countries. In any event, program conditionality and the implied cost of policy corrections significantly counterbalance the moral hazard argument. As importantly, the effectiveness of the Fund's role is inherently linked to its unique cooperative character and this, in turn, ties in to its ability to maintain an adequate quota base in light of the changing demands and evolving circumstances of the world economy.

The staff report SM/02/253 presented three illustrative scenarios to evaluate future demand for Fund resources. Even though only one of them resulted in a depletion of the FCC and the activation of the Fund's borrowing arrangements, market volatility and the experience of successive international crises lead to the conclusion that this possible scenario is not far-fetched and should be provided for. Additionally, the use of NAB and GAB is limited to specific purposes involving threats to the international monetary system and, moreover, the future demand for Fund resources is subject to substantial uncertainty. All of these reinforce the notion that reliance on owned resources (quota subscriptions) would be more consistent with the Fund's objectives.

In sum, we are of the opinion that the critical issues of the adequacy of Fund resources, the distribution of quotas, and the governance structure merit further discussion with the aim of achieving the broad support necessary to propose a change in quotas. Furthermore, additional time is required to evaluate important developments such as world economy trends, the experience with current large users of Fund resources, and the potential for financial market instability. Therefore, like Mr. Padoan and Mr. Bossone, Mr. Yagi and Mr. Miyoshi, and Mr. Shaalan and Ms. Farid, we support the submission to the Board of Governors of the proposed report and of a draft resolution whereby the Board of Governors would resolve to continue the 12th quota review and request the Executive Board to complete its work and submit a final report by October 31, 2003.

Mr. Usman submitted the following statement:

It is rather unfortunate that we are yet to obtain broad enough consensus to enable us to move positively forward on the matter of the role and size of the Fund and the adequacy of Fund resources. Our chair supports the need for a general increase in quotas, given the prevailing uncertainties and vulnerabilities of the global economy. Moreover, there are still lingering concerns about the strength and durability of the recovery in major industrial countries. Our chair believes that the Fund needs adequate resources to fulfill its role and responsibilities of promoting international financial stability and there can be no better time than now to strengthen its capacity and readiness to meet the daunting challenges that we now face.

Closely linked to the Twelfth General Review of Quotas is the still pending assignment requested five years ago by the then Interim Committee (now IMFC), to review the quota formulas. We believe in the two reviews (of quotas and quota formulas), account must be taken of the need to address the issue of the governance structure in the Fund with a view to giving developing countries, especially African countries, greater representation and voice than they now have, given their numerical size in the membership and involvement in Fund programs. An increase in the basic votes is of course one way of looking at the issue, but a combination of this and some other innovative ways could also be considered. In this connection, we support also the idea of adjustments to remedy the out-of-lineness of some countries so affected either in the context of a general quota review or as a separate ad hoc review.

In conclusion, we concur with the staff on the rationale for extending the current review of the Twelfth Review of quotas until after the 2003 Annual Meetings, as provided in paragraph 21 of the staff report. We support, therefore, the extension of the Twelfth General Review of Quotas until after the 2003 Annual Meetings. Meanwhile, however, we believe we ought to go ahead with the review of the quota formulas and hope that consensus will be reached on safeguarding the interests of developing countries.

Mr. Zurbrügg and Mr. Moser submitted the following statement:

We continue to believe that the Fund's current resources are adequate, and a quota increase is thus neither necessary nor desirable. Given that the Board discussions in February and August clearly revealed a lack of sufficient support for a quota increase, we do not see much merit in the staff's proposal for an extension of the current review. Instead, we favor concluding the Twelfth Review and support the alternative decision proposed by Ms. Lundsager and Mr. Baukol.

As pointed out by other Directors, if a severe shock to the world economy were to require rapid action on quotas, the Board could open the Thirteenth General Review at any time. Leaving the Twelfth Review open would thus not have an evident benefit. However, like Ms. Lundsager and Mr. Baukol, we believe that it would send the wrong message on the adequacy of the Fund's resources and on our perception of the possibility of future crises.

The staff report essentially gives two reasons for and extension: first, the difficulty in predicting future demand on Fund resources, also because of possible changes to the CCL, and second, the need for more time to reach an agreement on many still open issues with regard to quota formulas. Both arguments fail to convince.

The difficulty in predicting future demand on Fund resources due to uncertainties with regard to trends in the world economy is on open-ended problem that is not to be resolved by waiting one more year for additional information. This problem is addressed by periodic general reviews, not by the extension of individual reviews. Regarding the CCL, we continue to doubt that the Board will be able to agree on changes that could eventually make this facility usable.

As to the open issues with regard to quota formulas, previous discussions over the last years have made it sufficiently clear that we are far from a consensus. It is thus hard to believe that these issues could be resolved in the context of the Twelfth Review. Discussing them separately seems more promising to us.

Ms. Indrawati and Ms. Phang submitted the following statement:

We thank the staff for a succinct report which has set out clearly the status of discussion of the main issues considered under the Twelfth General Review of Quotas. Based on this objective evaluation of the status of the issues covered in the four main areas of the quota review, the staff has recommended an extension of the current review to allow more time to review developments that are critical for reaching a decision on a quota increase and we strongly support their recommendation.

The discussions thus far under the Twelfth General Review of Quotas has helped to clarify the main issues related to the four main areas outlined in paragraph 3 but unfortunately no consensus was attained. More importantly, there was no clear majority. This suggests that more time is needed to arrive at a clear decision. For example, in the case of the role and size of the Fund, the consensus of views was that the Fund should have adequate resources to fulfill its main role of maintaining stability in the international financial system. However, there was a virtual deadlock on the adequacy of Fund resources: in terms of absolute numbers, 14 chairs were in favor of a quota increase while 10 were against but in terms of voting strength the balance swung against a quota increase with 54 percent against and 46 percent in favor of the increase. Hence, we support Mr. Portugal's observation that the Fund has fallen far short of reaching consensus on a very important issue and more time is needed for a decision to be reached.

It might be helpful to consider the reasons for the lack of consensus to assess if an extension of time is indeed called for. As pointed out by the staff, there was general agreement that increased globalization and integration had increased external vulnerability as well as risk of financial contagion. The protagonists for a quota increase therefore felt that this had increased the "premium on prudence," as cogently expressed by Mr. Le Fort and Mr. Pereyra, for example. However, those who were against a quota increase argued that this could be addressed through (a) improved surveillance through increased transparency (mainly through publication of staff reports), assessments of vulnerability, adoption of international standards and codes, conduct of FSAP and improved understanding of capital account issues etc with the aim of enhanced crisis prevention; (b) new crisis resolution instruments such as the SDRM which would reduce the need for big rescue packages; and (c) expanding the role of PSI thus reducing the need for extra resources.

We can go along with these arguments in general under normal conditions and assuming perfect markets exist. However, recent events have cast more than a shadow of doubt on the persuasiveness of these arguments in view of a global environment that is fraught with high uncertainty and high risk aversion on the part of investors. In such an environment, transparency did not help Argentina which is still grappling with a huge financing gap. While it might be useful to carry out vulnerability analyses to help countries take preventive action to plug potential loopholes, the demands on data quality and availability are higher than can be met by most countries. At the same time, the methodology for a vulnerability analysis is still largely at a preliminary stage and needs further refinement, including shifting it to a more forward-looking focus. More importantly, it should be recognized that oftentimes, the crises are triggered, not by domestic weaknesses but by events outside a country's control. As for crisis prevention through observance of international standards and codes, even standards setters like the United States have not been spared from market shattering fraud. What is most disquieting now compared to earlier periods is that the source of the disequilibrium is emanating not from the peripheral countries but from the large economies, as clearly highlighted during the Board's recent discussion on the Global Financial Stability Report and alluded to in Mr. Shaalan's preliminary statement.

An important concern for developing countries which depend on exports to the large economies is that despite the highest standards of surveillance and transparency, large economies with systemic influence, such as the United States, Japan, and Germany have yet to recover from the bursting of the asset bubbles. Considering the orders of magnitude of the derivatives and equity bubbles involving trillions of dollars and their systemic impact on the rest of the world, would the confluence of sluggish global recovery with rapid growth of debt worldwide contain the seeds of a financial implosion on a scale beyond anything experienced thus far? As pointed out in several other preliminary statements, the deterioration in market conditions in the major financial centers has heightened investor risk aversion, exacerbating the financing difficulties faced by emerging economies. In such a difficult environment of high contagion, the Fund should stand ready to provide assistance to mitigate the negative effects arising from regional and global systemic risks. It is clear, therefore, that the Fund would need a more substantial cover than its present SDR 52 billion in FCC (which had declined significantly from SDR 65 billion in 2001). Since economic recovery is the critical factor which determines whether there will be dire consequences for the equity markets and the balance sheets of financial institutions, companies and households, and since the hoped for recovery has remained elusive for the past two years, we concur with the staff that it would be premature to conclude the review now. It would be logical to extend the period for the completion of the quota review until the Annual Meetings in 2003 as the economic trend, etc. should be a lot clearer then.

On the involvement of the private sector and the use of new instruments such as the SDRM for crisis resolution, there is potential to be explored further but we concur with the staff that these are still work in progress. In the meantime, we have yet to see any tangible results of the PSI initiative and we agree with Mr. Le Fort and Mr. Pereyra that the worst-case scenario cannot be ruled out. We should also be mindful of the asymmetric cost of the Fund having more resources than needed, as pointed out in several preliminary statements.

Finally, we join Mr. Yagi and Mr. Miyoshi and Mr. Portugal in stressing the importance of resolving the issue of correcting the distributional and equity aspects of the quota issue. While there was no consensus on the quota formula itself, there was a fair degree of convergence of views and there was virtual consensus on the importance of a quota distribution that would better reflect the relative economic positions of member countries. These are important achievements that should be followed up on and resolved at the completion of the Twelfth General Review of Quotas.

For all of the above reasons, we support the staff's proposal for an extension of the current review with a view to reaching a final decision on a quota increase immediately after the 2003 Annual Meetings.

Mr. Ondo Mañe submitted the following statement:

We would like to thank the staff for providing Executive Directors with the opportunity to exchange views on the complex issue of quotas in this quota review exercise. Today's report emphasizes two options: one is to conclude now the Twelfth General Review, with no increase in quotas. The other is to defer this decision, with a view to reaching a final decision on a quota increase during the Twelfth Review immediately after the 2003 Annual Meetings. We believe that, because there are a number of uncertainties that are not yet resolved, there is a need to keep the door open on this important issue. Therefore, this chair supports the extension of the current Twelfth General Review. Like Mr. Usman, Mr. Yagi, and other Directors, we continue to see merit in a quota increase, in order for the Fund to ensure that its mandate is fulfilled efficiently.

Although we are still far from forging a broad consensus for a quota increase, after extensive discussions held over the past two years, we think that providing more time will be necessary to ensure that taking into account a clearer policy of access, private sector involvement, and sovereign debt restructuring, the quotas will represent more accurately the relative economic position of member countries and that the cooperative nature of the Fund is fully reflected in the decision-making process. In that context, we continue to note that sub-Saharan African countries remain underrepresented at the Board. Thus, we believe that a successful conclusion of this process through further considerations of the basic votes and quotas increase will be necessary to improve the voting power of this group.

We also note with great concern that the different formulas that were presented all lead to further erosion of the small countries' quota shares. At a time when we are trying hard to reduce poverty and improve growth prospects in Africa and elsewhere, having only its 100 percent of quota access is not enough in the light of daunting tasks a country has to deal with. We think that by improving these countries' access to Fund resources, we will be sending a clear and positive message to the world community of our determination and commitment to these countries.

It is to be noted that sub-Saharan countries have experienced the largest proportionate decline in quotas in recent years. One important reason has been the erosion of the relative weight of the basic vote. We, therefore, encourage the staff to explore the possibility of restoring the role of basic votes to their original functions.

Despite the absence of the necessary broad support for a quota increase, we think that progress was made in clarifying key quota-related issues, such as the role of the Fund and the adequacy of its resources, the distribution of quotas, as well as possible changes to the quota formulas. In that context, it is encouraging to note that a broad agreement has emerged for the Fund to have sufficient resources to fulfill its role in the international monetary system. Thus, we need to build on these efforts, in order to maintain the momentum achieved so far. We believe that it may be premature to conclude the review now.

In conclusion, we would like to reiterate our support for the extension of the current review in quotas. Overall, we continue to see merit in a quota formula, which is simple and transparent and help improve internal governance of the Fund in terms of participation of all member countries in the decision-making process.

Mr. Reddy submitted the following statement:

We thank the staff for an articulate summary of the discussions held so far as part of the Twelfth Review. A consensus on whether a quota increase is required at this time and if so, how it should be distributed has so far eluded the Board. With less than two months left for the notified completion of this review, the basic decision before the Board today is whether to conclude this review without a quota increase or extend the period of completion.

We support the staff recommendation to extend the completion of the Twelfth Review until October 31, 2003, and thus keep our options somewhat open with possible potential benefit and virtually zero extra cost. This course of action is appropriate for a number of reasons. Ongoing Fund crisis prevention and resolution initiatives, including the forthcoming discussions on access policy and CCL, may have an impact on the future demand for Fund resources and thus on perceptions about the size of the Fund. Hopefully during this extended period, a more comprehensive view of current global uncertainties may also be available, as noted by the staff. Furthermore, the additional ten-month period may provide adequate opportunity for reaching agreement on revision of the quota formulas; which the Board was enjoined to do by the Interim Committee after the Eleventh Review, five years ago.

Regarding the view that such an extension by the Board may signal its recognition of the inadequacy of the Fund's resource base as well as the possibility of agreement being reached on a quota increase, we are not overly concerned. This is because such a view is outweighed by the facts that such extensions have occurred during previous reviews and that the considerable difference of opinion amongst members on the size and distribution of quotas is public knowledge. In fact, the extension may generate a positive signal to the public and markets by demonstrating the openness of members to continue considering the issue of demonstrating support to the Fund, despite the wide variation in their views.

As regards specifics, we are not comfortable with the staff suggestion that the future work program on quotas also include identification of out of line countries based upon a framework, which appears to be independent of the revised quota formulas. The alternative approaches referred to in Footnote 12 presume a set of formulas, which this chair has not been able to accept for reasons highlighted during our earlier interventions. We are thus unable to agree to the suggestion that the Board could consider an ad hoc quota increase for out of line members before agreement has been reached on quota formulas. To provide a sound basis for the definition of out of lineness, and thus a sound basis for identification of out of line members, this proposal needs to be considered only after the quota formulas have been revised. We therefore suggest that the second paragraph of the Report to the Governors, which incorporates this proposal be suitably amended.

While associating itself with other Directors, this chair would like to reiterate its position, that the Fund resources should be adequately buttressed in a forward-looking manner so that it is enabled and empowered to effectively fulfill its mandate. As part of this exercise, and as articulated by this chair and several others in this forum, the quota share of the developing countries must rise appropriately to match their growing importance in the world economy as well as to provide them a larger profile in the governance of the Fund.

Mr. Oyarzábal and Mr. Varela submitted the following statement:

At outset, we would like to thank the staff for the work done so far on issues related to quotas, and also for the concise and informative paper for today's discussion.

The current discussion on quotas focuses particularly on three main aspects:

- The Twelfth General Review and the related question of a possible quota increase,
- The review of the formulas used to calculate quotas, and
- The need to have an ad hoc quota increase for a selected group of countries whose actual quota is significantly out of line.

These three aspects are highly relevant for the life and function of this institution. As this Chair has emphasized in previous discussions on quotas, the credibility and legitimacy of the Fund is at stake here. Not only the role of the Fund in the world economy can be affected by the decisions—lack of decisions—regarding quotas, but also the very basic principles of good governance and democracy.

These three aspects are closely interrelated, but it is clear that they do not necessarily need to be tackled together at the same time in a single uniform package. In fact, they need to be perceived and analyzed as relevant separate issues, each of them deserving the full attention of the Board and the whole membership.

The main question under discussion today is whether the Twelfth General Review should be completed now or extended until October 31, 2003. The staff is proposing an extension in order to allow more time for the consideration of a possible quota increase and we concur with them.

We support the extension of the Twelfth General Review for several reasons. First of all, the world is undergoing a phase of significant uncertainty. Even in the most advanced countries there are no clear signs yet of a strong recovery. Moreover, although most developing countries are enjoying a stable situation, several emerging economies will be in a particularly critical stage during the next six to nine months amidst increased volatility in the international financial flows and the main equity and debt markets. The demand for official funding may substantially increase as a result of an undesired evolution in those countries, or adverse developments in other economies as a result of an unexpected deterioration of the overall economic environment.

In view of these factors, the current level of one-year forward commitment capacity of SDR 52 million might not be as comfortable as assumed by other colleagues. In fact, the FCC has decreased about 30 percent since 2000 and it could be rapidly depleted if further substantial financing is needed. The current concentration of risks further complicates the situation. And so does the fact that the capital account crises are now more frequent, demanding sizeable funding from official sources if stability is to be preserved.

Additionally, as pointed out by the staff, the discussion on relevant policy issues is not over yet. Issues such as the SDRM, access policy or the CCL review feature prominently in the Board work program for next year. Advancing them will shed more light on the amount of financial resources the Fund must have in order to fully comply with its mandate. It is true that some of the issues under discussion may result in a smaller demand of Fund resources. But it does not seem prudent to take decisions on the need of Fund resources without concluding at least some of those discussions. Once this work is done, we will have a more sound footing for estimating future financing needs.

In sum, waiting until October for a final decision on increasing the quotas would allow the Executive Board to take a more informed and better based judgment. On the contrary, completing now the Review could easily backfire in a few months ahead. The credibility of the Institution may be affected in case a new call for quotas is to be made within next year, after rejecting a quota increase now. Moreover, if the decision is postponed, the markets will get the right signal that the Fund is carefully analyzing the evolution of the world economy and is ready to support any foreseeable need to help a country should a crisis takes place.

Looking forward, we join Mr. Portugal in recognizing the considerable progress made by many members of the Fund in adopting stronger crisis prevention measures in recent years. Many efforts have been made by the developing countries and particularly in some emerging countries towards implementing sound policies within more robust frameworks affecting the financial sector, the exchange rate and the fiscal and monetary policies. In order to continue providing the right incentives, the international community should pay due regard to these efforts and take them into account when considering what should be the role and the size of the Fund in the world economy.

Regarding the formula review, we think that it should be concluded as soon as possible. This chair supports a full discussion of this issue in order to promptly comply with the 1997 Board decision. In this vein, we would like to see more time devoted to this matter in the following months. The question of basic votes could be contemplated in the context of a new formula, as a possible way to enhance the representation of poorer members of the Institution.

Finally, on the ad hoc increase of quotas for a number of countries that are out of line, we fully endorse the views expressed by the staff in this regard. As it has been already supported by the Directors, it is urgent to solve this situation in a prompt and adequate manner. It should be noted that this

> matter can be addressed independently of the conclusion of either the Twelfth Quota Review or the discussion on the new formula. As the staff points out, this problem exists regardless of the specific formula used, so the judgment about which countries are affected by the misalignment and its solution can be made irrespectively of the quota formula that would be finally adopted or the outcome on the general quota increase.
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> Therefore, we fully support the staff's intention to continue analyzing this issue and to identify as soon as possible in a fair and objective way which countries are most seriously out of line with their relative position in the world economy. We urge the staff to make a concrete proposal to the Board regarding the criteria that could be used in this regard and to present to us a first approach on how this problem could be addressed in the near future.

Mr. Shaalan remarked that Mr. Portugal had noted an interesting phenomenon over the past several years—specifically after 1997—when countries had found it necessary to accumulate their international reserves. The questions that followed were, first, what was the cost to those countries; and, second, what impact did the rising level of reserves have on global economic developments. These two aspects were relevant to the discussion on the Twelfth General Review of Quotas, and merited further examination by the staff.

Mr. Wei made the following statement:

> We thank the staff for their concise and balanced report. I would like to join Mr. Yagi and many others in supporting the staff's proposal for an extension of the current review so that a final decision on a quota increase can be reached immediately after the 2003 Annual Meetings, for the following reasons.
>
> First, I think an extension of the current review will allow the Board more time to take into account the latest economic and market developments and ongoing policy related discussions, such as quota formula. Although there might be some concerns that the extension may signal the inadequacy of the Fund's resource base, I think that the extension reflects the prudent way in which the Fund is continuing to examine the quota issue instead of concluding the review now. The Fund's continuous work on quota issues is of critical importance at this juncture when the global economy faces so many uncertainties.
>
> Second, I would like to reiterate that the Fund must be equipped with sufficient resources to be able to fully play its role in crisis prevention and resolution. We must take a forward-looking stance in today's world where unexpected capital account crises erupt from time to time. The most recent financial turmoil in some Latin American countries has created an enormous demand for Fund resources—far beyond past experience. We can expect that the demand on the Fund's resources will further increase once the Fund and the Argentine authorities reach agreement on a program. Although the status

of Fund liquidity is not a question for the time being, according to the recently approved liquidity benchmark, we should avoid judging whether the Fund's resources are ample solely in view of past experience; instead we should take into account the needs that may arise in the future.

Third, I welcome the ongoing discussions on CCL and SDRM and note that, by all means, we should provide ourselves with an ample resources buffer when implementing these initiatives in a prudential way. We acknowledge that both issues have important implications for a quota increase and the SDRM discussions are also most valuable in establishing a concrete mechanism for private sector involvement in crisis prevention and resolution. I look forward to progress being made in redesigning the CCL and the discussion of the SDRM. With the improvements in the design of CCL, probably members when facing the need will request the Fund's assistance under this facility.

Fourth, taking the above two points into consideration, we can conclude that it would be wise to make a decision on a quota increase in the twelfth quota review. At the same time, we call on swift action to finish the work on the revision of a quota formula—which has been ongoing for the past five years—to appropriately reflect the rapid changes in the world economy in which the developing countries as well as many Asian countries have enjoyed vibrant growth.

Last but not least, we express our sympathy for those countries whose actual quotas are out-of-line by all kinds of measurement and hope this situation will be corrected when we make our quota increase decision. While we support an ad hoc increase for these countries, we believe that the major industrial countries should cede some of their shares in the spirit of cooperation to accommodate their request. At the same time, we strongly support an increase in the representativeness of African countries in an appropriate way.

Mr. Bischofberger made the following statement:

Our position on the question of a possible quota increase is well-known and it has not changed. Therefore, we associate ourselves with those chairs who argue that the Fund's resources are currently at a comfortable level, and that a quota increase is neither necessary nor desirable.

Like Ms. Lundsager, Mr. Bennett, and Mr. Zurbrügg, we are in favor of concluding the Twelfth General Review of Quotas with no quota increase. We believe that an extension of the review period as proposed by the staff would send wrong signals to both potential Fund borrowers and market participants. We, therefore, support the alternative decision and report to the Board of Governors attached to Ms. Lundsager's and Mr. Baukol's preliminary statement.

Completing the review with no increase in quotas would send a credible signal to Fund borrowers and private lenders that official resources are limited, thereby significantly reducing moral hazard. Moreover, substantive progress in important policy areas, including access policy and PSI, is more likely in this case. At the same time, we are not convinced by the staff's call to allow more time to assess the impact of new policies on the Fund's resource base, particularly regarding possible changes to the CCL. We remain skeptical about whether making the CCL more efficient is feasible at all.

Finally, on the question of aligning quotas more closely with the economic weight of member countries, we think that this issue should be dealt with in the context of our ongoing discussions on a revised quota formula separately from a quota review.

Mr. Shaalan requested that Mr. Bischofberger elaborate on his assertion that an extension of the review period would give the wrong signal to markets, while concluding that the review would give the right signal.

Mr. Bischofberger pointed to paragraph 21 of the staff paper, which stated that the staff would recommend an extension of the current review with a view to reaching a final decision on a quota increase during the Twelfth Review immediately after the 2003 Annual Meetings. That sentence could be construed as a clear precommitment of the Board to a quota increase, which, in his view, was the wrong signal, particularly as the staff paper was proposed to be published.

Mr. Boitreaud made the following statement:

I will be very brief since I share the remarks made by several colleagues, in particular Mr. Padoan and Mr. Bossone in their preliminary statement. We support the staff's proposal for an extension of the current review, with a view to reaching a final decision on a quota increase immediately after the 2003 Annual Meetings. A strong argument in favor of the completion of the Twelfth Review relates to the likely impact of the introduction of new policies, such as stricter access limits, PSI, and the elaboration of an SDRM on Fund financing and the signals we are sending, as underlined by Mr. Bischofberger.

But it is indeed difficult to determine the optimal size of the Fund at the very moment we are working on these major changes in the modalities of the Fund's interventions. Moreover, improvements in all these areas will be, at best, gradual and marginal, even if we could establish an effective sovereign debt restructuring mechanism over the next years. We also have to take into account the circumstances under which our recent discussions on quota issues have taken place: a global slowdown, followed by a progressive and uneven rebound, sustained high volatility in the international and domestic capital markets, and a global crisis of confidence, to list but a few.

The Fund's decision on quotas should not reflect temporary circumstances but should take into account structural and long-term developments. However, the opacity and volatility of the current period do not facilitate the analysis of such long-term developments. So, on balance, an extension of the Twelfth Review may be warranted. A number of current world economic uncertainties could be resolved in the coming year and we will make progress on the Fund's policies on SDRM, PSI, surveillance, and access in the period ahead.

In conclusion, and to speak on the substance, let me reiterate this chair's support for a general quota increase. I will not repeat the reasons behind this stance, as we have expressed them during previous discussions. I will mention only one. We continue to support the convergence between calculated quotas and actual quotas. Ad hoc increases could be a solution, but they imply that all members of the Fund would accept a relative decrease of their own quotas, which is rather unlikely. A general quota increase would be another way to deal with this issue.

Finally, I would like to express our support for the proposal made by Mr. Ondo Mañe and Mr. Usman to restore the role of basic votes to their original function.

Mr. Al-Turki made the following statement:

I thank the staff for the concise and well-focused presentation for today's discussion. My views on the matter are already on record from presentations I made during the Board's discussions earlier this year. Therefore, I will be brief.

I remain of the view that the Fund now has ample resources to support its present and prospective central role in the international monetary system. I also share the view noted in the staff report that concluding this review by keeping the Fund's size unchanged would help reduce the system's potential moral hazard. In addition, I see no merit in the staff's argument for delaying the conclusion of this general review to discuss either the potential resource implications of possible changes in the Contingent Credit Facility or the case for any ad hoc quota increases. These are separate issues that could be dealt with independently at any time as needed.

Accordingly, my preference is to recommend immediate conclusion of the Twelfth General Review of Quotas without any increase in quotas.

Mr. Andersen made the following statement:

I can be relatively brief as this chair's positions on the issues raised in the staff paper are rather similar to those expressed in the statements by Mr. Bischofberger, Mr. Bennett, Mr. Zurbrügg and Mr. Moser, and

Ms. Lundsager and Mr. Baukol. Thus, for many of the same reasons emphasized by those colleagues, I am not convinced by the arguments presented by the staff in favor of an extension of the current review.

In particular, I agree with Mr. Bennett that quota increases should be based on longer-term considerations, not cyclical factors, and I do not see the rationale for a strong connection between the CCL and the quota review. Moreover, I share the view expressed by Ms. Lundsager and Mr. Bischofberger that leaving the review open could give rise to misleading impressions to the public and the markets. Taking into account the development of the Fund's policy on crisis prevention and crisis resolution, our chair finds the Fund's resources and current liquidity to be adequate to meet foreseeable demands. Continued work in these areas, including on PSI and access limits, and increased focus on the quality of the Fund's assistance, thereby enhancing its catalytic role, should hopefully effectively reduce the need for large new financial packages.

Accordingly, our conclusion is that the 12th Review should be closed on time without an increase in quotas. I support an alternative decision and report to the Board of Governors along the lines suggested by the U.S. chair.

Moreover, I agree with Mr. Bennett that the 13th review could and should be launched immediately if developments warrant revisiting the adequacy of the Fund's resources. Such a review could be finalized within a timeframe that suits the needs of the Fund. In any case, the Fund's liquidity situation and prospects should be closely monitored at all times.

Finally, we do also share the view that our discussions during the 12th Review has contributed to progress in clarifying a number of quota-related issues, including quota formulas and certain aspects of governance and representation, and that work on these issues can continue. As noted by others, we are still not close to a consensus in these areas, so to discuss them separately as mentioned by Mr. Zurbrügg and Mr. Moser may be a more promising route.

Mr. Prader made the following statement:

After setting aside about SDR 30 billion for prudential reasons, the Fund's one-year forward commitment capacity (based on its own resources) was SDR 52 billion at the end of October 2002. There is thus no immediate need for a quota increase, and no chance of a sufficient majority in the Board of Governors to support such a decision. I therefore see no reason for us to prolong our consideration of the need for a quota increase for another nine months.

In other words, the position of the countries of my constituency has not changed since the last meeting. Our chair remains ready to support an increase of Fund quotas whenever the Fund's liquidity threatens to fall too low to allow it to support its members with temporary access to its resources, in order to solve balance-of-payments crises. I am confident that if an urgent need for a quota increase should emerge for economic reasons, the international community will rise to the occasion and quickly approve an increase in the Fund's capital. There is therefore no need for further lengthy discussions in the framework of the Twelfth Review.

There is, however, a problem whose resolution does not have to wait for a general quota increase. I refer to the chronic underrepresentation in Fund quotas of several developing countries, including Bahrain, Botswana, Korea, Singapore, Thailand, and Turkey. I support the proposals in paragraph 21, which call for identifying those members whose actual quota shares are seriously out of line with their relative positions in the world economy, and recommending possible ad hoc quota increases for them even in the absence of a general increase in quotas.

Mr. Lushin made the following statement:

Let me begin by saying that we support conclusion of the 12th General Review of Quotas and share views expressed by Ms. Lundsager and Mr. Baukol, Mr. Bennett, Mr. Zurbrügg, Mr. Bischofberger and some other Directors.

Indeed, the conclusion of this Review will not impede the initiation of the 13th General Review of Quotas if a serious shock to the world economy makes the need for a quota increase unambiguous. Right now the Fund has a sufficient level of liquid resources and any quota increase will be chiefly of precautionary nature. Therefore, even if there may be a case for an immediate quota increase, it is hard to argue that this increase should be sufficiently large. At the same time, going for a small increase will hardly be justified, given the amount of effort required and difficulties that should be overcome on this way. From this it follows that we should embark on a quota increase only when there will be a clear need in a large augmentation of Fund's Resources, which obviously is not in place at the current moment.

Concerning our work on a new quota formula, we believe that it can continue outside of a quota review and in this context options could be explored on how to address the situation in a small group of countries whose actual quota shares are seriously out of line with their relative position in the world economy.

Mr. Callaghan made the following statement:

The main argument used by those Directors who want to conclude the Twelfth Review seems to be on the basis that, because views on the need for a general quota increase are divided and that we do not seem to be close to the required 85 percent majority, then there is no need to continue discussions under the Twelfth Review. But those Directors who support an extension seemed to say that it is because views are so divided that we need more time to consider the issues further. Moreover, while support for a quota increase is short of the required 85 percent majority, Ms. Indrawati and Ms. Phang note that, on voting strength, views for and against an increase are roughly equally divided.

We have noted in past discussions on this issue that valid judgments can be made for and against a quota increase. We are dealing with matters of judgment, and this needs to always be recognized. But our work on assessing the adequacy of Fund resources is far from complete, not simply in terms of not being able to reach a consensus one way or another, but perhaps, more importantly, there is continuing uncertainty as to the various issues that we should take into account in determining the adequacy of the Fund's resources. Our consideration in this area must surely be described as work in progress.

While it comes down to judgment, we have to apply as much analytical input as possible. We have discussed many issues, such as the decline in quotas relative to such indicators as global GDP, world trade, international capital movements, reserves, and so on, but I do not think we can say that we have a good understanding of the relevance of these trends to the demand for Fund resources. Furthermore, we are still struggling with the review of quota formulas. This cannot be separated from judgments on the appropriate size of the Fund.

Those Directors who want to conclude the Twelfth Review now say that if developments warrant revisiting the adequacy of IMF resources, then the Thirteenth Review could be launched immediately. In fact, I would have thought that the Thirteenth Review would have already been launched on the conclusion of the Twelfth Review, and what those Directors mean is that its conclusion in support of an increase in quotas could be accelerated ahead of the five-year schedule, if needed. However, the reality is that, for this to occur, we are likely to be facing a very difficult international environment, with a number of countries in crisis. Before we reach that stage, it would clearly have been better to have advanced and refined our analysis of the factors that need to be considered in forecasting the adequacy of Fund resources. Certainly, we could continue this analysis in the context of the Thirteenth Review, but there would be no immediacy in the work. There is another five years before we would need to report to the Board of Governors, assuming we are not faced with a series of crises before then.

In contrast, if the Twelfth Review is extended, we maintain some momentum in the all important effort of refining our judgment on the adequacy of Fund resources. It may be that in 10 months' time there is still not the required majority to support a general increase in quotas, but hopefully we will have refined our analysis and our judgments. For that reason alone, we will all be better off.

Importantly, there is also the question of the under-representation of quotas by some countries, and this looms very large for one member of this constituency, namely Korea, although it also applies to a number of other countries in Asia. As we have seen from all the various approaches to specify in the quota formula, Korea is significantly underrepresented, as is the Asian region as a whole. We cannot realistically separate the crucial question of addressing the problem that some countries' quotas are significantly out of line from the issue of the general review of quotas. As we have seen in the past, general quota increases have proved to be an important aspect when addressing questions of quota distribution.

Quota distribution goes to the heart of the legitimacy of the Fund. To conclude the Twelfth Review without meaningful steps to address the issue of the under-representation of quotas sends a very negative signal to those countries whose quota shares are significantly out of line. Certainly, with the Twelfth Review concluded, we could say we are continuing to work on the issue of quota representation but, as noted previously, the Thirteenth Review does not need to be concluded for another five years. What sort of message does this send in terms of our desire to ensure that quota shares reflect economic developments? In summary, we are in favor of an extension of the Twelfth Review until the 2003 Annual Meetings.

Mr. Yakusha made the following statement:

It became clear at the Board meeting last August that we are not close to a qualified majority in favor of a quota increase. The position of this chair has not changed since August. We see no need, and do not support the proposed extension. We also feel that a general quota increase is not desirable while the important issues of PSI and access policy have not been resolved. Expanding the size of the Fund at this time may create moral hazards and compromise the objective of creating a more efficient crisis resolution mechanism.

The staff paper mentions selective quota increases and a possible increase in basic votes. While these issues are important and legitimate, they have no direct relationship with the assessment of the overall size of the Fund. In case of unforeseen developments—and I do not mean unforeseen developments of regular business cycle-related circumstances, but unforeseen developments of a structural or systemic nature—this chair stands ready to launch and complete the Thirteenth Review at short notice.

We do not have any strong views on the publication of this particular paper as we have not seen many new arguments proposed by the staff.

Mr. Brooke made the following statement:

> My authorities continue to have an open position on the potential need for a quota increase. While we think that the Fund's current liquidity position is adequate, we recognize that there are still considerable uncertainties about the potential impact on the demand for Fund resources arising from the various proposals for changes to IMF policies, and we are also interested to explore further the various ideas to enhance the voice of developing countries within the Fund. Consequently, we are willing to support the staff's recommendation that the Board of Governors extend the deadline for the completion of the Twelfth Review.

Mr. Mirakhor said that he supported the staff's recommendation.

The Acting Chair (Mr. Sugisaki) asked the Secretary where the Board stood on the proposed decision.

The Secretary (Mr. Anjaria) replied that there was a majority in favor of extending the quota review period but it was not a strong majority.

Mr. Mirakhor noted that, as Directors were aware, management and Executive Directors had always strived to achieve a consensus on major decisions of the Board. The Secretary had just pointed out that, while there was a majority, it was not a clearly strong majority. As a possible compromise for the consideration of Executive Directors, he proposed that the Board complete the Twelfth Review with the understanding that the Committee of the Whole (COW) would continue to receive reports from the staff without interruption on the quota increase and related issues that had been raised by Directors. Such a compromise should be agreeable to both sides. Once the Twelfth Review was completed, the Thirteenth Review would commence and continue for a period of five years, during which the Board might decide, at any time, to report on a quota increase to the Board of Governors. What remained to be considered were the reports on the work program that the staff had to submit to the Executive Board and to the International Monetary and Financial Committee. Consequently, the present COW would continue to receive reports from the staff on the quota increase and quota-related issues.

Ms. Lundsager said that she agreed with Mr. Bischofberger's point that the Fund should send a clear signal to markets and to the public. If the work on quotas continued, it might be interpreted by markets that an increase in quotas remained a possibility. In the same vein, to conclude one review and start another one immediately would send a contradictory signal to markets. It was important to ensure clarity in Fund policies, including progress on a sovereign debt restructuring mechanism, access, and the Contingent Credit Line. Regardless of the decision on the Twelfth Review, the Fund would continue to monitor the situation closely, which was a responsibility of the Board. She herself regularly looked at the financial transactions plans on the Treasurer's Department's Web site to speculate on what might be happening and how much the United States might be asked to contribute to the transfers in the coming periods. The public message should be made clear that the Fund concluded the Twelfth General Review of Quotas but would continue to monitor developments. A break was needed between the conclusion of the Twelfth Review and the start of the Thirteenth Review.

As regards the procedures, the question was whether a new COW would be established right after the Board of Governors decided to conclude the Twelfth Review and to immediately start the Thirteenth Review, Ms. Lundsager asked. The present COW had been established only a year ago, namely, in December 2001. The Board had worked on the quota formulas—starting with the discussion on the report of the Cooper Commission and several follow-up discussions—in the absence of a COW for almost four years. The discussion on the quota formulas could continue after the conclusion of the Twelfth Review, although it would be difficult to reach any agreement on that until member countries knew exactly how the new formula would actually affect their quota shares. Views on the quota formulas differed widely, which made it unlikely that the Board would be able to achieve further progress at the present time.

Mr. Mirakhor responded that, on the question of whether or not the compromise meant that the Thirteenth Review would be opened immediately, it was his understanding that once one review was concluded, another one would start automatically. The question was when to form a COW. He had proposed that the COW continue or a new committee start right away, depending on a legal opinion. As far as the signal was concerned, the report to the Board of Governors would only state that the Executive Board recommended that the Board of Governors conclude the Twelfth General Review of Quotas without mentioning the formulation of a new COW. The understanding that a COW would be formed immediately could appear in the Chairman's summing up, statement, or other mechanism considered appropriate by management. The staff would then continue its work on the quota increase and quota-related issues and report to the COW. By this means, the signal to the public would be clear that the present review was closed. It was only an understanding within the Executive Board that Directors agreed to proceed with the work program without interruption.

Mr. Shaalan commented that, while he personally attached much value to reaching a consensus, he also attached equal value to how that consensus was reached. By agreeing to close the Twelfth Review and immediately begin the Thirteenth Review with the establishment of a new COW could send a wrong signal to the public that the review process would continue. It would appear more appropriate to extend the present review rather than to conclude it artificially.

Mr. Bennett thanked the Dean of the Board, Mr. Mirakhor, for his proposal and his efforts to find some common ground for reaching a consensus. While conceptually the Dean's proposal had some merit, it might be difficult to explain to the public why another review was needed immediately after completing the present review with the conclusion that the level of reserves available to the Fund was adequate for the foreseeable future. The public would be aware that the Fund would continue to monitor the situation but not in the context of a rejuvenated review of quotas. In making a decision on the Dean's compromise proposal, it was necessary to consider the text that described why the Board was recommending a completion of the Twelfth Review and what conclusions the Board had reached after one year's work on the level and adequacy of Fund resources. That text would be the mechanism through which the views of the Board were conveyed to the public. He agreed with Ms. Lundsager that it was important to convey some certainty to market participants and the international community.

Mr. Shaalan said that he agreed with Mr. Bennett on the importance of providing the reasons for the conclusion of the present review. However, the signal might be confusing if, on the one hand, the Twelfth Review was concluded based on the conclusion that the Fund's liquidity was adequate, while, on the other hand, the Thirteenth Review started immediately, which was an unusual practice. The Twelfth Review had not commenced until four years after the completion of the Eleventh Review.

Mr. Bennett agreed with Mr. Shaalan that the Thirteenth Review should not start right away as that would send a confusing signal. While recommending the conclusion of the present review, the Board could agree to carry on the work related to quotas outside the general review framework, not in the context of the Thirteenth Review.

Mr. Shaalan said that Mr. Bennett's suggestion—that the Board agreed to do something but told the public something else—was unacceptable in terms of the governance of the Fund.

Mr. Yagi said that, while he agreed with Mr. Callaghan's comment that it was important to consider the impact of the signal on markets, the substantive issue of the adequacy of Fund resources still needed to be considered. The inadequacy of resources might lead to difficulties in the Fund's rescue operation to countries in crisis, thus incurring tremendous cost on those countries. Therefore, the signaling effect, while important, should not be the only consideration.

Mr. Zurbrügg said that Mr. Callaghan's comment pointed to the basic problem regarding the scope of the quota review. Mr. Callaghan had suggested that a general quota increase was needed to solve another more fundamental question of representation. From the liquidity perspective alone, most Directors would probably agree that the Fund's liquidity was sufficient at the present time. Nevertheless, the mixed scope of the current quota review was influencing the decision to postpone a conclusion of the quota review in the hope that the Board might be able to solve the representation issue over the next nine months, which appeared to be a valid argument for countries whose actual quotas were out of line of their calculated quotas. While his chair had accepted in previous Board discussions that the representation issue warranted further consideration, it should not be used as an excuse to postpone the current quota review. The representation problem would remain even after the extension period of the Twelfth Review ended. The Dean had made a legitimate point regarding the practice of reaching consensus at the Board, which he fully shared. However, a quota increase had always been one of the issues that led to a divided Board, and the public might have already been aware of the difference in views between creditors and debtors.

Mr. Yagi remarked that ad hoc quota increases should be discussed within a set timeframe in order not to lose the momentum. It would be difficult to continue the discussion on that and on other quota-related issues without a predetermined timetable.

Mr. Shaalan said that he was compelled to intervene by Mr. Zurbrügg's statement that Directors agreed that the Fund's liquidity was appropriate and hence, by implication, there was no need for an extension of the current quota review, and that the only remaining consideration was the question of selective quota increases. The present liquidity of the Fund did not necessarily lead to the conclusion that the Twelfth Review should be completed. It took up to five years to come to a quota increase when that was deemed necessary. The attempts to accelerate a quota increase in the past had not always been successful. Therefore, it was not the adequacy of Fund liquidity alone that would dictate an extension of the quota review. One argument in support of the extension was the fact that there were certain countries that clearly needed a revision in their quotas to better reflect their relative positions.

Mr. Mirakhor said that, as it stood, there was a slim majority for the staff's position. The report to the Board of Governors would only refer to the staff's proposal and not how the Executive Board had arrived at its recommendation. The Board should try to reach a consensus rather than reporting on a decision that had been reached with a very slim majority, which would not augur well for transparency. If the Board were to accept the staff's proposal, the decision would simply state that the Board, which implied a collective Board, had decided that the Twelfth Review period was closed, nothing beyond that. Although, currently, a decision was in favor of the staff's proposal, a broader consensus should be attempted to form a unanimous view of the Board that there remained questions that had not yet been adequately answered and required further work. The only disagreement was on the timing of the formulation of the COW for the Thirteenth Review. He was of the understanding that the Thirteenth Review would start immediately after the Twelfth Review was closed, unless the Legal Department had a different understanding. The only functional question was whether the COW would continue to receive reports from the staff on those outstanding issues.

The Acting Chair (Mr. Sugisaki) remarked that quotas were the fundamental issue for the institution. He, therefore, highly appreciated Mr. Mirakhor's efforts at reaching a wider and broad-based consensus within the Board. He was not comfortable with obtaining Board approval of a proposal with a very thin majority. Directors were encouraged to try to reach consensus on one proposal or another and to express their views.

Mr. Andersen said that he was willing to consider any proposal that could lead to a consensus and was fully prepared to reflect further on a concrete proposal. At the same time, he also agreed with Ms. Lundsager on the need to send clear signals to markets as clarity was indeed one of the aims in all important policy discussions at the Board. In the present environment characterized by high risks and uncertainties, the Fund had an important role to play in sending clear, confidence-enhancing signals. While a small majority was in favor of the staff's proposal, it was clear that the Board was still far from the required 85 percent majority in favor of a quota increase at the present time. Therefore, caution should be taken when sending any signals to markets.

Mr. Brooke noted that, despite Mr. Mirakhor's best efforts, it would still be extremely difficult for the Board to reach a consensus decision on any proposal. He suggested that, for the sake of transparency and candor, the report should admit that the Executive Board was divided and that the majority, albeit a slim one, was in favor of maintaining the discussion until the 2003 Annual Meetings. It was not likely that other alternatives would secure broader support or produce a much different result. The Board should instead be honest in its reporting to the Board of Governors and also in its communications with the outside world that that was where the state of the debate was.

Mr. Mirakhor asserted that, indeed, the majority was in favor of the staff's proposal, but in none of the documents to be submitted to the Board of Governors would there be a reference to the fact that the Executive Board had decided with a small majority to extend the review period. Rather, the report would simply state the decision of the Board to recommend such an extension. It was not constructive to suggest that that decision was taken by a small majority. Therefore, in the spirit of cooperation, a broad-based consensus should be aimed for. Neither side would lose if the report simply stated that the Twelfth Review was closed, and then the Board could agree on a document that would be the basis for further work. Transparency was not an issue in this context as the staff's proposal made no reference to how the Board voted on the decision.

Mr. Prader said that he always appreciated Mr. Mirakhor's constructive proposals. It was embarrassing to make any recommendation to Governors based on a one-percent majority as that was analogous to a hamburger without meat or a paper tiger. He, therefore, agreed on the need to formulate a compromise proposal in this regard. Two elements were necessary if the proposal were to be accepted, however. First, as stated by Ms. Lundsager and Mr. Bennett, the message had to be clear that there was no need on liquidity grounds for a quota increase. As suggested by Mr. Bennett, the Board needed to see a draft text of the decision before making any judgment, and, if needed, meet again in one week's time. Second, the establishment of a COW, which was part of the confusing message and one of the most contentious issues, should not take place immediately.

Mr. Callaghan made the following further statement:

> You have mentioned earlier that you were very uncomfortable about any decision taken on a slim majority. You are absolutely right on that, and so is the Dean. There are very real concerns about the governance of the Fund, very real concerns about the appropriateness of representation of countries, and any decision that comes down to a slim majority is really highlighting those concerns. We cannot take decisions on very slim majorities, given that there are these real concerns about whether we are appropriately constituted.
>
> While I certainly share your concerns, and I think the Dean is absolutely right to see if there is a way forward on a compromise, I have been a little confused as to why Directors who are in favor of concluding the review are not, in fact, supporting Mr. Mirakhor's proposal, because from the point of view of those countries who are in favor of an extension, I am not sure what the compromise is for them. It seems very vague in the sense that we talk about signals, but the very clear signal that is going out is that the Twelfth Review is being concluded.

Now, Mr. Zurbrügg said that those countries on this very important question of under-representation, they want an extension in the hope that over the next nine months we might solve some issues, be it on addressing under-representation of countries or questions of basic votes. But the alternative is that if we conclude the Twelfth Review now, then there is no hope that there is going to be any movement at all in this regard over the next nine months. It will take place over the next five years, for if there is no timetable, even if we continue work, there is no specific progress point in terms of addressing that work. It becomes very vague.

On the question of signals, I think we can overplay it. I wonder when we talk about the confusing signals that will go out to the markets or to the external community if we constitute the Committee of the Whole, I just wonder how many people out there know the subtleties of constituting a Committee of the Whole. But, there is a very important signal on a matter that is of major concern for many countries, that is, this question of under-representation. The signal will go out now if we conclude the Twelfth Review, and we may well say we will continue to work on it, but there is a very clear signal that we are not doing anything about it.

So, that is the main signal I am worried about. On the extension, I do think we are overplaying how the markets will perceive that, along with questions of moral hazard and concern that we think we may need more Fund resources. There has probably been more of a concern if people think that we are not always monitoring the Fund's resources.

So, I am particularly concerned about the signal that we can give on this question of the representation. It is a very fundamental one. It goes to the governance of the Fund, and it goes to all the concerns you are raising. I think that is the one that we would put particular emphasis on.

Ms. Manno shared Mr. Callaghan's view that, for countries that supported extending the period of the Twelfth General Review of Quotas, Mr. Mirakhor's proposal was not appealing. Therefore, she supported Mr. Brooke's position on that point. However, it would be useful to consider the draft language and delay the decision for a few days.

Ms. Indrawati said that she strongly supported Mr. Callaghan's view that the issue was not only about the signal on the Fund's reserve level, but also that of governance and quota distribution, which were equally important. A lack of consensus on quota distribution that better reflected the relative economic positions of member countries undermined the importance of governance and equity in the Fund.

Ms. Lundsager remarked that a general increase in quotas had to be based on a judgment that there was a global liquidity need for such an increase. Quotas should not be increased for redistribution purposes. The U.S. authorities would remain firm on that position. Representation issues needed to be discussed in another fashion. She agreed with Mr. Callaghan that Korea was underrepresented in the Fund. But, ad hoc increases for a small number of countries would have to be taken from other countries' shares. In the process, countries that were currently underrepresented might become even more underrepresented. Therefore, it might not be fair to all the members. There were no simple solutions to the distribution and representation problems, and extending the period of the Twelfth Review for nine months would not resolve any of those issues in that time frame. Even in the absence of a quota increase, technical work on those issues, including on the quota formulas, could continue.

As regards the signal, apparently there had been no public announcement in December 2001 when the COW had been formed for the Twelfth Review, Ms. Lundsager recalled. During the four-year period prior to that, technical work on the quota formulas had already started. To close the current review and form a new COW or reformulate the existing COW would send a very confusing signal.

Mr. Yakusha said that, while he had some sympathy for Mr. Mirakhor's proposal, he also attached great importance to the clarity of the message. In that regard, the language of the report and the decision was important. He, therefore, supported Mr. Prader's suggestion that a draft text be provided for the consideration of Directors and their authorities. It was also advisable to postpone the Board's decision for a few days.

Mr. Wei said that he appreciated Mr. Mirakhor's efforts to forge a consensus and could support his compromise proposal, with a clear understanding that a COW would be created immediately. Although the Board was evenly divided, a majority—albeit narrow—did represent 15 Executive Directors. Their views should be heard by the outside world; that signal should be made clear to the public. He agreed with Mr. Callaghan that many of the outstanding issues, including ad hoc increases for a number of countries and the representation of developing countries in the Fund, should be addressed within the framework of a general quota increase. Those issues could not be solved in nine months.

Mr. Mirakhor responded that, in his compromise proposal, the decision that the Executive Board would submit to the Board of Governors would simply state that the Twelfth Review was completed. While the language of the summing up would be at the discretion of management, the summing up should contain at least two components: first, that a COW for the Thirteenth Review would be formed simultaneously with the completion of the Twelfth Review; and, second, that the staff would continue its work on the quota increase and related outstanding issues. That, in his view, was a transparent compromise.

The Acting Chair (Mr. Sugisaki) recapped that the essence of Mr. Mirakhor's proposal was that the Board completed the Twelfth Review and immediately formed a COW to start considering the Thirteenth Review, and that the staff would continue to work on outstanding issues relating to quotas.

Mr. Boitreaud stated that he too appreciated Mr. Mirakhor's effort to reach a consensus. However, he agreed with Mr. Callaghan's observation that Directors who were in favor of an immediate completion of the Twelfth Review would benefit the most from the consensus. Yet, their reaction—that they would accept the consensus so long as the completion was not followed by an immediate reopening of the discussions by the COW—

raised some skepticism about the possibility of having a consensus at all. This was indeed a divisive issue where, perhaps, one should not try to find a consensus.

Mr. Shaalan said that he fully agreed with Mr. Boitreaud's comments.

The Acting Chair (Mr. Sugisaki) noted that Directors had expressed their initial views on Mr. Mirakhor's compromise proposal, while some wished to have more time to reflect on the issue. He wondered whether Directors would agree to discuss Mr. Mirakhor's proposal within their constituencies and with their authorities before indicating their final positions, or their positions expressed at the current discussion would remain firm. So far, it appeared that there was not much change from the positions initially expressed on the staff proposal. If there was room for further reflection on Mr. Mirakhor's proposal, it would be advisable to postpone the decision for a few days. Mr. Brooke had expressed his view that a majority was a majority, suggesting that he would be comfortable with taking a decision on the basis of a slim majority.

Mr. Mirakhor remarked that a majority was a majority elsewhere but not in the Fund's Board where Directors always tried to arrive at a consensus. He asked that Directors consider any compromise proposal that might command broader support, not necessarily the one he had proposed. In the case of the transparency discussion, Mr. Bennett had come up with a compromise proposal on which a consensus had later been secured. His effort had been appreciated by every member of the Board as it had brought the Board closer together. The decision on quota issues was much more important than that on transparency, as quotas were the very core of the Fund. It would not constructive to report to the outside world that the decision on the current staff's proposal had been taken on a slim majority.

The Acting Chair (Mr. Sugisaki) reiterated that he was not comfortable with taking decisions on the basis of a slim majority—a feeling that was shared by many Directors. Therefore, a compromise was being sought. Mr. Mirakhor had made a specific proposal, and Mr. Prader had proposed a postponement to reflect on Mr. Mirakhor's proposal.

Mr. Prader stated that it was in fact Mr. Bennett who had suggested that a draft text be circulated for consideration. It might be useful to call a brief Board meeting in one week's time. Apparently, Mr. Mirakhor's compromise proposal could not command sufficient support. Still, it had provided some basis for further consideration.

Mr. Bennett said that he took Mr. Mirakhor's points with a great deal of caution. It would be useful to take a few more days to see whether a compromise could be forged, although that compromise, if found, might not be a comfortable one for half of the membership. Perhaps, Mr. Boitreaud was correct in expecting no such compromise. One of the key issues was when to officially start the Thirteenth General Review. There remained plenty of time and considerable room for taking that discussion, which would then send a signal to the international community that the Fund was determined to examine again the adequacy of its resources. The COW for the Twelfth Review had commenced only in the fourth year after the completion of the previous review. The effects of the signal varied with the date for starting the COW. The longer the delay, the stronger the signal to the international community would be that the Fund was satisfied with the overall level of its resources. Therefore, care should be taken when picking the appropriate time for the start of the COW.

The Acting Chair (Mr. Sugisaki) stated that, in his understanding, Mr. Mirakhor's proposal consisted of the following elements. First, the Twelfth Review would be concluded, with no mention of the formulation of a new COW in that decision. Second, a new COW would be formed immediately in a separate decision. Third, the COW would continue to receive reports from the staff on the quota increase and related issues. As far as the signal was concerned, it would simply be that the Twelfth Review was completed. Therefore, by taking two separate decisions, the concern over sending the wrong signal should be addressed.

Mr. Mirakhor confirmed that that was the correct interpretation of his proposal.

The Acting Chair (Mr. Sugisaki) asked whether Directors would agree to reflect further on Mr. Mirakhor's proposal as outlined above.

Mr. Lushin said that he had sympathy for Mr. Mirakhor's proposal and would invite other Directors to consider further how to forge a compromise. With regard to the Thirteenth General Review, it was not clear what type of action would be necessary to activate it. Would the Thirteenth Review be activated automatically after the Twelfth Review was closed or a special decision had to be taken?

The Treasurer (Mr. Brau) replied that, if the Executive Board decided to conclude the Twelfth Review and the Board of Governors voted and agreed with that proposal, then the period of the Twelfth Review would conclude by January 30, 2003. At that time, the period of the Thirteenth Review, which was a five-year period, would begin automatically. However, for the Executive Board's formal work on the Thirteenth Review to begin, the Board would need to reach a separate decision, needing a majority of the votes cast, on establishing a COW to work on the Thirteenth Review. That decision must be taken at a minimum twelve months prior to the end of the five-year period.

The Acting Chair (Mr. Sugisaki) clarified that the establishment of a COW did not require a resolution of the Board of Governors; it was an Executive Board decision. Thus, Mr. Mirakhor's proposal envisaged the completion of the Twelfth Review with the understanding that the Executive Board would agree to form a COW for the Thirteenth Review immediately after the decision on the completion of the Twelfth Review was adopted by the Board of Governors.

Mr. Zurbrügg wondered whether the reconstitution of the COW would be made public.

The Acting Chair (Mr. Sugisaki) responded that that fact would be published for the sake of transparency, but the extent of publicity was a separate issue.

Mr. Bennett asked whether a COW, once established as envisaged in Mr. Mirakhor's proposal, would be required to report to the Board of Governors within a specified period of time, or it would just have to report in time for a decision on the Thirteenth Review to be adopted by the Board of Governors by the end of the five-year period.

The Treasurer (Mr. Brau) responded that the COW formally reported to the Executive Board. Unless the COW recommended to the Board and the Board agreed to an extension of the period of the review, the review was concluded. There was no requirement for the COW to complete any work earlier than the end of the five-year period.

Mr. Bischofberger asked whether the Treasurer could confirm that the establishment of a COW immediately after the start of the Thirteenth Review did not call for any precommitment in terms of the results.

The Treasurer (Mr. Brau) confirmed that the establishment of a COW did not prejudge any result; the COW was free in its deliberations.

Mr. Wei stated that the COW should begin to work immediately. The Managing Director, in his capacity as Chairman of the COW, should call a meeting at the earliest convenience of the Board. While that needed not take place in a few days' time, it should not be delayed for too long.

The Acting Chair (Mr. Sugisaki) requested that Directors take a few more days to consider Mr. Mirakhor's proposal and provide feedback to the Secretary, which would then form the basis for the next step. The conclusion had to be reached quickly so that the report and the draft decision could be submitted to the Board of Governors in time for the conclusion of the Twelfth Review by January 30, 2003.

Mr. Brooke said that he agreed to the Acting Chair's proposal. It was not clear, however, whether a new text, as Mr. Prader and Mr. Bennett had suggested, would be forthcoming for Board consideration or Directors were asked to provide feedback based on the oral discussion at the Board.

The Acting Chair (Mr. Sugisaki) replied that further clarification was not deemed necessary.

The Treasurer (Mr. Brau) added that that would depend on the consultations and the feedback from Directors. If the feedback indicated some shift in positions, it would be open to Directors to consider submitting a revised text or at least options on a revised text to the Board, so that the Board could look at either the revised text or the options for a revised text at its next meeting.

Mr. Mirakhor suggested that the Secretary should formulate a decision that would be submitted to the Board of Governors based on the compromise proposal, and circulate that to Directors as soon as possible, together with a draft Chairman's summing up or Chairman's statement at the conclusion of the current Board discussion. He himself would be available for consultation, if need be.

The Acting Chair (Mr. Sugisaki) agreed to ask the Secretary to draft points of Mr. Mirakhor's proposal along the lines that he had earlier summarized. The draft resolution, based on Mr. Mirakhor's proposal, would not include any language on the formation of a new COW. There was an understanding that Board members agreed to act on the formation of a new COW, a decision that would be taken separately.

Mr. Prader asserted that, in order to be a true compromise, the proposal should contain some of the views expressed by Directors who had been skeptical of Mr. Mirakhor's proposal, including that on the Fund's liquidity position as the rationale for completing the Twelfth Review.

Mr. Mirakhor said that, while he appreciated Mr. Prader's suggestion, he would prefer to keep his suggested proposal unaltered to avoid sending confusing signals. Directors could then suggest changes based on his original proposal.

Mr. Andersen said that the public should be informed of the outcome of the Board discussion if a new COW would be established immediately. He wondered whether that would be mentioned in the summing up.

The Acting Chair (Mr. Sugisaki) responded that there would be no summing up or press release at the end of the current Board discussion. There would be a public statement when the decision was adopted by the Board of Governors, but that on the establishment of a new COW would only be made when that decision was taken by the Executive Board at a later date, possibly in February.

Mr. Bennett commented that, to be clear on the signal to the public, if the practice of the Twelfth Review were to be followed, the five-year period of the Thirteenth Review would start on January 30, 2003, and a new COW would have to be established by the end of January 2007 at the latest, allowing a four-year lapse before establishing a new COW. Mr. Mirakhor was suggesting that a COW be formed not in four years' time but immediately after the conclusion of the Twelfth Review, which would send quite an extraordinary signal to the public. It might be perceived as the Fund lacking confidence in concluding the Twelfth Review. A COW for the Thirteenth Review could be formed anytime within the four-year period; its timing was important in terms of the strength of the signaling effect. If the Board decided to establish a COW immediately as Mr. Mirakhor had suggested, then the COW should start work right away as argued by Mr. Wei. But if the Board were to delay the establishment of a new COW until two to three years later, that would send quite a different signal. If it were shorter than four years, it would distinguish the Thirteenth Review from the Twelfth Review in that the work on a quota increase would start earlier.

Mr. Mirakhor explained that, subject to confirmation by the Legal Department, his impression was that, irrespective of the past practice, any Executive Director could call for the formation of a COW; a decision required a simple majority. Therefore, if that majority—clear or slim—felt the need to form the COW, it could be formed any time. It needed not wait until four years from the closure of one review to start the next one.

The Acting Chair (Mr. Sugisaki) concluded that Directors agreed on the need to find a broad-based consensus on the quota issue. The current staff's proposal was not supported by a broad majority of Directors. He, therefore, requested that Directors further reflect on Mr. Mirakhor's proposal and provide feedback as soon as possible in the spirit of compromise. In addition to indicating whether the compromise proposal was acceptable, Directors might wish to suggest revisions to the staff's or Mr. Mirakhor's proposal or make their own proposals. It would be desirable if either of the existing two proposals could command wider support. Directors' further input into the process would be appreciated.

2. SINGAPORE—2002 ARTICLE IV CONSULTATION

Documents: Staff Report for the 2002 Article IV Consultation (SM/02/348, 11/8/02; Cor. 1, 12/5/02; and Cor. 2, 12/6/02); and Selected Issues and Statistical Appendix (SM/02/358, 11/21/02; and Cor. 1, 12/5/02)

Staff: Lee, APD; Kashiwagi, PDR

Length: 1 hour, 45 minutes

Ms. Indrawati and Ms. Sia submitted the following statement:

The Singaporean authorities would like to thank the IMF staff for the 2002 Article IV consultation. The discussions on recent developments and outlook of the Singaporean economy, and the perspectives afforded by the staff on short and longer-term policy responses were stimulating and insightful. This statement provides an update on the latest economic developments and discusses some of the views on policy issues raised in the staff report.

Economic Growth

The Singapore economy continued its recovery from the 2001 recession, with GDP growth expanding at a robust average rate of 11 percent in Q1-Q2 2002, on a quarter-on-quarter seasonally adjusted, annualized basis. The growth was led mainly by the manufacturing sector, which benefited from global inventory correction in the early part of the year, as well as capacity expansions in the domestic pharmaceutical industry. However, the growth momentum reversed sharply in Q3, with GDP falling by 10 percent, along with the deterioration in the external environment. This retraction in growth was broad based and reflected a weakening in both domestic spending and exports.

The domestic inflationary conditions remained benign, with the absence of external cost pressures and the slack in labor and product markets. Consumer prices declined by 0.4 percent (year-on-year) in both Q2 and Q3, and on a sequential basis, have begun to level off. For the year as a whole, CPI inflation is forecast to come in at between –0.5 percent and 0 percent.

Considering the weaker and more uncertain outlook in the global economy, the authorities have revised the Singapore GDP growth forecast for 2002 down to 2–2.5 percent from 3–4 percent. Growth is expected to remain weak in the first half of 2003, and the official growth forecast for 2003 is 2–5 percent.

The authorities welcome the staff's strong endorsement of the fiscal and monetary policy measures taken in response to the economic downturn in 2001.

Exchange Rate Policy

The Monetary Authority of Singapore (MAS) has adopted a neutral monetary policy stance since July 2001, with the policy band centred on a zero per cent appreciation of the Singapore dollar nominal effective exchange rate (S$NEER). In view of the benign inflationary environment, and to facilitate continued economic recovery, the MAS decided in Jul 2002 to maintain its current policy stance of a zero per cent appreciation in the S$NEER for the second half of 2002. This neutral exchange rate policy stance, coupled with the soft domestic interest rate environment, has resulted in easy overall monetary conditions throughout 2002.

The authorities welcome the staff's strong endorsement of the steps taken to increase the disclosure of its monetary policy stance and the transparency of the policy framework, particularly through the semi-annual publication of the Monetary Policy Statement (MPS) and the Macroeconomic Review. The latter provides further details on the authorities' assessment of macroeconomic developments as well as in-depth studies on various issues of interest. The authorities have also been more actively communicating its methods, forecasts and views to the media and the public, reaching out to its target audience through the website, seminars, briefings, and publications. The greater disclosure and transparency on monetary policy have been welcomed by market participants and the general public. Going forward, the authorities will continue to take steps to enhance transparency.

The authorities would also like to point out that the S$NEER policy band is sufficiently wide to accommodate the usual exchange market fluctuations and, within this band, the S$ exchange rate is freely determined by the market. The MAS only intervenes when there is significant impetus for deviation from the policy band. There is therefore little reason to suggest the potential for confusion between policy-induced movements in the exchange rate and market volatility. In fact, with greater understanding of the policy intent in the markets, the frequency of intervention in the foreign exchange markets has been sharply reduced.

Fiscal Policy

On the fiscal front, two off-budget packages amounting to 8.4 percent of GDP were announced in 2001, aimed at helping Singaporean households and businesses tide over the downturn. Coupled with the measures introduced in the FY 2002 budget, this resulted in an expansionary fiscal stance, which was assessed to be generally conducive to the current economic situation, and should deliver a moderate boost to real GDP in 2002.

The FY 2002/03 budget represents a balance between the need to improve competitiveness and attract global talent, and the need for fiscal prudence. Key initiatives to improve competitiveness include reductions in corporate and personal income tax rates, to attract and retain high-skilled workers, and boost corporate returns in the medium run. In line with the government's overall strategy to shift the tax revenue base more towards indirect taxation, the GST will be raised so as to offset the loss of revenue from the reduction in income tax rates. In addition, the corporate and personal income tax rates will be further reduced to 20 percent by the FY 2004/05 budget, barring a major change in the economic and political climate.

The authorities welcome the staff's endorsement of the government's overall tax strategy. They acknowledge the urgency of the tax reform, but note that the pace of tax reduction needs to be balanced against the need for fiscal prudence, given the necessity to ensure that the budget remains in balance over the medium term. The staff had also questioned the heavy reliance on direct income transfers instead of direct spending to boost the economy. The authorities would like to emphasise that the fiscal measures are directed at easing the burden of adjustment rather than using direct public sector spending to offset the retraction in exports, which represents up to 70 percent of aggregate demand in the economy. The measures—which include a comprehensive cost reduction package—should place the private sector in a competitive position to take advantage of a decisive turnaround in external conditions when it occurs. Finally, the authorities indicated their willingness and capacity to take further measures, should external developments take a turn for the worse.

On the issue of medium-term fiscal targets, the authorities would like to point out that while it could be desirable to publish such targets, there is less of a need to do so in Singapore, where there is a strong record of budget surpluses. The philosophy underlying Singapore's fiscal policy is the maintenance of modest surpluses over the medium term. Nevertheless, the authorities remain committed to transparency as a means to improve policy design and implementation of fiscal policy.

Economic Review Committee

Even as measures were put in place to deal with the cyclical weakness in the economy, the authorities also recognised the need to ensure that Singapore remains competitive in the medium to long term. To this end, the Economic Review Committee, comprising representatives from the public and private sector, was set up in November 2001 to fundamentally review Singapore's development strategy and formulate a blueprint to restructure the economy. The thrusts of the recommendations from the various sub-committees have been to enhance the competitiveness of the economy by reducing marginal tax rates and increasing the flexibility of the factor markets, deregulating and liberalising the industries, diversifying the manufacturing sector, developing the services sectors, and encouraging private initiatives.

The authorities recognise the negative impact that such economic restructuring might have on the labour market, and share the staff's concern that structural unemployment could prove to be a challenge for Singapore going forward. The authorities note the staff's recommendation of strengthening the social safety net, including through the introduction of an unemployment insurance scheme. However, the authorities are concerned that such a step might exacerbate the structural unemployment problem by creating incentives for possible erosion of the work ethic. Hence, Singapore's approach in this area will continue to be one of focussing resources on training and skills upgrading, community-based assistance to help families tide over periods of adjustment, and some government assistance for those with no other sources of help.

The staff commented that progress in divesting GLCs already designated for sale would send a strong signal about the government's intentions to boost entrepreneurship. The authorities would like to reiterate that the management of GLCs is strictly on commercial principles, and hence that government ownership of GLCs does not inhibit entrepreneurship on the part of the GLCs. The authorities also emphasised the government's fiduciary responsibility to obtain a fair price for the divested GLCs. More generally, the issue of encouraging entrepreneurship has to be assessed and tackled in a holistic fashion, which is why the various sub-committees of the ERC had focused their efforts on identifying where impediments to private sector enterprise could be removed and incentive structures strengthened.

Financial Services Sector

The development of the financial services sector is a key pillar of Singapore's diversification strategy. Significant liberalization measures for the financial services sector were first put in place in 1998, and the authorities have progressively introduced changes to enhance and strengthen the regulatory and supervisory framework. The policy on the non-internationalization of the S$ has also been substantially liberalized over the last few years, with two remaining safeguards which act as a deterrent against outright speculation against the Singaporean dollar. The remaining restrictions do not constitute an impediment to the development of the capital market in Singapore, and feedback from the private sector has been very positive about the liberalization. Hence, the authorities do not share the staff's view that these remaining restrictions could deter foreign investors from tapping the Singapore dollar markets. Nevertheless, the authorities will continue to review the policy, and do not rule out further liberalization at an appropriate time.

On the staff's suggestion that Singapore could further expand the distinctions in market conduct rules between wholesale and retail market activities, the authorities felt that the existing regime, as fine-tuned by the introduction of the Securities and Futures Act and Financial Advisers Act, which came into effect in October 2002, already differentiated these activities to a considerable extent.

The authorities disagree with the staff's assessment that Singapore's high capital requirements for local banks could have led them to engage in riskier lines of business. The Basel Committee of Banking Supervision has emphasised that the 8 percent Capital Adequacy Ratio (CAR) computed under their rules is a minimum that is only appropriate for diversified and well-managed banks. In recognition of this, several supervisors around the world require, where appropriate and on a supervisory basis, banks to maintain CARs in excess of 8 percent. Many international banks also voluntarily maintain CAR in excess of 8 percent. In fact, the risk profile and capital levels of any bank are largely dependent on the strategies and risk appetites of its managers. Under the risk-insensitive 1988 Basel Capital Accord, banks with higher risk appetites may already pursue higher risk businesses at no higher capital cost. The higher 12 percent minimum regulatory capital requirements in Singapore takes into account the riskier geographic region that our banks operate in, and in fact hinders banks from taking excessive risks relative to their capital base. It is not apparent that this requirement has led banks into indiscriminate investment into riskier lines of businesses. Banks are generally prudent in their business practices, and have voluntarily maintained CAR levels in excess of the 12 percent regulatory minimum for many years, even during stress periods for the credit and other markets that they operate in.

In addition, the staff cited the high exposure of banks and insurers to property sector as another source of risk, noting that more than 40 percent of the domestic loan book (and a similar share of insurance company assets) are directly or indirectly exposed to the property market. The authorities would like to clarify that the bulk of this 40 percent share of property loans are made up of home mortgages, which historically carry much lower risk, while only 10-15 percent of the loans are extended to property developers. In addition, given the tightened credit standards and the strong financial standing of property developers, the authorities believe that credit risk from this sectoral concentration is low.

On statistical issues, it is worth noting that Singapore has complied fully with the Special Data Dissemination Standard (SDDS) prescription on the dissemination of national accounts estimates. While the priority has been on the compilation of quarterly output-based GDP estimates, which is among the timeliest in the world, Singapore will continue to review and improve the compilation and dissemination of our national accounts estimates, including quarterly expenditure-based GDP estimates. In addition, an inter-agency committee headed by the Ministry of Trade and Industry–The Statistical Advisory Committee–has been set up recently to conduct a thorough review of the statistics in Singapore as well as the resources allocated to this area.

On the issue of anti-money laundering and combating the financing of terrorism, the authorities would like to inform the staff that the Parliament has enacted the Terrorism (Suppression of Financing) Act, to give effect to the UN International Convention for the Suppression of the Financing of Terrorism. Singapore is expected to ratify the Convention before the end of this year, and the Act will be brought into operation thereafter.

The authorities would like to put on record their appreciation of the staff's efforts during the consultation. In particular, the staff's critical assessment of Singapore's economic fundamentals and the authorities' policy responses to structural challenges are greatly valued.

Mr. Reddy submitted the following statement:

We thank the staff for a set of well-written documents and Ms. Indrawati and Ms. Sia for their helpful statement. The Singapore authorities have faced a challenging environment since the last consultation with external shocks leading the economy into a recession in 2001 after its earlier sterling performance. In such a situation, the authorities are to be commended for their skilful macro economic management of the economy including the accommodative policy response, which has encouraged the ongoing recovery. However, with external demand unlikely to improve substantially in the near term, and the possible impact of the regional situation on investor confidence, this trade-dominated economy continues to face challenges.

The intention of the authorities to proactively respond to this situation is clearly reflected in the mandate of the ERC as well as the recommendations of the sub committees, which have already submitted their reports. We support the policy intentions to diversify and upgrade manufacturing activities, develop the service sector, and enhance human capital. The recent reduction of personal and corporate income taxes will improve the attractiveness of the business environment and effectively compete for FDI flows. The switch to the offsetting indirect tax increase broadens the tax base and anticipates future pressure on direct tax revenue arising from demographic changes. Even though a lowered budget surplus is expected next year, the authorities' willingness to consider providing additional fiscal stimulus if warranted is appropriate, given their medium term objective of maintaining a balanced budget.

We commend the steps taken by the authorities to improve the disclosure of its monetary policy stance. On the suggestion to further amplify this stance, we agree with the authorities that they need to maintain their policy flexibility by not committing to explicit targets as well and refraining from providing details underlying the management of the exchange rate.

Given the structural changes the economy, and the increasing emphasis on high value added industries, the unemployment rate and the nature of unemployment needs to be closely monitored. While the emphasis of the authorities on retraining and improving the efficiency of the job search is appropriate, we urge the authorities to consider the staff suggestions regarding strengthening of the social safety net, while simultaneously avoiding an adverse impact on work incentives.

We wish the authorities all success in their challenging policy endeavors.

Mr. Portugal and Mr. Rambarran submitted the following statement:

Singapore had been enjoying a favorable economic performance in the 1990s and weathered well the Asian crisis due to strong fundamentals and skillful policies. However, Singapore last year experienced its most severe recession since independence as the global slowdown took a heavy toll on the dominant technology sector, particularly in electronics manufacturing. Real GDP growth contracted sharply and job cuts pushed the unemployment rate to a historical high. The authorities responded with sizable fiscal stimulus and monetary easing to cushion the impact of the large downturn, and the economy appears set to recover moderately into next year. This generally encouraging outlook, however, remains clouded by the uncertainties associated with the on-going world recovery and the evolving security situation in the region and the Middle East.

At the same time, the authorities are reacting to regional competitive pressures that threaten to diminish Singapore's long-standing role as a hub in Southeast Asia. An Economic Review Committee has produced a long-term strategy to move away from the corporatist state model that has been Singapore's hallmark for the past four decades to a more entrepreneurial one, driven by creativity and innovation. We commend the authorities for their pragmatic approach to dealing with the twin challenges of a sharp cyclical downturn and structural changes to enhance Singapore's role as a regional hub.

We support a more vigorous use of counter-cyclical fiscal policy than in the past. The two off-budget packages in 2001 and the new measures in the FY 2002/03 budget would impart a substantive stimulus to demand. Given the strong fiscal policy track record and substantial financial position, there is ample room for further fiscal easing, if necessary, while maintaining a balanced budget over the medium term. Such commitment by the authorities, as indicated in Ms. Indrawati and Ms. Sia's helpful statement, assures the public and financial markets that the government's longstanding tradition of fiscal prudence is not at risk. We support staff's call to consolidate and strengthen the social safety net system so as to help ease the burden of ongoing restructuring, particularly among low-skilled workers where structural unemployment is high.

We welcome the easing of monetary conditions since last July when the Monetary Authority of Singapore (MAS) shifted to a neutral stance to support economic activity. Given the benign inflation outlook and the strong external position, we believe there is room for further monetary easing, if economic conditions deteriorate. We commend the MAS for its recent initiatives to improve the transparency of its exchange rate-centered monetary policy framework, and welcome the valuable comments by Ms. Indrawati and Ms. Sia relating to disclosure and transparency of the exchange rate policy band.

The authorities have been implementing a comprehensive program of reforms in the securities, insurance, and banking sectors to strengthen Singapore's position as a financial hub. We welcome the initiatives to broaden and deepen capital markets, to further open the domestic banking system, and to eliminate restrictions on the international use of the Singapore dollar. The MAS is also moving towards risk-based supervision and disclosure-based regulation. We recognize that financial liberalization poses new risks and creates new sources of vulnerability. We are pleased that Singapore's financial system has been resilient in the aftermath of recent global and regional financial disturbances, and look forward to the results of the FSAP. Perhaps the staff could provide some details on the proposed establishment of a deposit insurance scheme.

A growing and prosperous China and its entry into the WTO should be seen as an opportunity for increased bilateral and regional cooperation rather than as a threat to Singapore's role as a regional hub. Box 3 of the staff report shows that Singapore's exports to China, Taiwan-Province of China and Hong Kong, SAR have more than tripled in the last decade, and currently exceed exports to the United States, its largest overseas market. A growing Chinese middle class is also a potential market for health care, education, and financial services.

We encourage the authorities to cushion the Singaporean economy from the very dynamic but volatile electronics sector by broadening the manufacturing base and sustaining attempts to deregulate and open up the banking, telecommunications, and power sectors. The private sector has a very strong potential for employment creation and growth. Similarly, the government-linked companies (GLCs), which dominate the commanding heights of the Singaporean economy, have contributed to Singapore's economic success and some could even become global powerhouses. We welcome the plans to strengthen entrepreneurial incentives, including partnerships among GLCs and divestment of non-strategic GLCs, which appear to strike an appropriate balance in allowing more competition into the market.

In conclusion, we wish the authorities well in their challenging endeavors.

Mr. Le Fort and Mr. Costa submitted the following statement:

Singapore's economy is truly impressive. Leaving aside the impact of external developments, the Asian crisis and the 2001 global slowdown, which led to relatively shallow recessions in Singapore, GDP growth has been consistently quite high. GDP growth in 2000 was 10 percent and the current account surplus 17 percent of GDP, which widened to 21 percent of GDP during the recession year of 2001, concomitant with a gross national savings rate of 54.5 percent. In addition, the strong fiscal position of the past allowed the authorities to react firmly to the 2001 downturn with fiscal stimulus packages amounting to 8½ percent of GDP. Notwithstanding such a strong fiscal effort, the overall fiscal position for 2001 and 2002 remained in surplus.

The staff makes a commendable effort in drawing possible scenarios in which the strength of Singapore's economy could be challenged. Paradoxically, the foremost risk stems from likely favorable developments in China that may transform the largest Asian country in competitor of tiny Singapore. Redirecting, among other things, foreign direct investment and the associated technology transfers that may be instrumental in building comparative advantages in capital-intensive production. Without disregarding the potentially adverse consequences for particular Singaporean industries, we believe that China's more intensive trade integration through its accession to the WTO creates other opportunities for growth and other benefits that could more than compensate negative effects.

However, in the short-run, as it happens with almost all open economies these days, the outlook for the Singaporean economy is weak and very much linked to the prospects for the recovery in the world economy at large and more specifically, to that of the U.S. economy. Thus, no matter how sound domestic policies are, it may still be difficult to withstand the impact of negative external factors such as a generalized loss of confidence that has negatively impacted equipment investment throughout the world. An indication of the new times is the weaker recovery that is taking place now, after the 2001 slowdown, with a projected growth this year of 2 to 2.5 percent and of 2 to 5 percent for 2003 vis-à-vis the one that took place in the following two years after the Asian crisis: 6.9 percent and 10.3 percent respectively. There is little the authorities can do to in the short-run to cope with these factors. However, they seem to be prepared to react promptly to the medium-term challenges of a more competitive international environment, as it transpires from the strategic reforms recommended by the Economic Review Committee (ERC). Before briefly assessing these reforms we will now turn to macroeconomic policy issues.

On fiscal policy, looking at the measures described in Box 1, there is a matter of concern that around a third of the total amount of the stimulus packages, covering larger expenditures and lower revenues, was represented by a boost to infrastructure projects. Item that was larger than the sum of taxes and fees rebates and the assistance to local enterprises. We are unaware of the infrastructure needs in Singapore but given the Japanese experience we are hesitant to grant the benefit of the doubt to the effectiveness of such expenditures. The question is to what extent these infrastructure expenditures will be able to increase the profitability of private sector projects and thus private investment? The staff's comments would be welcome.

In addition, the fiscal strategy by which personal and corporate income tax rebates are expected to be compensated by an increase in the GST tax contains some risks. The tax rebates may no be enough to elicit the expected supply-side response, given the tax competition policies prevailing in the region. Thus, the GST increase may be more recessionary than expected which, coupled with the wage restraint policy in place, may lead to intensified deflationary pressures.

Monetary policy, in turn, was also eased in the face of the 2001 downturn, through the flattening of the usual appreciating trend of the trade-weighted exchange rate index and through lower domestic interest rates. The staff is right in presenting this as a welcome break with a rigid policy stance determined exclusively by the outlook for the medium-term and we join them in praising the pragmatism of the authorities. Nonetheless, the authorities made it clear that their change of approach is only transitory, we hope that a prompt economic recovery will let them return to their cyclically neutral policy framework.

Inflation has hovered at very low levels, averaging 0.7 percent a year and there have even been incipient signs of deflation. We hope that the knowledge drawn from staff studies included in the selected issues paper may also be helpful to prevent deflation. In addition, we welcome the authorities' continued improvement of the disclosure of its monetary policy stance, particularly through the introduction this year of the Macroeconomic Review in their semi-annual Monetary Policy Statement and support staff's call for further progress in transparency.

Regarding the reforms recommended by the ERC, the pension and housing reforms have been given particular attention in the report. The housing sector plays a significant role in Singapore given the widespread home-ownership. Freeing up that capital through ways that make homeowners' equity available for investment opportunities or smoothing consumption seems a worthwhile undertaking. The staff mentions the risk of greater volatility propagating through the property market but presents some reassuring considerations. In any event, we were somewhat surprised that given the high concentration of loans in the real estate sector, the non-performing loan ratio of the banking system has reached 8 percent in June 2002. We wonder if some signs of structural weaknesses in the real estate market may be there even before the new norms are put into place. The staff's comments would be appreciated.

The ERC recommendations for the service sector aim at further developing financial services and information-communication-technology. We share the thrust of the ERC's views on financial services and find convincing the reasons offered by the authorities to leave in place the two remaining restrictions. Among other services, it is worth noting the recommendation to enhance Singapore's human capital through arts, culture, sports and recreation. It is also important that those good dispositions find an institutional environment that allows for the full realization of the renewed potential. In this regard, we would like to emphasize the importance of restructuring the government-linked corporations. We share staff's advice to accelerate the timetable for reducing government ownership in GLC, but we would like to hear more on what are the actual intentions of the authorities in this regard. In addition, we would appreciate additional staff comments on their assertion that privatization could reduce potentially conflicting objectives of maximizing shareholder value and meeting national development needs.

Finally, on the labor market, the continued rise of long-term unemployment is a revealing sign of the impending structural weaknesses; the authorities, as it transpires from the comprehensive statement of Ms. Indrawati and Ms. Sia, are fully aware of the importance of this development not only from the point of view of the Singapore economy's efficiency and competitiveness but also regarding social consequences. We support the authorities' view that the best way to face the latter problem is through active labor policies aimed at retraining and facilitating job search while addressing specific social needs through community-based assistance rather than through the introduction of an unemployment insurance scheme.

Mr. Shaalan and Mr. Bakhache submitted the following statement:

We would like to thank the staff for a succinct presentation of recent economic developments and the generally pragmatic approach to assessing economic policy in Singapore. The topics in the selected issues paper are also timely and pertinent as they reflect some of the key policy issues that need to be addressed in the period ahead.

Singapore's economic performance has been exemplary not only during good times but also during some of the most challenging periods in the country's recent history. As was the case during the Asian crisis, which was, by and large, skillfully weathered, the authorities have been taking commendable actions to address the recent recessionary conditions surrounding this small and open economy.

With a history of prudent macro economic policies and well thought out and forward looking structural reforms, Singapore has become one of the most stable and resilient economies in the region. While growth has varied pretty much in tandem with developments in other countries in the region and expectedly so, Singapore has managed to maintain positive growth rates with the exception of a relatively short period of time in 2001, attributable mainly to the drop in demand for electronics exports. The economy's resilience is evidenced by the relatively low level and variability of consumer price inflation and the maintenance of strong fiscal and current account surpluses even during times of economic declines. The real effective exchange rate has shown an impressive stability throughout the second half of the 1990s. All these factors keep Singapore in an enviable position relative to other countries in the region. This financial stability is commensurate with Singapore's role as a leading financial center in the region and we welcome the high premium the authority continues to place on it.

Against this background and in spite of the downside risks that could dampen the short-term outlook, it is difficult to identify sources of significant vulnerability in the Singaporean economy. The uncertainty facing Singapore is associated primarily with the risks arising out of the delayed global recovery, particularly in the country's major export markets. Another main risk, not only to Singapore but for many other countries, stems from a possible attack on Iraq, which we presume is what staff has in mind with the reference to political instability in the Middle East, and its repercussions on oil prices, global demand, and investors' confidence.

With regard to the issue of vulnerabilities, Singapore is actually well positioned to address the short-term challenges without jeopardizing the country's financial stability. The challenges, in our view, are centered on ensuring that the momentum of the recent recovery does not falter. Given the present macroeconomic policy mix and the combination of the strong fiscal position and outlook along with the likely limited effectiveness of monetary policy, it seems that the burden of further macroeconomic easing should mostly fall in the fiscal area.

The conduct of monetary policy has been quite appropriate, and like staff, we support the shift to a neutral stance. At the same time, we tend to agree with the authorities that given the limited extent to which monetary conditions can affect the real sector, further monetary easing is not likely to lead to much increase in economic activity. In fact, there is already a high degree of liquidity in the banking sector and there does not seem to be merit for increasing it further.

While aiming at price stability in the context of the medium-term orientation of the monetary policy framework, the authorities have to be mindful of the potential for deflation in the economy. In this regard, while some countries in the region are still facing some inflationary pressures, these pressures, broadly speaking, have been declining, and a number of other countries have entered a deflationary phase. Given the economy's high degree of openness, the possibility of deflationary pressure in Singapore is not remote and should therefore be examined. The staff report makes a passing reference to this issue in the context of the discussion of factors that will likely keep inflation low.

On fiscal policy, we very much support the fiscal stimulus in 2001. The emphasis on supply-side measures through cost reduction to help boost competitiveness, however, this may not be enough to generate the needed stimulus in the economy. In addition, the staff is right in questioning the efficacy of income transfers at a time when risk aversion throughout the economy is prompting higher precautionary savings. Given the large fiscal surpluses that have characterized fiscal policy over the past years, we believe there is ample room to implement policies directly aimed at stimulating domestic aggregate demand. Such counter-cyclical policy is an appropriate means of minimizing output fluctuations by offsetting the decline in external demand associated with the global slowdown.

Moving to medium-term issues, it is also clear that the economy is also in a good position to take on the challenges posed by the changing regional environment and its implications on Singapore's comparative advantage. In this regard, we wonder whether there is an estimate of the cost of the strategic reforms suggested by the Economic Review Committee. While some of the tax measures have already been implemented and accounted for in the budget, it would be interesting to examine the manner in which the cost of other measures would be absorbed or financed. We generally support the ongoing reforms including restructuring industries and the strengthening of high value added sectors that rely on skilled labor. Here, however, we believe it is important to avoid the potential distortions that supply-side reforms may create in the process of reorienting economic activity in the country.

With regard to government-linked corporations and government ownership in them, we are sympathetic to the authorities' position not to rush privatization of its holding in these corporations. The potential conflict between maximizing shareholder value and meeting government national objectives exists, but does not provide reasonable ground to accelerate privatization in an environment of weak investor interest. In any case, the government has amply shown its good judgment and prudence in this regard.

Mr. Mirakhor submitted the following statement:

While the economy appears poised for a moderate recovery this year, Singapore's medium-term prospects will depend on the authorities' ability to restructure and develop new industries in line with the recommendations of the ERC.

In the fiscal area, the pace of tax reductions needs to be balanced against the requirements of fiscal prudence and budget balance over the medium term. Nevertheless, given the government's record on fiscal management, further fiscal action is possible if circumstance warrant it.

We welcome the recent initiatives on disclosure of the monetary policy stance, which could serve as a platform on which to anchor expectations on macroeconomic fundamentals with a reinforced forward-looking orientation.

While the GLCs have been historically successful, we encourage the authorities to increase private ownership in them and divest those designated for sale as market conditions permit.

The authorities' reluctance to institutionalize a welfare apparatus in the labor market is understandable. However, strengthening the social safety net should remain an option if the present system should come under strain.

The authorities' intention to review the policy on the two remaining restrictions on the international use of the Singapore dollar at an appropriate time is welcome.

We thank staff for a well-written report and Ms. Indrawati and Ms. Sia for an illuminating statement. After suffering a sharp cyclical downturn—which was exacerbated by the turmoil in export markets in the wake of events of September 11—the Singapore economy appears poised for a moderate recovery this year, thanks in large part to the prompt implementation of supportive macroeconomic policies. Nevertheless, solidifying the nascent recovery remains a challenge in the near term, given the downside risks from the continued uncertainties about the strength and durability of the global recovery. Over the medium term, the economy's growth trajectory will importantly hinge on the authorities' commitment to restructure and diversify the economy in line with the recommendations of the Economic Review Committee (ERC). In the light of the authorities' track record, there is every hope that Singapore will meet the challenges being posed to its traditional role as a regional hub.

The relatively modest outlook for real GDP growth in the near term would seem to suggest that macroeconomic policies should maintain their present “easing bias”. The two fiscal stimulus packages announced last year provided timely support to aggregate demand while boosting competitiveness and profitability. Looking ahead, staff seems to be somewhat concerned that the scheduled increase in the GST in 2003 could exert a drag on the recovery and feel it should be made conditional on the recovery being firmly on track. The staff is also concerned that the hoped-for benefits from some of the tax measures may be slow to materialize, and urge a faster phase-in of tax cuts. While there may be merit in staff’s advice, as Ms. Indrawati and Ms. Sia rightly underscore, the pace of tax reduction needs to be balanced against the requirements of fiscal prudence, given the importance of ensuring budget balance over the medium term. In any event, the government’s long-standing reputation for fiscal prudence would appear to accord it the flexibility and room for further modest fiscal action should circumstances warrant it.

Monetary policy remains appropriately supportive of a recovery in activity and we concur with the authorities that the present policy stance should be maintained while being vigilant to the need for a further easing if the recovery should falter. We welcome the recent improvements in the authorities’ disclosure policy in the context of the semi-annual Monetary Policy Statement and Macroeconomic Review. While these initiatives have helped foster public understanding of policy intentions, they could serve as a platform to reinforce monetary policy’s forward-looking orientation, anchor expectations on economic fundamentals, and shift the focus away from potentially volatile developments in the exchange market.

In the structural area, the pace and character of industrial restructuring and its likely impact on the labor market presents the authorities with difficult challenges. Ms. Indrawati and Ms. Sia say that the continued management of government-linked corporations (GLCs) does not run counter to the government’s intentions to boost entrepreneurship since the management of GLCs is in accordance with strictly commercial principles. Given the historical success of GLCs, their argument would appear to have weight. Nevertheless, we encourage the authorities to increase private ownership in GLCs to help boost efficiency and divest those already designated for sale as market conditions permit. The authorities’ approach to dealing with labor market disruptions in the wake of ongoing industrial restructuring is to focus resources on re-training and improvements in the efficiency of job search as opposed to “institutionalizing a welfare apparatus”. We support this approach. However, consideration could be given to strengthening the social safety net, including through a limited unemployment insurance scheme, if the present system is seen to come under strain.

Singapore’s financial system has been resilient in the face of the recent economic downturn with manageable and low risk exposure and continued efforts to refine its risk-based supervisory framework. We look forward to the completion of the FSAP, which should afford an opportunity to examine financial stability issues in greater detail. As the country positions itself in the changing global financial system, the staff questions the need for maintaining two restrictions on the international use of the Singapore dollar. While Ms. Indrawati and Ms. Sia note that these restrictions serve as safeguards against speculation and do not impede the development of the capital market, we welcome the intention to continue to review the policy with a view to further liberalization at an appropriate time.

Mr. Ondo Mañe submitted the following statement:

We welcome the indications of economic recovery in Singapore from the 2001 recession caused mainly by the global slowdown and the low demand in the electronics sector. The authorities have used macroeconomic policies judiciously to help the recovery. Despite the fact that the economic indicators may appear less bright by Singapore's standards, overall economic performance can be described as good, as the Singaporean authorities have always managed their economy very well, and have always followed the right policies. This is again shown by the strategy that they have developed to ensure that Singapore meets the new challenges that they face and that the economy remains dynamic and prosperous. We strongly commend the authorities for their approach.

We share the thrust of the staff appraisal. However, we would like to comment briefly on: (i) fiscal policy; (ii) monetary and exchange rate policies; (iii) and structural reforms.

Fiscal Policy

The fiscal stimulus packages introduced in 2001 have been timely to respond to the recession, and we agree that policies for the near term should maintain their easing bias. We also support the tax reform recommended by the ERC. We agree that the tax cuts envisaged will help to improve competitiveness, and attract and retain the high-skilled workers on which Singapore relies. However, we wonder if staff could comment on the revenue effects of these measures, over the medium-term. Do they view these measures as helping to improve production, and lead to an increase in employment, which appears to be an important objective of the authorities?

Monetary and Exchange Rate Policies

We commend the authorities for their prudent monetary policy stance that aims at preserving price stability and maintaining an exchange rate compatible with the external conditions. The publication of Monetary Policy Statement (MPS) and the Macroeconomic Review (MR) by the monetary authorities is also an encouraging step to help the market participants forge their expectations and decisions.

Singapore's exchange rate has served the authorities well and has demonstrated some resilience during the Asian crisis. The authorities have indicated that the exchange rate band is sufficiently wide to accommodate the usual exchange market fluctuation, which we can support.

Structural Reforms

Although the policy developed for many decades have allowed the Singaporean to be owner of their home, the pension and housing system need to be revamped. ERC has recognized a need for change for the system to adapt to modern financial organization. To this end, we welcome the decision to shift mortgage financing of Housing Development Board (HDB) properties to private banks. We also encourage the authorities to consider ways to allow HDB flats to be used as collateral.

The government has recognized the need for a disengagement from state-owned enterprises to allow these companies to improve their efficiency and expand internationally. While it is encouraging, we concur with the government's prudent approach, in order to obtain fair prices for the GLCs. We also urge the authorities to set an appropriate regulatory framework to entice more competition that could benefit consumers.

We encourage the authorities to enhance further the labor market flexibility to maintain the country's competitiveness. In view of the relatively high unemployment rate, we concur with the staff that the government should consider strengthening the social safety net. We also share the view that reforms should be directed at encouraging unemployed people to seek re-employment. We urge the authorities to persevere in their approach to concentrate resources on re-training and improving the efficiency of job search.

Singapore has a well-regulated and strong financial system. However, for Singapore to maintain and further increase its role as a Global Financial Center, given the complexity of new financial instruments and the generalization of off-balance-sheet activities, the authorities need to reinforce the supervision of risk-based institutions. We welcome the authorities' participation in the FSAP, after subscribing to the SDDS, which is a very good step towards improving transparency.

Ms. Lanza made the following statement:

After surging by more than 10 percent in 2000, GDP growth in Singapore declined by 2.0 percent in 2001, due to a global slowdown, which has resulted in a collapse in electronics exports, a sharp inventory correction and a severe contraction in fixed investment. In 2002 Singapore is thus confronting the task of getting the economy back on an expansionary track. With a global demand for electronic products still languishing, growth had to come from diverse sectors in the economy, and so has in fact happened, as the first semester of the year has been characterized by a revive of the chemical cluster and a deepening in pharmaceutical exports which however has not proved to be long-lived. The third quarter GDP estimates have in fact indicated a sharp slowdown in the economic momentum. Singapore is therefore facing the delicate challenge of revamping the economy through the developing of new industries and the skilful management of its comparative advantages. As we broadly agree with the thrust of the staff appraisal, we will limit ourselves to a few comments for emphasis.

Macroeconomic Policies

Policy responses to the cyclical downturn have proven to be appropriate and launched with a careful timing. The Singaporean authorities have, in fact, switched their monetary policy stance from restricting to neutral, thus easing monetary conditions and supporting domestic demand, and fiscal stimulus has been in place since mid-2001. Although much of the stimulus could still be in the pipeline, private consumption and investment have not yet responded very favorably. In particular, gross fixed capital formation in the third quarter has proven remarkably weak, showing a contraction of almost 13 percent compared to the previous year. We thus share staff's concern that the phase-in of tax reductions may be too slow and prove not to be sufficient to encourage risk-taking entrepreneurship and attract foreign investment, particularly at a time in which competition from China and other regional neighbors is rapidly intensifying and most multinational companies are increasingly de-localizing productions in fiscal and labor-cost most competitive countries. Moreover, fast rising in the unemployment rate at 4.8 percent, a figure unprecedented in the country since the mid-eighties, may jeopardize some of the fiscal stimulus, steering precautionary savings. Stimulating the domestic industry and attracting investment through the enhancement of the country's competitiveness will thus be the only way to fully capture the benefits of the overall fiscal strategy. The authorities have clearly been very active on these grounds, as they have designed a new strategy aimed at improving competitiveness and encouraging private initiatives, while strengthening the service component of the economy and promoting internationalization.

A New Growth Paradigm

The road ahead may prove a challenging one at a time in which Singapore's role as a regional hub is increasingly disputed by its low-cost regional competitors and by the increasing importance of China in the world business panorama. Together with the appropriate macroeconomic policy mix it will be crucial that Singapore reap the benefits of its comparative advantages in maintaining a leading role in the region. We find the authorities' idea of robustly developing the service sector with a particular emphasis on financial and legal services, education, healthcare, the arts and trade and logistics a compelling one, especially when we look at it within a context of the economics of urban agglomeration. This may prove a useful perspective because the factors that drive growth in modern urban agglomerates are fundamentally different by the ones that drove traditional economies. New models of spatial economics suggest that certain types of urban agglomerates may enjoy increasing returns of scale which reverse the perspective on the usual considerations of cost competitiveness as the role played by large cities such as London or New York in leading innovation and shaping consumers' tastes compensates for the costs of congestion because the process of agglomeration and interaction generates externalities that produce tangible economic value. As recently underlined by a Deutsche Bank report the success of Singapore in bridging over its traditional specializations in electronics to establish its role as an innovation-generating and consumers' hub will impinge not only in its ability to reduce taxes to attract investments and human capital but fore mostly in the concurrent process of reforms the authorities will be able to carry out in the financial sector, in housing, in the pension system and in property finance. Of course, the whole attempt is not without risks and the authorities should place a great attention in carefully substantiating their strategy as investors are becoming increasingly skeptical towards knowledge-based economies after the dot-com bust. Moreover many experiences of "planning" an innovative/creative center have failed, as it has been the case with many science and technology parks. However, Singapore has all the elements to make this a successful story: human capital, cultural diversity, openness towards attracting foreign talents, and a new cultural center.

We therefore believe that the authorities are well placed to make the leap and wish them every success in this challenging endeavor.

Mr. Ísleifsson made the following statement:

I would first like to thank the staff for a well-written report and the selected issues paper. I am also grateful to Ms. Indrawati and Ms. Sia for their informative statement.

The Singaporean authorities have shown in recent years their skill to successfully weather economic storms and to secure satisfactory economic performance. I believe that Singapore has proved that a small and open economy can perform well in times of global uncertainty.

As I broadly share the thrust of the staff appraisal, I would like to comment only on few points for emphasis.

First, I share the concern of the staff and the authorities that the Singaporean economy is too narrowly based and that structural reforms in the direction of increased diversification are needed. I welcome the creation and first proposals of the Economic Review Committee. The implementation of these reforms should maintain the high level of competitiveness of the Singaporean economy, which, according to the recent World Economic Forum is ranked as number four in the world.

Second, I support the authorities' recent fiscal and monetary measures that have helped the economy to recover from a sharp cyclical downturn. I welcome the improvements in the disclosure of the monetary policy stance but I believe that more can be done in improving the transparency of the monetary and fiscal policy framework. I do not share the authorities' view that Singapore's strong record of budget surpluses lessens the need to publish the medium-term fiscal targets. To be quite frank, I fail to see a link between budgetary outcomes and transparency. In this context, I would also like to urge the authorities to publish the staff report and to consider a preparation of a fiscal ROSC.

Third, while agreeing that the Singaporean bank system in general seems to be strong, I have some concerns towards the level of non-performing loans and the exposure of banks and insurers to the property sector. I look forward to the results of the ongoing FSAP, as I believe that Singapore's status as an important regional financial center increases the importance of a thorough FSAP exercise.

With these remarks I wish the authorities every success.

Mr. Dohlman made the following statement:

The authorities have demonstrated sound management of the Singaporean economy over the past two years, as the country has faced both cyclical and structural economic challenges. We commend the authorities for implementing significant fiscal stimulus packages in 2001 and 2002, particularly tax relief for households and measures to lower business costs. These policies were an appropriate response to the worst recession in the country's history. Part of the fiscal stimulus package included the New Singapore Shares program, which aims to distribute 2.7 billion Singapore dollars in dividend-paying shares to all Singaporeans, as described in Box 1 of the staff report. We would be interested in the staff's assessment of this specific program.

Looking forward, the staff suggests that the sales tax should not be increased in January 2003 unless a recovery has clearly taken hold. Given that this is now less than a month away, and that recent data seem to be mixed, we believe that an immediate increase in the sales tax would be premature and should be delayed.

Despite calls for fiscal transparency in the 2001 staff report, progress in this area has been limited. The 2001 report also noted that disbursements from endowment funds were not being reported as a component of expenditures, and that no information was available on the stock of government foreign assets. Is this still the case? We agree with the staff's recommendation that the authorities should publish a medium-term budgetary framework, including fiscal targets, and we believe that this measure is unlikely to harm the authorities' credibility. We also urge them to undertake a fiscal ROSC.

We commend the steps that the authorities have taken to improve the disclosure of their monetary policy stance. However, as the staff suggests, they must do more to clarify the monetary policy framework—including through the disclosure of more of the monetary authority's research and analysis—in order to allow market participants to better understand how medium-term trends and other developments affect price stability.

Regarding AML and CFT issues, as described in Ms. Indrawati and Ms. Sia's statement, Singapore as been very supportive of international efforts to block the funding of terrorism. We commend Singapore for its actions in this area, and urge the authorities to continue to play a leadership role in the Asian region.

Regarding long-term structural issues, the Economic Review Committee has been innovative and bold in its preliminary analyses and recommendations. We look forward to the ERC's final report, and urge the authorities to incorporate these findings into their economic policies without delay. We have long urged the authorities to accelerate the divestiture of state holdings in government-linked corporations (GLCs). We are encouraged by the fact that both the ERC and the Fund agree that the divestiture of state-owned shares in GLCs would strengthen the private sector and support entrepreneurship in Singapore. Given the urgent need to promote entrepreneurship, we hope that the authorities will take bolder action in this area.

The authorities have made commendable progress in recent years toward liberalizing and consolidating the domestic banking system, and in removing restrictions on financial flows, as described in the Selected Issues paper. We agree with the staff that the monetary authorities' efforts to improve their risk-based supervisory framework will foster a more efficient and diversified financial sector.

Singapore has gradually liberalized its policy of non-internationalization of the Singapore dollar—only two capital restrictions remain. We welcome the staff's analysis of this policy in the Selected Issues paper, which suggests that these restrictions could discourage foreign investment. The staff and the authorities should continue to discuss this issue, particularly in light of the emphasis that the authorities have placed on the development of the financial services sector.

Finally, we join Mr. Ísleifsson in urging the authorities to publish the staff report and selected issues paper. In addition to the standard rationale for publication, there are several reasons why Singapore would benefit from the release of these documents. First, markets would respond favorably to the release of the Fund's analysis of the Singaporean economy, which would bolster Singapore's role as a regional financial center. Second, publication of these documents would improve Singapore's reputation as a leader among Asian economies. This would also be a welcome gesture given Singapore's role as the host of the 2006 IMF-World Bank Annual Meetings.

Mr. Cho made the following statement:

We commend the authorities for their effective management of the Singaporean economy—as noted in the staff report, even extremely volatile external conditions have not had a significant negative impact on growth. Singapore has been the envy of many of its Asian neighbors for the past decade, and its economy seems to be in the process of recovery after only a short period of negative growth. Though the economy is currently in the midst of a cyclical downturn, the authorities have sufficient latitude in terms of their economic policies to cope with the immediate challenges. Nevertheless, Singapore has one of the most open economies in the world, and the value of its exports is roughly equivalent to GDP—thus, it will be difficult for the authorities to manage vulnerability that originates from external sources. Indeed, the authorities' growth forecasts for next year range from 2 to 5 percent, which is indicative of the high degree of uncertainty that they perceive.

The authorities' record of fiscal conservatism combined with the high level of domestic savings have been the driving forces behind Singapore's high growth rate and relatively low level of external debt. Externally, the authorities have been able to deal with the vulnerabilities associated with Singapore's position as one of the largest financial centers in the region through a clear separation of the on- and offshore financial sectors, and strong prudential regulation of onshore banks.

Singapore's pegged and adjustable exchange rate regime, which is based on a trade-weighted exchange rate index (TWI), has proven effective in mitigating external vulnerabilities and promoting a low rate of inflation. Although this regime will continue to contribute to Singapore's strong performance, we believe that it will lose some degree of effectiveness owing to developments associated with globalization—particularly in the financial area, and from competitive challenges from neighboring countries. Moreover, a reduction in the segmentation of the on- and offshore banking sectors in order to maintain the country's competitiveness as a regional financial sector may create a new source of vulnerability. Furthermore, Singapore may be at disadvantage vis-à-vis countries like Hong Kong in terms of its ability to attract FDI inflows. The authorities are aware of these challenges, and they have implemented several policies in response, as was mentioned in Ms. Indrawati and Ms. Sia's statement.

Returning to the issue of the exchange rate regime, the staff recommends more transparency in order to help market participants distinguish policy-induced changes from market-related movements in the TWI. However, there seem to be some limitations to the transparency argument. As the authorities note, disclosing details like the TWI and target bands may undermine policy flexibility, and perhaps invite speculative attacks. Furthermore, the success of Singapore's exchange rate regime is not solely dependent upon active stewardship and timely adjustment by the monetary authorities—market flexibility is another factor in its success. In fact, the moderation of wage increases and cuts during the Asian crisis helped the Singaporean economy to remain competitive despite an appreciation in the real effective exchange rate. Such strengths should be cultivated, but given the need for restructuring and diversification of the country's industrial base, wage moderation may not be sufficient to ensure labor market flexibility. Singaporeans must be prepared to accept a change in jobs, and even a period of frictional unemployment while they search for work. A well-targeted social safety net will certainly make this transition period less painful.

Regarding the efficacy of income transfers as a method of providing fiscal stimulus, we would like to know why this policy has not been as effective in Singapore as it has in other countries. The staff attributes high precautionary savings rates to insecurity over employment conditions during the cyclical downturn. However, Singaporeans may be extraordinarily sensitive to job insecurity owing to the fact that the economy relies heavily on the external sector. As noted by Ms. Indrawati and Ms. Sia, exports are still a significant and reliable source of growth, which represent up to 70 percent of aggregate demand in Singapore.

Unemployment has risen to historically high levels in Singapore, but remains at a level that would be envied by many other countries. There may also be other reasons for the high degree of sensitivity to employment conditions, relating to the fact that Singaporeans face a significant potential loss of disposable income from unemployment when compared to other economies. Furthermore, this may imply that the country's social safety net is insufficient to prevent excessive concern about the loss of household income during an economic downturn. Similarly, we do not understand the rationale behind a civil service wage cut during a recession. It may be prompted by the government's efforts to promote wage restraint in order to maintain competitiveness. However, there appears to be little evidence of an erosion in competitiveness, or that the Singapore dollar is overvalued, while the rate of productivity growth remains acceptable. In this light, arguing for a wage cut in the midst of a recession, while household income is being replenished through income transfers, seems somewhat contradictory. The staff's comments on this issue would be welcome.

We are also concerned by the authorities' approach to tax reforms. The authorities seem to be quite optimistic about the supply-side benefits of a tax cut. However, the authorities also intend to increase the GST in order to compensate for a possible shortfall in tax revenues. Though we admire the authorities' fiscal conservatism, we wonder how this tax reform package will be interpreted by the private sector. In this light, we agree with the staff that the supply-side benefits of these reforms may be less significant than the authorities expect. Tax cuts are most likely to be effective in an environment where private entrepreneurial initiative prevails. Oxford Analytica recently reported that only 5 percent of Singaporeans intend to start businesses, which suggests that more than a simple tax cut will be required in order to promote private initiative. The authorities seem to be moving in the right direction, which is evident from their recent reform of the Central Provident Fund (CPF). We would also like to note that reducing the CPF's role as a provider of property financing will make more savings available as capital for new ventures, businesses, and for consumer financing.

Regarding the financial services industry, the authorities seem determined to maintain Singapore's status as a regional financial center, despite the challenges posed by a changing global financial system. In this light, the authorities recently undertook measures to bring offshore banking activities onshore, and to promote the internationalization of the Singapore dollar. These measures have increased the vulnerability of the country's financial system, and the authorities are now more concerned about the management of risk. We share the staff's view that risk-management would be more effective if the risk-based supervisory framework were updated, rather than by relying on restrictions on the international use of the currency and other bank-oriented provisions. Although the remaining restrictions are not significant obstacles to international financial transactions, they are somewhat arbitrary in that the authorities must make judgments as to whether certain transactions are the product of currency speculation—market participants dislike this type of uncertainty.

Regarding bank-oriented provisioning, though we admire the authorities' concern for the soundness of the banking sector, we would like to note that heavy reliance on capital requirements may be insufficient to preserve the soundness of the banking system in circumstances where banks are engaged in derivative transactions. This is particularly relevant for over-the-counter derivative transactions, which is an area that the authorities would like the banking sector to specialize in. However, such transactions are subject to a significant degree of risk if they are not carefully monitored and managed. In this light, a more sophisticated prudential framework needs to be developed. Furthermore, as noted by the staff, regulations involving capital requirements that are more onerous than the international standard may encourage banks to undertake high-risk financial activities, owing to the fact that they will expect a lower rate of return. This may be compounded by the fact that Singaporean banks now face increasing competition from neighboring financial centers.

Finally, while we welcome Singapore's decision to subscribe to the Special Data Dissemination Standard, we encourage the authorities to resolve statistical issues as soon as possible, and agree with the staff that the fiscal ROSC should be completed quickly.

The staff representative from the Asia and Pacific Department (Mr. Lee) made the following statement in response to questions and comments from Directors:

Regarding our assessment of the New Singapore Shares program, this income transfer scheme involves the disbursement of shares, which pay dividends over a five-year period. These shares can either be retained or sold by individuals who receive them. The dividend is an uncommon feature for such a program, and the staff is unclear about how this will provide incentives for the recipients of these shares to save rather than consume. Thus, it is conceivable that the dividend component of the fiscal stimulus package might actually reduce the efficacy of the policy's intended countercyclical impact on the economy. This is one of the main reasons why we questioned the efficacy of the income transfer scheme in an environment where Singaporeans already display a tendency toward a high level of precautionary savings.

Regarding the revenue effects of the tax cuts over the medium term, our estimates suggest that over the long run, supply-side incentives should boost output, though these measures will lower government revenues by about 1.5 percent of GDP. However, increases in the GST and indirect taxes are expected to offset this loss of revenues by about half, which will generate an overall surplus that is about 0.75 percent lower than it would have been in the absence of the tax cuts.

Regarding the effectiveness of supply-side incentives for increasing employment, based on the authorities' simulations, we expect these measures to cause a moderate increase in the level of employment—of about 0.5 percent over a ten-year period. Despite the fact that these projected gains are modest, the main objective of the supply-side incentives is to increase investment by an estimated 12 percent over the medium term—this would raise labor productivity and increase real wages by about 1.5 percent.

Regarding estimates of the costs of the strategic reforms that have been suggested by the ERC, most of their recommendations are focused on influencing the private sector's responsiveness to market incentives, particularly through the promotion of entrepreneurship. I have already discussed the costs of the supply-side tax incentives, and most of the ERC's remaining recommendations are aimed at changing the behavior and attitudes of market participants, which are difficult to quantify. Thus, I am unable to provide you with any additional estimates.

There was a question about whether infrastructure expenditures would be capable of raising productivity and private sector investment levels. The infrastructure-spending plan concentrates on industrial developments, roads, and railways. We expect that these projects will contribute to productivity and help shift Singaporean industries toward higher value-added activities, but we do not have any specific estimates of the impact of this spending on profitability or investment levels.

Regarding the financial sector, there was a request for additional information about the deposit insurance scheme. Although the authorities are still considering this issue, they intend to implement a limited form of insurance covering all deposits of up to 20,000 Singapore dollars per account. Premiums for this insurance scheme are expected to be risk based, and will probably be based on supervisory risk profiles. The deposit insurance scheme will likely cover about 85 percent of all deposits. However, the proposal is still under consideration, and we do not expect it to be implemented until 2004.

Regarding the link between real estate and non-performing loans, NPLs have declined from a high of 12 percent in 2000 to about 8 percent in mid-2003. Although bank loans are highly concentrated in real estate lending, these loans actually perform quite well as they have among the lowest default rates. Historically, empirical evidence suggests that bad loans are most often linked to the manufacturing and other commercial sectors.

There was a question regarding the potential for conflict between meeting national objectives and maximizing shareholder value in reference to government-linked corporations (GLCs). Private corporations typically aim to maximize shareholder value. In addition, the GLCs must also attempt to meet national objectives, including the diversification of national markets, the establishment of market niches in the region, and attempting to broaden the regional customer base in order to promote greater economies of scale. We do not believe that these two sets of objectives are mutually exclusive. However, we would like to emphasize that decisions regarding the operation of these entities should be left to the managers of the GLCs—this is the major source of potential conflicts of interest.

Regarding the apparent conflict between pursuing simultaneous wage cuts and income transfers, we believe that this is fundamentally a matter of proper timing and sequencing. The wage policies that have been implemented are aimed at lowering costs and improving competitiveness over the medium term. Conversely, the income transfer program was aimed at counteracting cyclical conditions. Thus, the two policies were not contradictory, as one was aimed at improving competitiveness over the medium term, while the other focused on providing stimulus when the level of aggregate demand was very low.

Mr. Cho noted that evidence of an erosion in competitiveness was required in order to justify the civil sector wage cut. However, the staff paper suggested that the rate of productivity growth had been adequate. Thus, the authorities' recommendations did not seem justified.

The staff representative from the Asia and Pacific Department (Mr. Lee) stated that this policy was forward looking, and that it aimed to ensure that public sector wages served as an example for the private sector, in order to encourage wage and cost reductions. Regardless of concerns over competitiveness, the objective of the policy had been to increase Singapore's attractiveness as a location for inward investment in production facilities.

Mr. Miyoshi made the following statement:

> At the outset, this chair would like to commend staff for an insightful report and to thank Ms. Indrawati and Ms. Sia for their comprehensive and candid statement.
>
> The authorities should be commended for having maintained skillful macroeconomic management in adjusting to the recent global economic slowdown. Their fiscal stimulus measures and neutral monetary policy have been effective so far. That said, as a country largely dependent on external demands, Singapore is facing the challenge of recovering from its unprecedented recession in 2001. Uncertainties over the global economic recovery and potential security risks in the region and the Middle East are casting a negative outlook over the period ahead. In addition, like other Southeast Asian countries, Singapore faces a transformation in trade and investment dynamism in the region with the emergence of China. I strongly support the authorities' focus on a medium-term oriented policy framework, as well as their aim to strengthen competitiveness through development of new high value-added industries, improvement of labor opportunities, and liberalization of the financial sector. The Economic Review Committee has made a number of valuable recommendations for reforms. I believe Singapore still has business confidence in its highly developed infrastructure, legal framework, and stable political and security environment. This confidence will be enhanced as the authorities reveal their strong commitment to reform through more policy disclosure. In addition to the authorities' efforts, I also note that the overall economic growth in the ASEAN region will have an enormous impact on Singapore's future growth, as the inter-Asian trade shares are increasing while exports to the United States are decreasing. I expect that the authorities' continued skillful macroeconomic management, and their implementation of effective structural reforms, will assist the country in regaining its economic growth and in strengthening its role as a regional hub.
>
> Now, I would like to comment on fiscal, financial, and structural issues as follows:

First, on the fiscal front, given the economic slowdown and significant records of fiscal surplus, I support implementing aggressive fiscal stimulus measures. Like staff, however, I feel the effects of the envisaged off-budget package this year may be limited to a certain extent. The reduction in corporate income tax will attract investors, but given the possibility of tax reductions in other countries, it might need further adjustment. Given the fact that only about 30 percent of the population is paying personal income taxes, the envisaged GST increase might adversely affect the low-income population. In addition, I share staff's concern on the efficiency of direct income transfers, because it might only increase saving motives in response to an uncertain economic outlook. In this respect, I agree with staff that the timing of the GST increase should be cautiously examined. I would also call for social measures targeted at assisting lower income people. In this sense, the social safety net and unemployment insurance scheme might both be useful if administered in a strict manner.

Second, on the financial sector, I welcome the progress made in banking sector reforms, disclosure of monetary policy, and internationalization of the Singapore dollar. The conservative policy on the Singapore dollar has contributed to limiting the adverse impact from the Asian crisis, but further liberalization is imperative for the country to strengthen its position as a regional financial hub. I also expect the development of capital markets in order to take advantage of the high savings rate of the country. I join other Directors in looking forward to the results of the FSAP to assess the recent and future outlook of the financial sector.

The progress made in property finance reform is welcome. Large savings in the CPF are not fully utilized for retirement pensions and this reform is essential to prepare for the aging population. It will benefit people by enhancing financial tools and creating more opportunities for capital investments. On the other hand, it might give rise to the housing asset price and the banks might have less forbearance in taking charge of collaterals. There is a need for Housing Development Board to continue to assist vulnerable people in securing housing and to mitigate their burden.

On structural reforms, I welcome the ERC sub-committee report on developing entrepreneurship and internationalizing enterprises. GLCs have contributed to Singapore's economic success, but their continued dominance in major competitive sectors leaves little room for the private sector to grow. I feel that their role must eventually be limited to strategic areas. Like Mr. Le Fort and Mr. Costa, I wish staff would elaborate more on the authorities' intentions and their reform plans for GLCs.

Concerning the emergence of China, I presume that domestic companies could have incentives to transfer even their strongholds to China for the sake of cost reduction. The staff's comments would be appreciated about the current movements of domestic enterprises, whether there are concerns of hollowing out and, if there are such concerns, their impact on growth and employment.

I note the ERC report makes an interesting recommendation to strengthen the spirit of entrepreneurship and innovation by a transformation in that spirit from old “5 Cs” to new “6 Cs”. I expect this new spirit will help strengthen competitiveness and help Singapore continue to be a strong regional center.

With these remarks, I wish the authorities the best in their future endeavors.

Mr. Wei made the following statement:

I would like to join other speakers in thanking staff for a set of informative and well-written papers and Ms. Indrawati and Ms. Sia for their helpful statement. Both have shed light on the challenges facing the economy and the policies pursued by the authorities.

After a number of years of rapid growth, the Singaporean economy suffered a severe downturn in 2001, mainly due to weak external demand in its major exports. However, the authorities have adopted a pragmatic approach and skillfully steered the economy on a path of mild recovery this year, which will further strengthen as, hopefully, the world economic recovery gains momentum next year. We strongly endorse the authorities’ policies that focus on restoring growth in the near term and strengthening the economy’s competitiveness in the medium and long term. Prudent and forward-looking policies have served the economy well in the past and, I believe, will continue to do so in the future.

Consistent with the authorities’ long track record of prudent and forward-looking macroeconomic policymaking, faced with the sharp downturn the authorities eased the monetary policy to a neutral stance and provided fiscal stimulus last year. These policy responses were appropriate and timely. Given the low inflation, the need to nurture the incipient recovery and looming uncertainties, it is fitting that the authorities maintain a neutral monetary policy stance and usher in more fiscal stimulus this year. However, I agree with others that there is still room for further relaxing of monetary policy if it is needed.

I join staff in welcoming the authorities’ move to greater transparency by publishing the Monetary Policy Statement and Macroeconomic Review and communicating policy considerations to the public.

Singapore has been exemplary in maintaining a prudent fiscal policy, which emphasizes budget balance over the medium term. Long-term fiscal prudence has helped the authorities to build solid asset positions which, in turn, have afforded it flexibility in providing fiscal stimulus or ushering in structural reform initiatives. In phasing in tax cuts and applying GST hikes, the authorities have rightly emphasized fiscal prudence and indicated their willingness and capacity to take further measures.

Singapore is a very open economy that has benefited tremendously from international trade in the past two decades as it established itself as a major exporter of electronic products and an international financial center. Faced with greater competition brought about by globalization, the authorities have taken commendable proactive steps to review industrial policy and formulate a restructuring blueprint to promote competitiveness, further develop their comparative advantage in the financial and service sectors, and strengthen bilateral and intra-regional trade relations. As major Asian economies maintain encouraging recovery or robust growth, closer intra-regional trade relations will help improve Singapore's growth prospects. As for the implications for Singapore of China's accession to the WTO, as Mr. Portugal and other Directors have pointed out, it brings more opportunities than challenges.

With the economic recession in 2001 and industrial restructuring underway, unemployment will become a more pressing issue for the authorities. The authorities fully recognize the challenges involved along with the economic and social implications and have rightly emphasized an approach of re-training and improving the efficiency of job search. In our view, both will contribute to expediting job search and re-employment and thus reduce the need of relying on a welfare apparatus.

Traditionally, the authorities have been conservative and cautious in regulating the financial sector, which helped Singapore to weather the Asian financial crisis successfully. In the past few years, to strengthen Singapore's status as an international financial center, the authorities have taken a series of measures to liberalize the financial markets and strengthen the regulatory and supervisory framework in adapting to the changing market conditions. In particular, they have liberalized most of the restrictions on non-internationalization of the Singapore dollar. Regarding the staff's suggestion that the authorities remove the two restrictions on capital market transactions, we agree with the authorities that the purpose of keeping them is to deter speculation against the Singapore dollar and that they are not impediments to capital market development. We regard the authorities' arguments as well grounded.

On pension and housing reforms, we join the staff in welcoming the authorities' efforts to refocus the Central Provident Fund (CPF) as a core retirement scheme and limiting its savings for housing financing. On the issue of boosting entrepreneurship and the efficiency and timing of divesting government-linked corporations (GLCs), we share the authorities' view that boosting entrepreneurship has to be addressed in a holistic way and the authorities' plan to invigorate the entrepreneurship of the private sector itself sends a strong signal. The GLCs are run strictly on commercial principles. In our view, the authorities are acting responsibly in prudently deciding which GLCs to divest and when to proceed.

In conclusion, we command the authorities for their forward looking and pragmatic approach in managing the economy. We wish them great success in their endeavors.

Mr. Jonas made the following statement:

At this stage, I will limit myself to few short comments on macroeconomic policies and structural reforms.

The latest GDP figures show that Singapore's recovery is still weak. Even though it has the strongest macroeconomic fundamentals in the region, Singapore is growing slower than the other countries there. It appears that in a rapidly changing environment, strong fundamentals are not enough: rapid growth also requires an element of stability and a sufficiency of dynamism.

Factors contributing to Singapore's recent poor growth performance probably include its economy's insufficient diversification and heavy dependence on external conditions. Singapore's exports are heavily concentrated on PCs, and the present weak global market for PCs has hit these exports hard. Countries like Taiwan and Korea, with better-diversified export structures, see their export growth remaining relatively robust. But exports are not the whole story. Weak domestic demand is also partly responsible to Singapore's poor growth. In the third quarter, in fact, external demand was quite strong, and the weakness of GDP growth reflects weaker domestic demand in general and the sharp decline in public and private investment in particular.

This brings up the interesting policy question of the efficacy of fiscal and monetary stimulus. The authorities have responded correctly to weaker growth with two fiscal stimulus packages, but we have yet to see any strong growth effect. A third of the stimulus package consists of public infrastructure investments, but overall public investment declined sharply in 2002. Mr. Le Fort and Mr. Costa ask whether Singapore really needs more infrastructure investment, and the staff has explained that these investments are directed inter alia at expanding industrial parks and railways, which should have positive effects on growth in the private sector. But these effects have yet to materialize.

The authorities are also trying to stimulate private income by reducing taxes and increasing transfers. Some Directors have already expressed doubts that higher income will result in higher spending, given the increase in economic uncertainty and the resulting bias toward increasing precautionary savings. And to the extent that it is directed to imports, higher spending does not contribute to higher output growth.

All this suggests that there is room for the authorities to apply fiscal stimulus more aggressively. I welcome the decision to phase in the increase in the GST. The authorities should also consider the proposal to create a social safety net or the unemployed. A safety net's negative effects on incentives to work can be minimized, and its benefits could include reducing the incentives for precautionary savings.

Monetary policy has likewise been appropriately eased, but banking lending has fallen sharply despite very low interest rates. Since the banks are awash with liquidity, it would appears that the deceleration is mainly demand-driven and reflects low investment activity on the part of corporations and their hesitation to contract new loans.

I have two comments on structural reforms. First, I note that the authorities plan to reduce corporate taxes as a way of attracting more foreign investment, boosting competitiveness, and encouraging entrepreneurship. However, I wonder whether tax measures can greatly improve Singapore's relative position, given the possibility that other countries in the region may do the same. I do not think that tax reforms alone can enable Singapore to maintain its position in the region: improved incentives for responding to market signals are also needed. Mr. Cho noted some interesting statistics, which indicate that only about 5 percent of Singaporean adults contemplate going into business for themselves. The rest of the labor force works in the public sector or for multinational corporations. This is a possible obstacle to increasing the dynamism of the private sector.

Second, I consider the authorities' ambition to make Singapore a regional financial center to be an appropriate objective. But to achieve it there may come a time when the authorities will have to remove the remaining restrictions on Singapore dollar transactions, as suggested by the staff. Larger financial flows could result in greater exchange rate volatility, which could be mitigated by the development of deeper and more liquid financial markets. But the authorities may also have to reconsider their policy of maintaining a narrow exchange rate band, which would be more difficult in such an environment. Increasing the flexibility of the exchange rate could also reduce the risk of speculative attacks on the currency.

Finally, I have a remark on the availability of data. The staff notes that data are available on a timely basis and that Singapore subscribes to the SDDS. I was struck by the fact the staff report contains no external debt data for 2001.

Mr. Al-Nassar made the following statement:

The global economic slowdown and the associated sharp decline in the demand for electronics have reflected in a severe recession in Singapore last year. However, the authorities' prudent economic management provided them with the flexibility to respond with sizable fiscal stimulus and monetary easing to cushion the impact of the large downturn. As a result, the economy appears well set to a moderate recovery this year. Nevertheless, the outlook is still uncertain, especially in view of the weakened external environment. As I broadly agree with the staff's appraisal, I limit myself to a few remarks for emphasis.

I welcome the substantial easing of fiscal policy in 2001 to deal with the external shocks. The authorities' willingness to take further measures if needed is reassuring. However, relying on revenue measures and income transfers in the high precautionary saving environment may not be enough to generate the needed stimulus in the economy. Therefore, stimulating the domestic aggregate demand directly seems appropriate to offset the decline in the external demand. In addition, as the economy matures, balancing investment and consumption is essential for sustained high growth. In this regard, I agree with staff's recommendation regarding the timing of the GST implementation.

On monetary and exchange rate policies, I welcome the accommodative monetary stance in view of the prevailing conditions. The move from tightening to a neutral exchange rate policy combined with low interest rates should facilitate the economic recovery. The authorities are to be commended for the semi-annual publication of Monetary Policy Statement (MPS) and the Macroeconomic Review (MR).

Turning to the medium and long term challenge of growing competition, the authorities' cognizance of the need to restructure the economy is reassuring. Forming the Economic Review Committee (ERC) to design a new long-term strategy for the economy reflects the commitment to this end. I am looking for its final report. Another potential support for the efforts in dealing with competitive challenges is the free trade agreements Singapore plans to sign as well as the increased regional cooperation. I agree with staff's recommendation to strengthen the social safety net, which can be complemented by the authorities' approach to train and upgrade skills.

With these remarks, I wish the authorities success.

Mr. Requin made the following statement:

I would like to thank the staff for their analysis, which is detailed, thorough, and remarkably synthetic. Their conclusion on the twin challenges faced today by the Singaporean economy (managing the recovery and restructuring the economy to adapt it to changes occurring in the regional competitive environment) is convincing. I also thank Ms. Indrawati and Ms. Sia for the valuable information provided in their statement.

Thus, regarding the diagnosis, I do not have many comments. Deflationary trends are a true matter of concern, even if they seem limited in comparison with those faced by Hong Kong for example. Even in these difficult times, Singapore still sticks to its reputation of a cautiously and well-managed city-state: in a context of slow growth and in spite of budgetary stimulation, the state still registers a fiscal surplus, and the current account remains structurally positive. To a certain extent, it also means the State still has resources for additional stimuli in case it appears necessary.

From a more general point of view, I observe that the Singaporean economy has grown over the past years through a model of development relying on an intensive capital accumulation both from domestic investment, spurred by high saving rates, and foreign direct investments. This model is today confronted with some limits due to the declines in total factor productivity and investment rate. Given the capital intensity ratio already achieved, near those of most developed countries, capital profitability is lower than in the past, and a greater part of national savings is invested outside the country, thus modifying the shape of value creation, today relying more on an expansion outside the country. In this perspective, as underscored by Mr. Wei the emergence of China in the regional environment should be seen rather as an opportunity rather than a threat. Hence, it is a complete overhaul of their economic model to which the authorities are committed today. In this important task, I would like to commend them for the dialogue implemented with the private sector in order to define the ways and the means for a new path of growth.

Concerning remedies, I would make a few remarks on budgetary and monetary policy, and then on the long-run strategy adopted by the authorities.

I note that, while supposed to stimulate the economy through a counter-cyclical shift, policies implemented to date have indeed a strong structural and supply-side content. The budgetary and fiscal packages in FY01 and FY02 have rather been targeted to foster investments and preserve the Singapore's attractiveness. One could wonder, as pointed out by Mr. Shaalan, if a counter-cyclical policy aimed at boosting private consumption more directly would have been more efficient. If some of the measures taken may have a positive impact on private consumption (for example the reduction in the personal marginal tax rate) the categories of the population benefiting from the measure might not be those having the highest marginal consumption propensity. As a whole, the budgetary package may prove to be insufficient to make domestic demand more dynamic. I was wondering if additional specific measures centered on more vulnerable categories may not have a stronger effect on growth but, from reading paragraph 15, it seems that the staff considers that, due to a precautionary saving behavior, the budgetary instrument might not be efficient. In these circumstances, the shaping of a social safety net may prove efficient to restore confidence, release precautionary savings and sustain private consumption.

As regards monetary policy, reverting to an issue tackled by Mr. Shaalan in his statement and by Mr. Jonas, I would like to ask the staff if they think the easing of monetary conditions may still have an effect on the economy at the current low level of interest rates. To put it differently, is there any risk of the economy being exposed to a liquidity trap phenomenon?

Singapore worked out a strategy to reinforce its competitive edge by buttressing its position as a financial center and by attracting and retaining workers with requisite skills through a fiscal reform aimed at cutting personal and corporate tax rates. On this last point, as other Directors who expressed concerns on this side like Mr. Ondo Mañe and Mr. Mirakhor, I wonder about the tax competition consequences that may result from this scheme. Considering that a lot of territories are striving to host financial centers, attract FDI and high-skilled workers, if generalized in all countries, this type of fiscal policy may have consequences on the way the fiscal burden is being distributed inside the country, thereby promoting a poorly redistributive system and increasing inequalities.

So there might be room for increased cooperation among ASEAN countries to deal with this type of issue, maybe in defining a code of good practices, or a minimal fiscal standard each country could abide by.

Consistent with the Singaporean goals, a divestment strategy by the state from industrial activities should also be considered. It would probably lead to a rise in the capitalization of the Singapore stock exchange while increasing market liquidity. It would also probably facilitate the regional or international expansion of local firms, especially as state enterprises traditionally face difficulties in taking stakes in foreign countries.

This being said, Singapore holds a lot of master trumps in regional competition, thanks to the quality of its workforce, its financial position, the soundness of its banking system and its track record, to meet the challenges ahead. So, I wish the authorities the best success in their endeavors.

Mr. Skurzewski made the following statement:

This year's consultation with Singapore is focused on two broad issues: the short term policy reaction aimed at restoring and maintaining a positive rate of growth, and the longer term approach aimed at restructuring and diversification of the Singaporean economy. I will offer few remarks on these issues, while I generally agree with the staff assessment and recommendations.

Coupled with the continued global slowdown and uncertainty Singapore is affected by increasing competition from other emerging economies in the region. This has brought a sharply declining GDP, and a rise in unemployment rate. The authorities rightly reacted with a sizeable fiscal stimulus package and monetary policy easing. The main monetary instrument, i.e. the exchange rate target band, has returned to its narrow range since then. But on the fiscal side, the authorities decided to cut the top income tax rates, as a measure thought to please businesses, and in line with the regional trend. The yet undecided GST increase seems to be a right choice in order to compensate the revenue loss resulting from other tax cuts. The staff may be making a valid point by advising to hold the increase until the recovery strengthens, however, I feel convinced by the authorities that its effects have already been neutralized by some income policy measures, including the one time distribution of the New Singapore Shares.

Turning to medium and long-term problems, the authorities are obviously well aware of the pressures threatening Singapore's long standing position of a financial and trade hub of the Southeast Asia. Another source of structural vulnerability is the large share of export-dependent electronics sector. To address these challenges the Economic Review Committee (ERC) is recommending, apart from the already mentioned tax incentives, the reform of the interrelated pension and housing financing frameworks, and restructuring of the industrial sector with possible decrease in state ownership of some government-linked corporations (GLCs). On the latter proposal, I agree with the staff's argument that privatization of the GLCs is likely to reduce the conflicting objectives of maximizing shareholder value and pursuing national development goals. In addition, divesting of the already designated for sale GLCs could provide resources to support the falling behind services sectors, which the ERC also suggests. As for the pension reform, I welcome the changes to CPF, the expansion of its investment options beyond the housing financing. As the staff rightly notes, Singapore residents enjoy nearly universal home ownership, thus allowing the CPF to focus on its retirement related function, and perhaps allowing for the Housing Development Board privatization in future.

Finally, the financial sector seems to be immune to the economic downturn as reflected by the stable non-performing loan ratio. It is supported by well-developed legal and regulatory framework, but like the rest of economy it will ultimately be affected by global consolidation and technology-induced changes. The ERC-identified new niches of wealth and risk management, and global processing services may well succeed in Singapore. I concur with the staff, however, that the remaining restrictions on the international use of the Singaporean dollar, even if kept just kept against possible speculative attacks, might be negatively seen by some market participants. I welcome the authorities intent to resume considerations of their removal.

To conclude, I note the further improvements in transparency of the monetary policy and, like Messrs. Ísleifsson and Dohlman, I encourage a similar progress on the fiscal side, and in this context I also hope that the authorities agree to publication of the report.

Mr. Palei made the following statement:

It appears from the staff report and from the informative statement distributed by Ms. Indrawati and Ms. Sia, that consultations between the authorities and the staff have been very productive. There are few, if any, disagreements on the policy issues.

I commend the authorities for their proactive response to the challenges posed by the cyclical downturn of 2001, as well as by the more entrenched competitive pressures in the region. In the fiscal area, the two off-budget packages amounting to more than 8 percent of GDP were timely. Although such a sizeable discretionary response was unusual for Singapore, it was fully justified by the severity of the recession. Notably, the fiscal injections did not undermine the authorities' impressive track record of fiscal prudence. From a more long-term perspective, I welcome the authorities' decision to reduce the direct income taxes and, at the same time, to shift the burden of taxation to consumption. This strategic step will certainly enhance the growth prospects for the Singaporean economy and will ease the adjustment to the social challenges facing society in the future.

In the monetary area, the adoption by the Monetary Authority of Singapore of the neutral stance since July 2001, have successfully guided inflation expectation of the market participants. The recent steps to further enhance transparency of the monetary policy will further strengthen its efficiency. Overall, an approach of gradually increasing the coverage of the periodic analysis of economic developments seems to be reasonable. In the small and open economy of Singapore, when the direction and size of major external developments are difficult to predict, it would be prudent to avoid too rigid presentation of the monetary policy. Over time, based on discussions of the semi-annual Monetary Policy Statements and on the recently initiated Macroeconomic Review, the authorities will sharpen their understanding of the market requirements in this area. Again, I commend the staff and the authorities for the attention to this critical area of macroeconomic policy.

While many Directors commended the authorities for the timely discretionary fiscal response and accommodative monetary policy, as the staff has correctly pointed out in their report, macroeconomic fine-tuning had never been a prominent feature of policies in Singapore. It is essential to see that some of the prominent measures that helped to deal with recession also had major structural components and medium- to long-term aspirations. With respect to the structural changes in the economy of Singapore, after many previous speakers, I have little to add. I would like to echo the comments of

Messrs. Portugal, Rambarran, and Wei on the nature of competition in the region. The latter should be viewed as a dynamic mutually beneficial process rather than as a zero-sum game. Hopefully, in the future, the staff could further develop this topic.

The depth of the economic downturn has contributed to the authorities' desire to sharpen their strategic focus that resulted in the work of the Economic Review Committee. This undertaking should pave the way for comprehensive changes in the economy of Singapore to make it more competitive in a rapidly changing environment. We are encouraged by the ambitious recommendations already released by the Commission and look forward to the release of the rest of the reports. We also hope that the completion of the FSAP for Singapore will prove to be useful not only for the authorities, but also for the Fund membership.

Mr. Joicey made the following statement:

Like other Directors, we welcome Singapore's strong performance, which has been achieved during both good times and bad. We support the authorities' efforts to offset the sharp economic downturn, and their initiatives to enhance medium-term competitiveness. We have very little to add to the staff report and Ms. Indrawati and Ms. Sia's helpful statement, though we would like to make a few quick points.

Regarding fiscal policy, the authorities' strong track record of fiscal prudence leaves Singapore in a good position to respond to the economic downturn with appropriate stimulus packages. Publishing a medium-term budgetary framework with fiscal targets and their underlying assumptions could further strengthen the fiscal framework. Rather than undermining credibility, we believe that this measure would strengthen the government's credibility by providing the underlying rationale for responses to economic downturns and significant shocks. Like other Directors, we encourage Singapore to participate in the fiscal ROSC.

Regarding monetary policy, the monetary framework appears to serve Singapore well. However, as Mr. Jonas and other Directors have noted, increasing financial integration may create new problems for the authorities. We welcome recent measures aimed at increasing transparency, and encourage the authorities to consider further steps to make the monetary policy framework more transparent.

Regarding the financial sector, we welcome the authorities' forward-looking approach to prudential supervision and regulation, particularly their efforts to strengthen the risk-based supervisory framework, the creation of a separate unit to monitor complex financial institutions, and the establishment of a new credit data sharing bureau. We also welcome Singapore's participation in the FSAP.

We would also like to pose two additional questions to Mr. Lee. The background paper provides a helpful forward-looking discussion of the risks and challenges associated with greater integration into the regional financial system. Could the staff comment on the exposure of Singapore’s financial sector to regional risks, particular those associated with Japan’s financial sector? We would also like to expand on an issue raised by Mr. Ísleifsson regarding the exposure of the financial sector to the property market. Has the FSAP accounted for the potential increase in risks that might result from an increase in the mortgage default rate?

Like Mr. Dohlman, we welcome Singapore’s progress with respect to AML and CFT issues. We are pleased that the Parliament has enacted the Terrorism Act to enable the ratification of the UN Convention.

Finally, like Mr. Ísleifsson and many other Directors, we urge the authorities to publish the staff report.

Mr. Haupt made the following statement:

As other Directors, we commend Singapore’s authorities for their excellent track record of economic policies and their skillful economic management during the recent downturn. At the same time, the staff report makes clear that even such a fundamentally strong economy as the Singaporean faces important structural challenges posed by a fast changing environment.

I largely share the staff’s appraisal on the short and longer-term challenges facing Singapore’s economy.

On short-term prospects and fiscal policy, the recent considerable downward revision of official growth forecasts and the renewed surge of unemployment in the third quarter suggest that the economy may be recovering at a slower pace than some of the competitors in the region. Going forward, there might therefore be room for some additional stimulus. Given the nature of Singapore’s monetary and exchange rate framework, we would agree with the authorities that the prime candidate for such measures is fiscal policy, despite the openness of the economy. A delay of the GST raise might indeed be helpful in this context. More generally, we very much support the reorientation from direct to indirect taxation and the focus on tax measures aimed to improve the supply side of the economy. In doing so, the planned general tax decreases seem clearly superior to any targeted tax incentives. At the same time, the planned income tax cuts will not bring much relief to the unemployed and to low-income earners. While I understand from Ms. Indrawati that the adjustment burden under the recession is to be mitigated by the planned direct income transfers, a better-targeted approach would be to reform and strengthen the social safety net. In addition, I take note of Mr. Lee's remarks on the possibly limited anti-cyclical features of the income transfer scheme. Mr. Requin and others have also alluded to this point.

On structural issues, we very much welcome the establishment of the Economic Review Committee and largely support its recommendations. In this context, we would specifically note that an accelerated timetable for reducing government ownership in the GLCs could have considerable pay-offs in terms of private sector development, which might outweigh any revenue losses resulting from less-than-strong market conditions.

On monetary policy, the recent easing of the policy stance seems appropriate. More generally, we support the medium-term framework of the authorities, which has also been confirmed by the staff's empirical analyses. We strongly welcome the recent steps to enhance the transparency of the framework and we would encourage additional steps in this direction, so as to refocus public attention away from the foreign-exchange market. Looking ahead, as noted by Mr. Jonas, it may eventually be worth considering a shift to a more flexible exchange rate system, in line with increasing international financial integration. That said, in the context of Singapore's present exchange rate-oriented framework, there may be some merit in leaving the target bands and the explicit exchange rate weights undisclosed, thereby leaving some scope for policy flexibility, as has already been noted by Mr. Cho.

Finally, I agree with those speakers who have called for higher fiscal transparency and the preparation of a fiscal ROSC, and, as Mr. Ísleifsson, Mr. Dohlman, Mr. Skurzewski, and Mr. Brooke, I would encourage the authorities to publish the staff reports.

Ms. Adam Gust called for the authorities to publish the staff report.

The staff representative from the Asia and Pacific Department (Mr. Lee) made the following additional statement in response to questions and comments from Directors:

Regarding the question about Singapore's external debt figures, there is in fact a two-year lag for the release of these statistics, but the SDDS will not actually require the authorities to report current data until September 2003. Thus, Singapore is currently in compliance with the requirements of the SDDS.

Regarding the issue of competitive challenges arising from economic liberalization in China, Singaporean industries do not compete directly with Chinese exports, even in the electronics sector. Singapore's manufactures are at the high end of the value-added scale, while Chinese manufactures consist primarily of low-end processing activities. Looking forward, we agree with many Directors that it is unclear whether the benefits to Singapore of trade creation associated with China's liberalization will outweigh a potential loss of competitiveness from an increase in China's comparative advantage in high value-added sectors. China is currently investing heavily in foundries and high-end semiconductor industries, which may challenge Singaporean industries in the future. These challenges are recognized by the Economic Reform Committee, which is attempting to promote industrial diversification—e.g., into the chemical and biomedical clusters—in order to maintain and bolster Singapore’s natural comparative advantages.

Regarding the question about whether Singapore is facing a liquidity trap, this simply cannot be the case as Singapore operates on an exchange rate-based monetary framework, and the channels of monetary policy transmission only work through the real effective exchange rate (REER). The REER is not limited in its movement, so there can be no formal liquidity trap. However, monetary policy is somewhat limited in its ability to control the REER, and therefore also in its ability to influence the real economy.

There was also a question about the financial sector’s exposure to foreign financial systems, including Japan’s beleaguered financial sector. This is in fact one of the stress tests being explored by the FSAP. Furthermore, it is my understanding that Japanese banks have withdrawn much of their lending to Singapore, and that their current level of exposure is relatively low.

Regarding mortgage defaults and how these might be managed, as you know, mortgages are collateralized loans, which are generally considered low risk. However, the situation in Singapore is rather unique in that private banks are actually servicing a higher-end clientele because mortgages for low-income citizens are provided through the Housing Development Board (HDB). Thus, Singapore’s private banks are not exposed to any real stresses on their loan portfolios because of bad mortgages. Default rates on mortgages, or more accurately the proportion of classified loans, have typically been about 2 percent historically, which is rather low in relative terms.

Ms. Sia made the following concluding statement:

We would like to thank the Executive Directors and their staff for their constructive comments and suggestions, which I would be forwarding to the Singapore authorities in full. On behalf of our authorities, I would also like to express appreciation to staff for their efforts during this consultation process, and the high standard of analyses in the staff report and selected issues papers.

As noted by directors and staff, the Singapore economy has been hit by a series of external shocks in the recent past, and a decisive recovery is dependent on the improvement in external demand conditions. In this regard, some external indicators have seen some tentative signs of improvement, for example in the PC and consumer electronics segments in the key global IT markets. This was reflected in Singapore's latest Purchasing Managers’ Index, which showed improved new export orders for electronic components, even as export performance have continued to hold up in recent months. While uncertainties in the global outlook remain, conducive monetary and fiscal conditions are in place to support a rebound in the major industrialized economies next year. As such, we look forward to a continuation of the positive developments in the Singapore economy and do not rule out a strengthening of the recovery momentum, especially towards the second half of the year.

We appreciate directors' and staff's support of our macroeconomic policy response, which was designed to alleviate the cost of adjustment during the downturn. Various budgetary measures have helped to reduce business costs and support disposable income in the household and business sectors. Given the significant import leakage in government spending due to the openness of the economy, the government has mostly chosen to cushion external shocks by influencing supply-side variables to reduce business costs, such as lowering corporate income taxes and other charges. The aim is to ensure that businesses are in good position to take full advantage of a turnaround in external conditions.

The Singapore government has over the years, built up capacity in budgetary resources to cope with times of economic weakness and uncertainty, such that the comprehensive fiscal measures do not seriously compromise its budget position even in the short-run. In the past week, the government has further announced that, in order to ease the concerns of Singaporeans in this time of uncertainty, it will phase in the planned 2 percent increase in the Goods and Services Tax rate and implement only a 1 percent increase in January next year. This pragmatic response was further enhanced by the decision of the government to maintain unchanged the full offset package, including the income transfers, that Singaporeans would receive to mitigate the GST increase. It should be noted that the original package was more than sufficient to offset the full increase in the GST.

Directors have noted the impact of the ongoing structural adjustment on the labour market. We wish to emphasize that the problem remains very much contained and that extensive infrastructure and facilities exists to provide the necessary income support in an efficient manner through a decentralized system. A network of Community Development Councils, self-help groups, charitable organizations provide the support needed within Singapore's specific socio-cultural context.

Turning to Singapore's longer-term challenges, our authorities had initiated the work of the Economic Review Committee as a strategic response to the increasingly competitive external environment. The recommendations made by the committee are aimed at creating a competitive infrastructure and business cost environment, and encouraging innovation driven activity.

In a similar vein, efforts have been directed at diversifying our export markets, chiefly through enhancing trade linkages with the East Asian economies. Although intra-East Asian trade flows are still too small to shield against foreign demand shocks originating from the industrial countries, such trade flows are expected grow over time and eventually provide a buffer against business cycles in the G3 countries.

The Acting Chair made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. Directors noted that in 2001 Singapore experienced its worst economic recession since its independence, after many years of stellar economic growth, mainly as a result of the global economic slowdown and a sharp drop in the demand for electronic exports. They commended the authorities' skillful negotiation of the recession with appropriate countercyclical policies that have paved the way for a modest economic recovery in 2002. Directors also welcomed the authorities' timely new medium-term development strategy, with wide-ranging restructuring and liberalization measures to promote new high-value-added activities, develop the services sector, and further enhance labor market flexibility.

Directors observed that, notwithstanding the moderate export-led recovery that has taken hold this year, economic prospects are clouded by downside risks. These risks relate to growing uncertainties about the strength of the global recovery—especially about the incipient rebound in the electronics sector—potential conflict in Iraq, and terrorist attacks in South East Asia. Therefore, Directors agreed that policies for the near term should maintain their easing bias. They expressed confidence that, over the medium term, the authorities will implement the recommendations of the Economic Review Committee to return the economy to a high-growth trajectory and to strengthen its resilience to external shocks. In this context, they noted that confidence in the financial system is high and the external position remains strong, and that economic restructuring is accelerating in the financial sector and spreading to the manufacturing and services sectors as Singapore responds to competitive challenges from abroad.

Directors noted that the well-timed fiscal stimulus packages announced last year in July and October had provided important support for domestic demand as the external environment deteriorated during 2001. Directors indicated that the government's reputation for prudent fiscal policies and its substantial net asset position should provide ample room for further fiscal action should the recovery be weaker than expected.

Directors welcomed the structural measures taken in the FY 2002/03 Budget to broaden the revenue base by further shifting toward indirect taxes, and to boost supply-side incentives by lowering marginal income tax rates. Given the global trend toward lower direct taxes, however, and taking into account the weaknesses in the economy, some Directors suggested accelerating the pace of income tax cuts. Also, while Directors noted the decision of the authorities to phase in the Goods and Services Tax increase, some considered that a delay in raising the tax might be appropriate.

Directors considered that the easing of monetary policy to a neutral stance in July 2001 and subsequent adjustments that provided additional support as external conditions weakened were appropriate. They believed that the current ample domestic liquidity and the low interest rate environment provide sufficient support for domestic activity. Nevertheless, given that inflationary pressures are expected to continue to be low, most Directors stressed that monetary policy should stand ready to ease further if significant downside risks and incipient deflation materialize.

Directors noted that the exchange rate-centered monetary policy framework has served Singapore well since 1981, noting that the external position remains very strong. Directors strongly endorsed recent initiatives taken to convey the authorities' policy intentions to the public, and most looked forward to further action to enhance transparency. It was noted that increasing disclosure about key macroeconomic fundamentals would help anchor expectations for monetary policy and reduce the attention paid by the private sector to increasingly volatile market-driven developments in the foreign exchange market. Increased transparency could provide the authorities with greater operational flexibility and allow the exchange rate to be a more effective shock absorber.

Directors welcomed the continued improvements being made to Singapore's already well-developed legal and regulatory framework for its financial system. Directors encouraged the authorities to continue to adapt their risk-based supervisory approach by linking bank capital requirements to individual risk profiles, and thereby enable domestic banks to compete more effectively in the domestic and international markets. They noted recent efforts by the Monetary Authority of Singapore to strengthen its capacity to gauge group-wide risk-taking within complex financial institutions on a consolidated basis and to monitor aggregate market risks and vulnerabilities. In this connection, Directors welcomed the authorities' participation in the Financial Sector Assessment Program.

Looking ahead, Directors observed that Singapore's financial markets face challenges from global financial industry consolidation and technological trends funneling activities to global centers. At the same time, modernization and liberalization among Singapore's neighbors could erode Singapore's traditional role as a regional financial hub. Directors believed that Singapore could bolster its attractiveness as a financial center by removing regulations that create unwarranted perceptions of binding restrictions on financial activity, and that discourage global investors and issuers from using Singapore as a center for their operations. In this regard, most Directors pointed to the remaining two restrictions related to the non-internationalization of the Singapore dollar as candidates for early reconsideration, though a few others felt that these restrictions provide some safeguard against currency speculation.

While there has been a welcome increase in the transparency of the monetary policy framework, Directors observed that more progress should be made on fiscal transparency. In particular, they encouraged the publication of a medium-term budgetary framework, and recommended the preparation of a fiscal ROSC to complement Singapore's self-assessment of the Fiscal Transparency Code. Directors also encouraged the authorities to adopt the new methodology outlined in the revised IMF manual on government finance statistics, including the compilation and dissemination of data on the net worth of the public sector. Directors expressed satisfaction with Singapore's efforts to combat money laundering and the financing of terrorism, and looked forward to the ratification of the UN Convention on the Suppression of the Financing of Terrorism by the end of this year.

Directors supported the authorities' approach to dealing with the high unemployment rate stemming from ongoing restructuring, which is to focus on retraining and improvements in the efficiency of job search. A number of Directors also recommended that consideration be given to consolidating and strengthening the social safety net, so long as such changes do not have adverse effects on work incentives.

Directors commended the authorities for implementing a wide range of other structural reforms affecting the pension system, housing policy, and the operations of Government Linked Corporations (GLCs). They supported the steps taken to reduce the bias in the Central Provident Fund (CPF) toward housing investment, and to encourage its diversification into alternative financial investments. Noting Singapore has one of the highest rates of home ownership in the world, Directors considered appropriate the privatization of some functions of the Housing Development Board, now that it has successfully met its mandate to provide Singapore residents with adequate housing. While acknowledging that GLCs have been managed strictly on commercial principles, several Directors encouraged the authorities to advance their plans for divesting these enterprises to bolster the credibility of the government's restructuring policies and to send positive signals about the government's intentions to boost entrepreneurship. However, a few Directors considered that the authorities were prudent and responsible in their approach to divesting the GLCs.

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/02/119 (12/5/02) and EBM/02/120 (12/9/02).

3. PERU—REPRESENTATIVE RATE FOR PERUVIAN NUEVO SOL

1. The Fund finds, after consultation with the authorities of Peru, that the representative exchange rate for the currency of Peru against the U.S. dollar under Rule O-2(b)(i) of the Fund's Rules and Regulations is the spot bid exchange rate for buying U.S. dollars based on data of such rates for the whole financial system as officially reported daily by the Superintendencia de Banca y Seguros (SBS) to the Banco Central de Reserva del Peru.

2. Banco Central de Reserva del Peru will inform the Fund of any changes affecting the definition of the representative rate. (EBD/02/157, Rev. 1, 12/4/02)

Decision No. 12900-(02/120), adopted
December 6, 2002

4. COMPENSATORY FINANCING FACILITY—REVIEW AND NEW DEADLINE

In Paragraph 33 of Decision No. 8955-(88/126), adopted August 23, 1988 (as amended), "August 30, 2002" shall be replaced by "June 30, 2003." (SM/02/364, 11/27/02)

Decision No. 12901-(02/120), adopted
December 6, 2002

5. CONTINGENT CREDIT LINES—REVIEW—EXTENSION OF DEADLINE

In Paragraph 22 of Decision No. 11627-(97/123) SFR, adopted December 17, 1997 as amended), "November 30, 2002" shall be replaced by "June 20, 2003." (SM/02/364, 11/27/02)

Decision No. 12902-(02/120), adopted
December 6, 2002

6. EXTERNAL AUDIT COMMITTEE—SELECTION OF MEMBER

Pursuant to Section 20(c) of the Fund's By-Laws, the Managing Director is authorized to appoint Mr. Philippe Adhémar to serve as a member of the External Audit Committee for a term of three years from the beginning of FY 2003. (EBAP/02/138, 11/27/02)

Adopted December 6, 2002

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAM/02/150, Sup. 1 (12/5/02) and EBAM/02/151 (12/5/02), by Advisors to Executive Directors, and by an Assistant to Executive Director as set forth in EBAM/02/151 (12/5/02) is approved.

8. TRAVEL BY MANAGING DIRECTOR

Travel by Managing Director as set forth in EBAP/02/141 (12/6/02) is approved.

APPROVAL: February 19, 2003

SHAILENDRA J. ANJARIA
Secretary