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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/8

10:00 a.m., January 18, 1985

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	A. Koné, Temporary
C. H. Dallara	M. K. Bush
	H. G. Schneider
B. de Maulde	
M. Finaish	T. Alhaimus
	M. Sugita
G. Grosche	B. Goos
J. E. Ismael	Jaafar A.
	G. W. K. Pickering, Temporary
A. Kafka	
	A. Lindø
R. N. Malhotra	A. S. Jayawardena
E. I. M. Mtei	A. Abdallah
F. L. Nebbia	B. Jensen
Y. A. Nimatallah	J. E. Suraisry
	E. M. Ainley, Temporary
	J. E. Rodríguez, Temporary
J. J. Polak	J. de Beaufort Wijnholds
A. R. G. Prowse	A. V. Romuáldez
G. Salehkhou	R. Msadek, Temporary
	T. A. Clark
S. Zecchini	N. Coumbis
	Wang E.

L. Van Houtven, Secretary
R. S. Franklin, Assistant

Also Present

Administration Department: G. E. Gondwe, J. G. Keyes. African Department: R. J. Bhatia, Deputy Director; S. M. Nsouli. Asian Department: P. R. Narvekar, Deputy Director; C. Sassanpour, G. Szapary, X. Vongsathorn. European Department: R. P. Hicks. Exchange and Trade Relations Department: J. T. Boorman, E. H. Brau, S. Kanesa-Thasan. External Relations Department: A. M. Abushadi, H. O. Hartmann, N. K. Humphreys. IMF Institute: S. El-Khouri; J. Bdaiwi, W. Y. Yong, Participants. Legal Department: J. K. Oh, S. A. Silard. Middle Eastern Department: A. S. Shaalan, Director; P. Chabrier, Deputy Director; F. Drees, S. H. Hitti, Z. Iqbal, H. E. Jakubiak, B. A. Karamali, A. Kayoumy, D. B. Noursi. Research Department: A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; C. P. Blackwell, K.-Y. Chu, M. C. Deppler, N. M. Kaibni, H. C. Kim, A. Lanyi, E. A. Milne, T. K. Morrison. Secretary's Department: A. P. Bhagwat. Bureau of Statistics: W. Dannemann, Director; J. B. McLenaghan. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: H.-S. Lee, G. E. L. Nguyen, A. Steinberg, E. M. Taha, D. C. Templeman, A. Vasudevan, M. A. Weitz. Assistants to Executive Directors: H. Alaoui-Abdallaoui, J. R. N. Almeida, W.-R. Bengs, J. Bulloch, M. B. Chatah, Chen J., J. J. Dreizzen, G. Ercel, C. Flamant, V. Govindarajan, G. D. Hodgson, J. M. Jones, A. K. Juusela, H. Kobayashi, M. Lundsager, A. Mustafa, J. Reddy, A. A. Scholten, L. Tornetta, A. J. Tregilgas, B. D. White.

1. SOMALIA - REQUEST FOR STAND-BY ARRANGEMENT

The Chairman remarked that Somalia's request for a stand-by arrangement had been removed from the Executive Board's agenda for the present meeting because a payment due by Somalia to the Fund had not yet been received. It was expected that the matter would be settled shortly and the item could be rescheduled. In that context, it was worth noting that the donors' meeting on Somalia would take place in Paris on January 23, 1985. Recent developments underscored the importance of a positive outcome of that meeting to help close Somalia's balance of payments financing gap projected for 1985.

Mr. Finaish added that the amount of Somalia's overdue obligations to the Fund was small, and the payment had been delayed essentially for technical reasons. He too expected that the matter would be settled soon and hoped that the donors' conference would produce the necessary financing so that Somalia's request for a stand-by arrangement could be brought back to the Board for approval.

2. JOINT STATEMENT - MINISTERS OF FINANCE AND CENTRAL BANK GOVERNORS - REPORT BY MANAGING DIRECTOR

The Managing Director, reporting briefly on his participation in the January 17 meeting of Finance Ministers and Central Bank Governors of France, the Federal Republic of Germany, Japan, the United Kingdom, and the United States, observed that the participants had held frank discussions, inter alia, on the problems of economic policy convergence. Since his participation in the meeting had been limited to the issue of multilateral surveillance, he had little to add to the joint statement issued by the participants at the conclusion of their meeting (reproduced as EBD/85/27, 1/22/85).

Mr. Dallara added that the meeting to which the Managing Director had referred had been one of a regular series of consultations among the Ministers and Governors on a range of international economic and financial issues. The participants had covered a number of topics, including the forthcoming Interim and Development Committee Meetings, the economic situation and prospects of members--as part of the process of multilateral surveillance--and recent developments in the exchange markets. On that latter point, the Ministers and Governors had expressed their commitment to working toward greater exchange market stability, and they had reaffirmed their commitment to pursuing monetary and fiscal policies that would promote steady, noninflationary growth. They had also stressed the importance of removing structural rigidities in their own economies in order to achieve the objective of such growth, and they reiterated their commitment--initially made at the Williamsburg Summit--to undertake coordinated intervention in the markets as necessary.

3. JORDAN - PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY - FLUCTUATIONS IN COST OF CEREAL IMPORTS

The Executive Directors considered a request by Jordan for a purchase in an amount equivalent to SDR 57.4 million under the decision on the compensatory financing of fluctuations in the cost of cereal imports (EBS/84/265, 12/20/84; and Sup. 1, 1/16/85).

The staff representative from the Middle Eastern Department made the following statement:

> The 1985 budget for Jordan was presented to the National Consultative Assembly on December 14, 1984. As the authorities have made some structural changes in the presentation of the accounts, the staff is not in a position to quantify fully the various components of the budget and make the necessary comparisons with previous years at this stage. However, on the basis of information received, the staff believes that the new budget represents a continuation of Jordan's prudent financial policies.
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> As for the policy package, a number of measures have been taken to strengthen government finances and to restrain import demand for luxury items. Increases have been effected in the prices of petroleum products, including aviation fuel, cooking gas, and electricity. Effective December 13, 1984, petroleum product prices were raised by 5-9 percent and electricity charges for large users by 36.8 percent. Effective December 27, 1984, the prices of both imported and locally produced cigarettes were raised by 8-16 percent. Effective December 28, 1984, the authorities raised tariffs on some imported goods such as televisions, VCRs, air conditioners, refrigerators, clothing, footwear, and furniture. On the other hand, reductions were made in the sale price of some basic commodities, namely, sugar and rice (by 11 percent) and meat (by 4.5 percent).
>
> In addition to the price measures taken to reduce the energy subsidy, a number of regulatory measures have been adopted to curtail consumption of fuel and to reduce the oil import bill. Also, the authorities have intensified their exploration efforts for petroleum and have allocated JD 14.3 million in the 1985 budget for this purpose, compared with the JD 4 million allocation in the 1984 budget.

Mr. Finaish, noting that all the requirements for a purchase under the compensatory financing facility had been met, expressed his confidence that his colleagues would approve Jordan's request.

Mr. Nimatallah stated that he supported Jordan's request, which appeared fully to satisfy all relevant conditions. First, a balance of payments need clearly existed: the current account had been in deficit since 1982, and the overall balance of payments had moved into deficit in the current year. The authorities had made a determined effort to limit the external deficit, and it was encouraging that the balance of payments was expected to be in surplus by 1986. Second, the export shortfall for which Jordan was requesting a purchase had been caused by factors beyond the control of the authorities, including the contraction in Jordan's main export markets and depressed world prices for phosphates. Similarly, an excess in cereal imports had been necessitated by the recent drought. Since the calculations on which the purchase was based relied on actual data, there was no risk of overcompensation. Moreover, the export shortfall and the excess in cereal imports should be viewed as temporary; the authorities had already taken steps to expand industrial capacity, explore new markets, and promote tourism. In the circumstances, Jordan seemed well placed to benefit from the expected economic recovery in the region in the period ahead.

The third, and perhaps most significant, requirement for a purchase under the compensatory financing facility was the test of cooperation with the Fund, Mr. Nimatallah continued. Jordan fully met the requirement with respect to a compensatory financing facility purchase above 50 percent of quota. The authorities had a good record of sound economic management, including prudent financial policies. In response to a decline in external grants and a fall in external demand, the authorities had moved promptly to restrain the growth of imports and to mobilize domestic resources; and their adjustment efforts throughout 1984 had been effective. Public expenditure had been sharply reduced, tax revenues had been steadily increased, and fiscal restraint had been supported by cautious monetary and credit policies, together with measures aimed at maintaining external competitiveness and promoting exports. Certainly those policies were proof that the authorities had been cooperating fully with the Fund to overcome Jordan's balance of payments difficulties. In sum, because the Jordanian authorities had been managing the economy well and had been cooperating with the Fund, Jordan was fully entitled to purchase under the compensatory financing facility.

Mr. Polak considered that Jordan's request for a purchase under the compensatory financing facility was little different from other such requests, except in the test of cooperation. There was no doubt of the existence of a balance of payments need in recent years, even including 1984, which had witnessed a decline in gross international reserves of SDR 172 million; the shortfall in exports of manufactured goods and phosphate rock had been caused by factors clearly beyond the control of the authorities; and Jordan had clearly experienced a temporary surge in the cost of cereal imports as a result of the recent drought. Moreover, the staff's arguments establishing the temporary nature of the shortfall had been persuasive.

However, Jordan's request for a purchase in the upper credit tranche of the compensatory financing facility was unusual in the sense that, because the authorities were not at the same time requesting a stand-by arrangement, it was somewhat more difficult to determine whether the policies being followed in Jordan were appropriate to meet the test of cooperation, Mr. Polak continued. According to Fund guidelines, cooperation was considered to be satisfactory if the "member's current and prospective policies were such as would, in the Fund's view, meet the criteria of the use of resources in the credit tranches...." When Indonesia had purchased under the compensatory financing facility in mid-1983 (EBM/83/113, 7/29/83), its drawing had been limited to 50 percent of quota, even though the staff had stated on that occasion that "the measures undertaken by the Indonesian authorities are an adequate response to the recent deterioration in the external position." He recalled having suggested on that occasion that, in such circumstances, the member should have access in the upper tranche if it qualified on the basis of the numbers. He welcomed the Jordanian request as just such a case, thus underlining the fact that the compensatory financing facility had not become merely an adjunct to stand-by arrangements.

If the staff had conducted a recent Article IV consultation with Jordan, it might have been able to rely on the Board's view--as reflected in the Chairman's summing up of the discussion--that the country's policies were appropriate, Mr. Polak said. However, Jordan was on an 18-month cycle, and the most recent consultation discussion had been in November 1983. Of course, management and staff might have delayed presenting Jordan's request to the Board until the occasion of the next consultation, which was scheduled to take place in a few months. He was happy that such an approach had not been adopted and that the staff had chosen to appraise Jordan's policies on the findings of a special mission. After all, an essential characteristic of the compensatory financing facility was its ability to function quickly, and any undue delay would have been inappropriate.

The nature of Jordan's case required the Executive Board to pass as serious a judgment on the country's policies as if Jordan had in fact requested a stand-by arrangement, Mr. Polak noted. Unfortunately, the information provided in the staff paper on which such a judgment should be made was less complete than that normally presented in connection with a stand-by request. Much of the information in Annex I was descriptive; and insufficient attention had been given to current policies in relation to recommendations in the most recent consultation. Nonetheless, certain points, which could be seen as lending support to the request, were clear: the authorities had sharply adjusted government expenditure to deal with a projected decline in grants in real terms; additional revenues had been raised; monetary expansion had been on a downward trend compatible with a low inflation rate and a satisfactory real growth rate; the pegging of the currency to the SDR had prevented a deterioration in the real effective exchange rate; and the country's exchange and trade systems were virtually free of restrictions. In noting the fiscal adjustments, the staff had observed that, as a percentage of GDP, the decline in government expenditure had been even larger than the decline in foreign grants, and he wondered whether the staff had appropriately estimated the ratio in Jordan's case. The implication seemed to be that it was normal for foreign grants to increase with the real growth of the economy and that any different development would demand painful adjustment.

Despite the adjustment he had mentioned, a number of questions remained, Mr. Polak said. The debt service ratio appeared quite low when properly expressed as a percentage of exports of goods and services; however, the ratio given in the staff paper did not seem to include the full service on military loans and oil credits, and he wondered about the importance of including such elements. On another matter, he observed that the new obligation for commercial banks to buy shares in commercial companies seemed to present a potential danger, not merely to the liquidity of the banks but also to the safety of depositors' claims, which were related in essence to the solvency of the banks. The fact that the purchases of shares by the commercial banks were limited to 10 percent of any company's capital was not particularly reassuring. Moreover, information on energy pricing was difficult to appraise, as petroleum prices had been presented only in units of local currency per liter, without any international comparisons; and no indication had been given of the size of the oil subsidy. It was to be hoped that those and other issues would be taken up in the next Article IV consultation discussion. In sum, he could agree that Jordan was continuing to implement generally appropriate policies in support of balance of payments adjustment. Since Jordan had satisfied the test of cooperation, he could support the proposed decision.

Mr. Goos indicated that he too was satisfied that Jordan's request met all the criteria for a purchase under the compensatory financing facility. He had no difficulty accepting the staff's view that the test of cooperation had been met; like Mr. Nimatallah and Mr. Polak, he considered that Jordan had responded to its external and domestic economic difficulties in a generally appropriate manner, and he was confident that it would continue to do so. He was nonetheless puzzled about the meaning and implication of some of the measures recently adopted by the authorities and mentioned in the opening statement by the staff. In particular, he would be grateful for further elaboration on the regulatory measures concerning fuel consumption and the oil import bill and on the price reductions of sugar and rice. In his view, it would be inappropriate if the price measures were to lead to an increase in government subsidies or if the regulatory measures had been adopted as a substitute for more appropriate exchange rate policies.

Mr. Malhotra stated that his chair could fully support the proposed decision. Jordan clearly had a balance of payments need, and the deterioration in the balance of payments appeared to be temporary in nature, reversible, and beyond the control of the authorities; moreover he could accept the staff's assessment that the policies being pursued by Jordan fully met the test of cooperation for a purchase in the upper credit tranche.

While Jordan's request was entirely in accordance with Fund policy and with the decision on the compensatory financing facility, the Jordanian case was the first in which a request for a purchase exceeding 50 percent of quota had been put to the Board without being accompanied by an Article IV consultation or a request for a stand-by or extended arrangement, Mr. Malhotra noted. It was to be hoped that, where circumstances warranted, the same approach could be adopted in other cases, which would give some assurance that the special facilities were not being de-emphasized. Finally, while the information contained in Annex I of the staff paper had, in his view, been sufficient, he agreed with Mr. Polak that a short summary highlighting economic policies might have improved the presentation.

Mr. Nebbia stated that he too could support the proposed decision. The Jordanian authorities had been making a strong effort to ensure continued economic growth and development through the pursuit of sound economic management and prudent financial policies. Jordan's economy had continued to develop in spite of the significant negative effects of less buoyant economic conditions in neighboring oil exporting countries and the impact of the world economic recession on the demand for its phosphate and other export products. The demand management and exchange rate policy responses of the authorities to those developments had been adequate.

The criteria for a purchase under the compensatory financing facility for fluctuations in the cost of cereal imports had been fully met, Mr. Nebbia continued. Clearly, Jordan was experiencing a real balance of payments need caused by a sharp drop in grants, a slowdown in export earnings, and an increase in cereal imports, all resulting from the severe drought. Moreover, Jordan had been cooperating with the Fund to seek appropriate solutions to its balance of payments difficulties, and the authorities had pursued sound policies over the past three years in order to adjust to deteriorating conditions in the external sector. In that regard, the decrease in total budget expenditures by 14 percent of GDP was impressive. The shortfall was temporary in nature and had been largely beyond the authorities' control. The weakening of external demand and a drop in export prices had led to falls in revenue, while the increase in cereal imports had been provoked by the severe drought. Also, it was noteworthy that, in calculating the amount of compensation under the facility, the staff had employed only actual data; hence, there was no risk of overcompensation.

The Executive Board had demonstrated commendable foresight in May 1981 by adopting the decision on the compensatory financing of fluctuations in the cost of cereal imports, Mr. Nebbia remarked. In some countries, the effects on the balance of payments of sharp but temporary fluctuations in the cost of imports had been as great as those of export shortfalls and often demanded similarly stringent adjustment policies. In Jordan's case, a decision had been taken to continue to feed the population regardless of the negative effects of such a decision on the country's balance of payments. Import costs of cereals had nearly doubled in 1984 compared with the average of previous years, and Jordan's use of the compensatory financing facility to meet that increase was appropriate.

Marketing problems resulting from developments in Jordan's traditional trading partners were as damaging to the external sector as the effects of protectionism in other external markets, Mr. Nebbia considered. It was interesting to note in that respect that the fall in the price of Jordan's major export product--phosphate--had not been as dramatic as declines in other primary commodity prices. Specifically, primary commodities like copper, silver, sugar, and cotton had experienced unprecedented and far sharper price declines, a fact that reinforced his view that the Fund should take a case-by-case and flexible approach in responding to members' requests for purchases under the compensatory financing facility.

Mr. Prowse said that he supported the proposed decision, especially given that the policy measures adopted in the recent past seemed appropriate and consistent with successful economic management. In particular, the overall budget situation was reassuring, as was the evident stability in prices. Jordan's request for a purchase was straightforward and met all the relevant requirements. The request was unique in that it was not associated with an existing or proposed program or arrangement with the Fund, a fact which made it difficult to assess the extent of Jordan's cooperation with the Fund. However, according to the staff, "the Jordanian authorities have a good track record of sound economic management and prudent financial policies," and that statement seemed indicative of precisely the sort of cooperation required by the Fund; moreover, in the previous Article IV consultation with Jordan, the staff and the Executive Board had concluded that economic performance had been both commendable and prudent. And a recent mission had determined that the authorities were continuing to implement appropriate adjustment policies, a judgment confirmed by the low rate of inflation and low external debt service ratio in 1984, together with the 3 percent rate of real growth in GNP.

Jordan had experienced an overall balance of payments deficit for 1984 of SDR 62 million, together with a decline in international reserves from SDR 1.8 billion to SDR 1.6 billion in the first nine months of 1984, Mr. Prowse observed. It was perhaps worth noting that, under the concept of balance of payments need as defined in the Articles of Agreement, a member could be regarded as having satisfied the requirement of need if its balance of payments position per se was of concern, if its reserve position was unfavorable, or if there were unfavorable developments in the trend of its reserves. The Jordanian case illustrated the important consequences of separating those three elements of need, and those distinctions should be borne in mind when the general decision on compensatory financing of fluctuations in the cost of cereal imports was reviewed in May.

Mr. Salehkhou remarked, that on November 21, 1983 (EBM/83/158), his chair had informed the Executive Board that Jordan had certain overdue financial obligations with respect to the Islamic Republic of Iran. He was happy to report to Directors that those obligations had been settled through the good offices and diligent efforts of Mr. Finaish and that Jordan was at present current in its obligations to the Islamic Republic of Iran.

Mr. Clark observed that Jordan's general policy stance seemed appropriate and he therefore had no difficulty supporting the request for a purchase under the compensatory financing facility despite the absence of an existing or proposed program of the sort that might be used to justify the argument that the country was cooperating with the Fund in an effort to overcome its balance of payments difficulties. Still, he had noted a marked deterioration in the current account of the balance of payments over the past three years. While the reasons for the deficit were clear, he was concerned that they might not be temporary and that further measures to narrow the deficit might be required.

He was broadly satisfied that the shortfall was beyond the control of the authorities, although some components of the shortfall--particularly exports of manufactures--seemed to reflect overbuoyant domestic demand, Mr. Clark continued. Finally, on a more general matter, he had the impression that, in a number of requests for purchases under the compensatory financing facility, the rate of export growth forecast for the postshortfall period had been a good deal faster than the actual rate of growth registered in earlier years. He wondered whether such projections were often realized; and he reiterated the request of his chair--put forward some months earlier--for a staff paper looking at experience relating to such forecasts and outturns and to other aspects of compensatory financing.

Mr. Dallara, supporting the proposed decision, noted that Jordan's request had not been brought forward in conjunction with an existing or proposed upper credit tranche program supported by the Fund. Clearly, the test of cooperation did not require a Fund program to be in place; but the Executive Board must be reasonably assured on the occasion of any proposed use of Fund resources that the policies and the current and prospective economic situation of a country were consistent with a correction of the payments problem and that repurchases were likely. Under normal circumstances, a request for a purchase under the compensatory financing facility did not demand detailed consideration of underlying economic policies, because those would already have been reviewed as part of an existing or proposed upper credit tranche arrangement. In Jordan's case, in the absence of such an arrangement, the Board must look more closely at the policy stance and prospects of the Jordanian economy. In that context, he would have preferred more information in Annex I of the staff paper about the actual relationship between the Fund's views on policies expressed at the previous Article IV consultation with Jordan and the current policy stance. In particular, the sort of information typically incorporated in the staff appraisal of an Article IV consultation report would have been helpful.

On the current stance of economic policy in Jordan, Mr. Dallara remarked that civil service wages had slowed substantially over the past few years. The restrictive wage policy, in combination with Jordan's broader fiscal and monetary stance, had reduced inflation significantly in 1984. As a result, real interest rates had become positive, a development that he hoped would be maintained. However, the real effective exchange rate had appreciated somewhat during the year, and he wondered whether the staff viewed that appreciation as a matter for concern, given that Jordan should perhaps be searching for new or expanded export markets.

According to a recently published fiscal report for 1984, current expenditures had been about 8 percent higher than the figures shown in Table 13 of the staff paper, Mr. Dallara commented. The later figures seemed to imply a somewhat larger fiscal deficit as a percentage of GDP than reported by the staff. At the beginning of the meeting, the staff had provided some details on recent policy measures that might well be designed to address the increase in current expenditures; but it was not clear how those measures could be translated into the type of statistics that the Board was accustomed to analyzing with respect to the overall fiscal position of members. Any light that could be shed on the situation would be welcomed, as would any contingency measures that the authorities might be contemplating in the fiscal area to ensure that the deficit did not grow much beyond the staff's estimate of 3.3 percent of GDP.

The staff representative from the Middle Eastern Department observed that the staff had gone to great lengths to glean as much information from its recent discussions with the Jordanian authorities as it would normally attempt to obtain for an Article IV consultation. While a direct link between the policy appraisal and recommendations of the most recent consultation and the current and prospective policy stance of the Jordanian authorities had not been drawn in Annex I of EBS/84/265--where the numbers on economic performance had been updated--the staff had attempted to make the relationship in the section on cooperation with the Fund in order to provide Directors with the sort of information that would appear in the staff appraisal in a stand-by or consultation paper. Because of the discussion on policy issues, the section on cooperation with the Fund was much longer than was usually the case in compensatory financing papers.

In response to Mr. Polak's observations on the comparison over time of the ratios of foreign aid and of government expenditures to GDP, the staff representative remarked that the staff had not felt uncomfortable adopting the somewhat unusual approach, given the special characteristics surrounding Jordan's budgetary system. Historically, foreign grants had been an integral part of Jordan's budget and in most years had financed all capital expenditures as well as a sizable proportion of current expenditures. Of course, the authorities were hopeful that by 1986 all current expenditures could be met by domestic revenues. Still, in view of the role played by foreign grants in Jordan's budget, the relationship between government expenditures as a percentage of GDP and foreign grants as a percentage of GDP was a convenient way of indicating the extent and nature of the adjustment that had been forced upon Jordan as a result of the drop in aid grants since 1981. As for the debt service ratio shown in Table 18, it was important to note that only repayments on military loans were excluded; repayments on revolving oil credits were included in the figures. Unfortunately, the staff did not have sufficient information on the size of the military debt burden to indicate the extent to which the ratio of debt service to exports of goods and services would be affected if military debt obligations were included.

Fuel subsidies for 1984 had amounted to approximately JD 15 million, which was equivalent to roughly 3 percent of current expenditures, the staff representative continued. As a result of fuel price increases effected during December 1984, the staff had calculated that the fuel subsidy would be approximately halved in 1985; more precise calculations were not possible at the present stage.

As to the rationale for reductions in the sale prices of sugar, rice, and meat, he understood that those reductions had been made to reflect the drop in world prices of those commodities in 1984; consequently, there should not be any increase in the budget subsidies.

It had been observed that, despite a general depreciation in the rate of the dinar over a two-year period, reference to a shorter period suggested that the currency had appreciated somewhat, the staff representative recalled. The staff had discussed exchange rate policy with the Jordanian authorities, who were keeping the matter under close review. At present, they saw no need for any change in the exchange rate to make Jordan's exports more competitive; however, they were looking into the possibility of linking the dinar to a special basket, which could provide them with greater flexibility in effecting exchange rate changes.

In raising questions on Jordan's 1985 budget, Mr. Dallara had made reference to a summary table, which unfortunately did not provide sufficient disaggregated data to permit the staff to arrive at figures that were comparable with the data for previous years, the staff representative commented. An exercise aimed at gathering such data would, however, be undertaken during the next round of discussions in February-March 1985. What was clear from the summary table was that domestic revenues and current expenditures were projected to increase by 14 percent and 11 percent, respectively, compared with expected actuals in 1984. Some confusion might have been created because the expected actuals in the summary statement were different from those in the staff paper; in fact, the figures contained in the staff paper were provided by the authorities as the expected actuals, while those in the summary statement appeared to be the revised budget estimates. In any event, on the basis of the latest available data, it was the staff's understanding that domestic revenues would cover 98 percent of current expenditures during 1985, thus bringing Jordan closer to its goal of achieving 100 percent coverage through domestic revenues by 1986.

The summary table also did not provide a complete picture for capital expenditures, although it gave some indication of trends, the staff representative remarked. Notwithstanding the lower than budgeted level of foreign grants during 1984, projected inflows for 1985 were at the same level as projected in the 1984 budget. The 1984 estimate had been for foreign grant inflows of JD 183 million, while the expected actual figure was closer to JD 125 million. The 1985 budget began with the projection of JD 183 million and related it to a much higher level of capital expenditures. In the event that foreign grants did not increase above current levels, there would be a shortfall in capital spending. As the figure for "net lending" could not be extracted from the information available, the actual magnitude of the overall budget deficit for 1985 could not be determined, but it appeared to be smaller than the 1984 budget figure. The bulk of the projected deficit for 1985 would be financed through external loans. The staff continued to feel that an overall deficit for 1984 of about 3.5 percent of GDP was a reasonable estimate.

The staff representative from the Research Department remarked that the staff was in the process of examining its experience with the projections relating to compensatory financing calculations. The intention was to produce its findings in the paper--to be discussed sometime in May--reviewing the decision on the compensatory financing of fluctuations in the cost of cereal imports.

The shortfalls in construction materials was attributable mainly to sharp changes in demand in neighboring countries, particularly Iraq, the staff representative from the Research Department explained. Following a strong decline in export value in 1982/83, a 21 percent recovery had been registered in the shortfall year because of the change in demand.

Mr. Finaish observed that Jordan was not an extensive user of Fund resources. Since it had become a member in 1952, it had made use of the Fund's resources only twice--once in 1971 and again in 1973--for a total of SDR 7.3 million in purchases under the compensatory financing facility. Praised as a member in good standing, Jordan had always worked toward good economic performance despite many difficulties, including a limited resource base, vulnerability to external factors, and continued occupation of the West Bank.

With regard to questions on the test of cooperation with the Fund, Mr. Finaish agreed with the staff that the discussions with the authorities had been comprehensive and that extensive data had been gathered. On the basis of that data, the staff had judged that the authorities were cooperating with the Fund to find solutions to their temporary balance of payments problems. Finally, he agreed with those who felt that approval of the Jordanian request would reaffirm the distinctive character of the compensatory financing facility, a confirmation that was important in light of the doubts that had recently been raised regarding the guidelines on access to the facility.

The Chairman remarked that the Jordanian case demonstrated that, when the Fund was satisfied that appropriate economic policies were in place, there need be no reluctance in approving the sort of assistance available under the compensatory financing facility. However, when such requests were put before the Board in the absence of a stand-by request or an Article IV consultation report, the staff should perhaps be more explicit in its appraisal of economic policies.

The Executive Board then adopted the following decision:

1. The Fund has received a request from the Government of Jordan for a purchase of SDR 57.4 million under the Decision on Compensatory Financing of Fluctuations in the Cost of Cereal Imports (Executive Board Decision No. 6860-(81/81), adopted May 13, 1981, as amended).

2. The Fund notes the representation of Jordan and approves the purchase in accordance with the request.

Decision No. 7889-(85/8), adopted
January 18, 1985

4. SINGAPORE - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with Singapore (SM/84/278, 12/20/84; and Cor. 1, 1/8/85). They also had before them a report on recent economic developments in Singapore (SM/85/7, 1/4/85).

Mr. Jaafar made the following statement:

The staff report for the 1984 Article IV consultation and the report on recent economic developments in Singapore provide the Board with two excellent sources of information on Singapore's economy. It is perhaps important for Directors to note at the outset that, in the appraisal, the staff views do not differ significantly from those of the authorities regarding the appropriate conduct of policies in 1984. And, his authorities found the staff's appraisal to be approriate and fair.

The picture emerging from these reports is that of a dynamic economy, evolving rapidly from a center for entrepôt trade in the early 1960s to labor-intensive manufacturing in the 1970s and finally to high-skill and high-value-added activities in the 1980s, all within a short span of 25 years since gaining self-rule in 1959. The strategy had been to open the country to foreign investment, taking advantage of the country's good location and excellent infrastructure. As a result, net foreign investment, in the form of nondebt-creating flows, reached S$20 billion by 1983, with 90 percent in direct investment and the rest in other foreign-equity ownership of companies, presently comprising 40 percent of the country's total.

Singapore has thus become one of the fastest growing countries in the world, rapidly joining the group of the newly industrialized countries. With a population of only 2 1/2 million, and a birth rate of less than 2 percent a year, it enjoys a per capita income (1983) of US$6,523, among the highest in the region and comparable to Italy. Average growth over the past five years has been at a comfortable 8 1/2 percent with relative price stability. Gross reserves at present stood at US$10.5 billion, which was equivalent to six months of retained imports and represented an appropriate cushion against external shocks. In line with the anticipated slower growth in overseas demand, growth forecast for 1985 is a comfortable 6-7 percent, still respectable by international comparison.

It is in terms of the conduct of policies, faithfully pursued over the years, that Singapore is distinguished from others. In public finance, which forms the cornerstone of its policies, Singapore follows a prudent and conservative path by matching expenditures with revenues. It is no accident that no deficits in the yearly budgetary outturn are observed, in spite of a projected deficit in the budget documents early each year. This has been the case since 1968, and FY 1984/85 is no exception. The original budget projected a deficit of S$3.7 billion, or 10 percent of GDP, but the actual outturn is estimated to be a small surplus or perhaps a balance.

The FY 1985/86 budget was still under preparation when the staff mission was in Singapore last October. However, my Singapore authorities do not anticipate a change in their fiscal stance, in spite of the strong evidence of slackening external demand in the coming year, especially in the United States. Higher expenditure outlays to support sagging total aggregate demand as in 1982 will not be repeated.

The dominant role of Government should not come as a surprise in a developing economy. But for Singapore, this role is expected to be reversed soon with the maturing of major public sector projects. The aim is to stabilize expenditure at the current level or even to lower it somewhat. As a proportion of GDP, public sector expenditure stood at 46 percent in 1983/84, as against a ratio of revenue to GDP of 47 percent for the same period (31 percent and 33 percent for the Central Government respectively). But a large share of the supply of private sector capital is traditionally met from foreign capital inflows in the form of direct investments and equity. In addition, as a proportion of the total labor force, employment in the public service is only 10 percent; there is no danger of crowding out.

The primary aim of monetary policy has been to promote a strong and stable currency. Indeed, this is entirely appropriate in view of the size and open nature of the economy and is in line with the need to sustain confidence and insulate the economy from foreign inflation, but also with an eye to maintaining enough flexibility to preserve external competitiveness. Domestic interest rates are therefore allowed to seek their own levels, subject only to the influence of market forces.

Although the excess demand for liquidity arising from the Government's financial operations has put continuously strong upward pressure on the exchange rate (which has appreciated by 14 percent in real terms since 1980), my authorities recognize the need for moderation in the interest of protecting export competitiveness. But the impact so far on exports, at least over the past two years, 1983-84, has been mixed. Some sectors--the labor-intensive, low-value-added industries--were obviously adversely affected by the loss of competitiveness on account of rising unit labor costs, but those developments were in line with the authorities' industrial restructuring policy. Exports by other sectors, on the other hand, are better able to compete and grow vigorously as a result of higher productivity gains. The authorities, therefore, will continue their present exchange rate policy, which aims at balancing the twin objectives of maintaining domestic price stability and safeguarding export competitiveness.

The essential, underlying rationale of industrial restructuring policy is to overcome the tight labor constraints that could inhibit growth prospects in the years ahead. The authorities' three-year wage correction initiative, adopted in mid-1979, formed part of the strategy to encourage industries to switch from low-value-added and labor-intensive industries to high-value-added and high-skill industries. The other part of this strategy is the provision of fiscal, financial, and locational incentives. The Skills Development Fund (SDF) is designed to assist training and skill upgrading, while the Science Park is aimed at promoting the concentration of high technology industries in one place in the hope that such concentration will assist in creating the desired critical mass for the new high-technology to take off. Tax breaks and reductions in bureaucratic red tape should also help in encouraging foreign firms to locate and invest in Singapore.

The results thus far have been encouraging. High labor costs have started to move the traditional factories away from Singapore, and other industries have taken their place. Textiles have been replaced by high-fashion designer wear, and from basic sawmilling to furniture manufacture. Some other low-skilled industries have disappeared altogether, and entirely new industries are beginning to emerge, including those making computers, precision machine tools, and other high-technology products. The value-added share of high-technology and high-value-added industries, excluding oil-related industries, rose from 68 percent in 1979 to 72 percent in 1983. Output growth for the same industries averaged 6 percent a year during 1980-83, compared with negative growth of 4 percent in the nonfuel manufacturing industries.

Growth in coming years will come as much from the development of high-technology and capital-intensive industries as from the development of Singapore as a financial center. The financial sector in recent years has consistently been responsible for the largest share of growth since 1980, averaging more than 30 percent a year. The growth in the Asia dollar market (ADM) is phenomenal. Total assets grew from only US$30 million in 1968, at the inception of the ADM, to US$112 billion by 1983. That rapid growth owes as much to fiscal incentives to encourage market development, as well as to other factors, most importantly Singapore's ideal geographic position, an excellent telecommunications facility, and a highly trained indigenous labor force.

In order to broaden the financial infrastructure further, the authorities recently promoted the funding of the Offshore Fund Management and Financial Futures Trading. The financial futures market was announced early last year and was linked to the Chicago Mercantile Exchange, while the Offshore Fund Management was given a boost with the announcement in April 1983 of the tax holiday scheme for syndicated offshore loans, syndication of guarantees, performance bonds, underwriting of debt issues, etc.

The aim is to make Singapore, by the 1990s, an international center offering financial, computer, information, consultancy and other professional services to the region. By that time, too, it should have ended its dependence on unskilled foreign labor.

Finally, my authorities are committed to an open trade practice and pride themselves on maintaining a free trade and exchange system. With a similarly liberal international system, the benefits for all countries are obvious. Therefore, recent developments impinging on free trade are of deep concern to my authorities. Tariff and nontariff barriers are hurting Singapore's exports. Nontariff barriers in the major markets are the more damaging in that they cause a great deal of uncertainty among Singapore's exporters; these barriers are more subtle, and the exact nature of the restriction is more difficult to ascertain.

Protectionist measures could bring lasting damage to Singapore's industrial development through their impact on direct foreign investment flows. Recent trends, worldwide, of multinationals redirecting their investment to countries with protected markets in order to circumvent trade barriers are of deep concern to my Singapore authorities. The role that direct foreign investment has played in Singapore's development has proven itself and should be underscored. Such adverse trends could prove detrimental to Singapore's progress.

Mr. Sugita remarked that, following a short period of slowdown, GDP in Singapore had registered a strong recovery in 1983 and 1984; and other current economic indicators--including employment, prices, the balance of payments, and reserves--reflected the outstanding health of the economy and were attributable to farsighted government policies.

Despite those achievements, investment in machinery and equipment had declined in 1983 and 1984, Mr. Sugita observed. If that trend were to continue, together with slow growth in housing and infrastructure--due mainly to the authorities' choice to work first toward satisfying the basic needs of the population--the scope for internally generated expansion would become increasingly limited, thus making the economy more dependent on external demand as a source of growth. Attributing the decline in capital investment to low capacity utilization in manufacturing, the staff was optimistic that the trend could be reversed in future. However, he wondered to what extent the high wage policy pursued some years previously had affected profit margins of enterprises and business prospects and failures. Also, had that wage policy been responsible, at least in part, for the decline of investment in manufactures?

The statement on page 43 of SM/85/7 that "the Singapore dollar has been pegged, within margins, to an undisclosed trade-weighted basket of currencies of Singapore's main trading partners" seemed to imply that changes in the exchange rate were made on a fairly mechanical basis, Mr. Sugita said. However, in the paragraph immediately following, it was noted that, "reflecting the traditional surpluses in the balance of payments and the low rates of domestic inflation relative to foreign inflation, the Singapore dollar has tended to appreciate against the currencies of major trading partners...," an observation which suggested that, to some extent, the exchange rate was determined by discretion or by market forces. He would welcome some clarification of the way in which the exchange rate was determined in Singapore.

The savings that had been generated through contributions to the Central Provident Fund (CPF) were impressive, Mr. Sugita noted. However, he wondered how and by what means the Government had persuaded the public to support such compulsory contributions at a time when the CPF was running a large surplus. Since the lack of savings was one of the major problems facing many countries in the world at present, the secret of Singapore's success in generating savings would be of benefit to all.

Mr. Ainley remarked that the Singapore authorities' successful management of the economy in recent years was commendable. Performance had been particularly remarkable for a small, open economy that had had to adapt quickly to the vagaries of world demand. Much of the authorities' success could be traced to the consistent pursuit of disciplined financial policies, which had created a climate of confidence and had led to a "virtuous" circle of high domestic savings and productive investment, both domestic and foreign. He welcomed the authorities' intention to maintain a prudent fiscal stance in 1985/86; the continued buoyancy of revenue provided scope for introducing new tax incentives for the private sector that should help to generate new investment in high-growth industries.

The return to free wage bargaining since 1984 had produced encouraging results, Mr. Ainley continued. Wage increases had moderated significantly, a development that, together with recent productivity gains, had sharply reduced the growth of unit labor costs. That, in turn, had strengthened external competitiveness to the extent that new industries should be able to respond flexibly to future changes in external demand. The role of monetary policy in Singapore was limited by the integration of domestic and international capital markets. However, the authorities had been able to make effective use of the available monetary tools, both to supply needed liquidity to the banking system and to prevent "round tripping" by banks in the Asian dollar market. The renewed growth of that market should provide Singapore with further opportunities to develop as a financial center; and the authorities' recent moves to attract offshore banking business were a further example of Singapore's ability to adapt quickly to changing conditions in the region.

The strong appreciation of the exchange rate since 1980 had helped to maintain domestic price stability and had assisted the authorities in their effort to phase out low-skill, labor-intensive industries, Mr. Ainley commented. Still, he agreed with the staff and Mr. Jaafar that the recent slowdown in the rate of appreciation should be beneficial for Singapore's new high-technology industries, especially since the risk of importing foreign inflation had been lessened by the slowdown in inflation in Singapore's industrial trading partners. For the medium term, the authorities' strategy of continuously upgrading the economy, based on the principle of comparative advantage, had helped to keep the outlook quite favorable. However, he shared the authorities' concern about the adverse impact of protectionism on trade and on foreign investment.

Mr. Wijnholds observed that Singapore had experienced continuing high growth, no inflationary pressures, an unbroken series of budget surpluses since 1968, and a modest current account deficit that was more than financed by capital inflows, mainly in the form of nondebt-creating direct investment. The record was one that few countries could match; and, while some exogenous factors had worked in the economy's favor, the policies of the authorities clearly had played a crucial role in the country's success. The authorities' outward-looking and financially sound economic policy approach could serve as an example to others, although he understood that circumstances in other countries might make it more difficult for them to emulate Singapore's performance. An interesting point to be noted from Singapore's experience was that it was quite possible for countries to achieve high growth rates while running budget surpluses.

Budgetary discipline in Singapore was excellent, although total public sector expenditure had risen rapidly in recent years to 46.5 percent of GDP in 1983/84 from a level of 38 percent of GDP some four years previously, Mr. Wijnholds continued. He understood from Mr. Jaafar that the Government intended to stabilize expenditure at the current level or even lower; given the experience in Europe with very high public sector expenditure as a share of national income, he warmly endorsed that aim.

Singapore was an export-oriented economy, and the expected lower growth in the United States in 1985 would undoubtedly affect Singapore's exports, Mr. Wijnholds remarked. Still, the staff was projecting an increase in real growth of 6 percent on the basis of the rather conservative assumption of growth of 3 percent in the United States; as such, he was not greatly concerned about Singapore's exports, and he hoped that the authorities would not depart from their present exchange rate policy, which had been helpful in reducing inflation.

Singapore was one of the more important offshore financial centers, with deposits at present exceeding US$100 billion, Mr. Wijnholds noted. The growth of the Asian dollar market had slowed in 1983, following a very rapid increase in earlier years; however, assets had again begun to grow at an annual rate of 14 percent during the first nine months of 1984, which was a rate considerably faster than that registered in other international financial centers such as the Eurocurrency market. Singapore had been increasing its share of the market for international financial intermediation, although regional lending was expected to slow in the near future. The Government had introduced further tax incentives to strengthen the role of Singapore as an international financial center and, in so doing, seemed to be following an ongoing trend that might not necessarily be all for the good. It was to be hoped that the authorities were at the same time working to improve supervision over offshore banking activities. On page 5 of SM/84/278 the staff had made reference to an inflow of monetary capital brought in by banks to strengthen their capital base, partly for prudential reasons. He wondered whether that inflow was related to the amendments to the Banking Act of 1984, and he would be interested in knowing the extent to which that Act pertained to the external activities of the banks. Also, he noted that the practice of "round tripping" by banks--which had complicated domestic monetary policy in the past--had been dealt with by the authorities.

Finally, remarking on Singapore's strong international reserve position, Mr. Wijnholds observed that the member's financial contribution to the Fund was rather modest; indeed, Singapore had not yet accepted the quota increase under the Eighth General Review. Also, according to press reports, Singapore had a reputation for active management of its foreign exchange reserves. Specifically, the Monetary Authority of Singapore had been listed by the Financial Times (London) as among the top three "traditional heavyweight speculators" in foreign exchange markets. He invited the staff or Mr. Jaafar to comment on that description.

Mr. Prowse noted that the successful management of the Singapore economy could provide lessons for others. During the past five years, real growth in Singapore had been five times the average registered in the OECD countries, while the rates of inflation and unemployment had been only half the average rates in the OECD. In searching for reasons for Singapore's success, the staff had placed emphasis on prudent financial management, the use of appropriate incentives, and the commitment of the authorities to upgrade the economy. While those factors might serve as a partial explanation for the success of the Singapore economy, there were some other more interesting elements that had been included in the staff report and in Mr. Jaafar's opening statement. Those espousing "conventional wisdom" would be expected to advise against too rapid a growth in the public sector; however, it seemed that in Singapore a very large and rapidly growing public sector had played an important and positive role in the development of the economy. The public sector had grown from 36 percent of GDP in 1979/80 to 46.5 percent of GDP in 1983/84, an increase of nearly 30 percent, much of which had taken place in the statutory boards. Such a development might be of concern in other countries, but the statutory boards in Singapore had, with two exceptions, operated profitably. Moreover, government intervention had been consistent and had been aimed at amplifying market forces while facilitating the adjustment process through labor training and the promotion of ample savings.

Beyond the good performance of the public sector enterprises, perhaps the most important element in Singapore's success had been the growth that had been encouraged not by expansionary demand management or fiscal deficits but by prudent policies that had led consistently to fiscal surpluses over a long period, Mr. Prowse remarked. Of course, there were some curiosities associated with Singapore's broad policy stance. First, budget outcomes seemed consistently to be different from projections by as much as 10 percent of GDP. In previous years, the staff had explained that the discrepancy was due mainly to conservative forecasting by government departments concerned about meeting revenue targets and staying within expenditure estimates. Second, Singapore at present had an internal public debt equivalent to about 76 percent of GDP, which must be seen in the context of no government financing requirement for the past 16 years. He presumed that was because of the requirement that the Central Provident Fund and the Post Office Savings Bank invested in long-term government debt. The corollary of their actions was the accumulation of government deposits with the Monetary Authority of Singapore, which in turn invested abroad. Those financial arrangements had resulted in an upward bias to budgetary outlays and revenues, stemming from rising debt servicing costs and growing profits for the monetary authority. Also, the CPF was at present the provider of housing finance and health benefits, which meant that social welfare expenditures were channeled through the CPF rather than through the budget. He wondered whether the staff saw such financing arrangements as having any medium-term implications for the budget, particularly with respect to the need to raise revenues in order to service the substantial internal debt.

Monetary policy was broadly appropriate, Mr. Prowse considered, especially given that the exchange rate--which was the main focus of such policy--did not seem to be resulting in unacceptable pressures on external competitiveness, reserves, or inflation. There were some oddities in monetary policy, including the yield on treasury bills and the practice of "round tripping," which avoided the reserve requirements. However, it was questionable whether such practices were worth pursuing with the authorities in the context of what was, after all, a very successful economy. Finally, he could endorse Singapore's concern about the growth in protectionism in international trade. He admitted with regret that some members in his constituency were among those applying restrictions to Singapore's exports.

Ms. Bush remarked that the authorities' management of the Singapore economy was commendable. The growth that had been experienced in recent years was partly attributable to the outward-looking policies adopted by the authorities--particularly export policies and policies encouraging direct investment--which had been complemented by measures aimed at promoting domestic savings and investment to finance that growth.

Budgetary discipline was the cornerstone of good economic management in Singapore, Ms. Bush considered. She was thus somewhat concerned by the increase in reserves from 27 percent of GDP to 34 percent of GDP between 1980 and 1984 and the increase in expenditure from 25 percent of GDP to 33 percent of GDP over the same period. To some extent, those increases reflected the natural buoyancy of the tax system and the growth of public investment expenditures, some of which would level off when programs like housing construction were completed. Indeed, Mr. Jaafar had made reference to the maturing of certain major public sector projects and to the authorities' aim of stabilizing or lowering expenditures thereafter.

The public sector had certainly played a large role in the Singapore economy, Ms. Bush noted. Still, open-market policies had been implemented, and it was apparently the intention to reduce the role of the Government in future; she presumed that the proposed cut in personal income tax rates would contribute to that objective.

Singapore's experiment with deliberately increasing wage rates over a three-year period in order to force inefficient companies to adjust seemed to have yielded the desired results, Ms. Bush continued. However, a comparison with relative price and unit labor cost movements through 1983 raised some questions about profitability; she wondered whether the staff could provide any further information regarding unit labor cost data for 1984 or projections for 1985 that might throw some light on the question of profitability. In that context, the substantial real effective appreciation of the exchange rate since 1980 might also raise some questions. Still, the staff's medium-term outlook for the balance of payments was reassuring; despite the expectation of a rise in the current account deficit to about 4 percent of GDP in 1988, she presumed--based on the present outlook--that the amount would be easily financeable.

Mr. Jayawardena considered that it would not be unreasonable to compare the successes of the Singapore economy with the achievements of city-states like Venice, which had achieved great wealth and prosperity in the Middle Ages by reaping the benefits of international trade. The city-states had formed such an integral part of the international trading system that their successes and failures had tended on occasion to fluctuate dramatically with the fortunes of international trade. In that regard, he welcomed the measures adopted by the Singapore authorities to insulate the economy from the vagaries of world trade. The industrial restructuring policy reduced dependence on labor-intensive industries and aimed at promoting Singapore as a "high-tech" center that could generate higher value added in production and exports. The transformation was being achieved at the direction of the Government, which played a dominant role in Singapore and helped the economy to stay ahead of its competitors by anticipating future economic development.

Because the problems of managing an economy like that of Singapore were somewhat different from the problems of managing a larger economy like that of, say, India, the lessons to be learned from Singapore were valuable but not necessarily universal, Mr. Jayawardena continued. Prudent domestic financial management was essential to the success of an economy like that of Singapore, which depended upon international confidence, and he had great admiration for the way in which the authorities had managed the economy. He noted that their strong currency policy might well have been a necessary adjunct to the industrial "correction" policy, under which the authorities were attempting to transform Singapore from a labor-intensive to a capital- and technology-intensive economy.

Mr. Msadek noted that Singapore's economic and financial performance over the past few years was indicative of the economy's impressive development and resilience over a 20-year period. At a time when the international environment had been characterized by deep economic recession, declining world trade and an international debt crisis before beginning a strong albeit mixed recovery, real growth in Singapore had remained at a comfortable level. Moreover, the transition toward high-skill and high-technology industries had accelerated, inflationary pressures had remained low, and the external current account deficit had improved markedly during the period.

As noted by both the staff and Mr. Jaafar, Singapore's development, while it had benefited to a great extent from a number of exogenous factors--including an excellent geographic location--should be credited mainly to the authorities' shrewd economic and fiscal policies aimed at building external confidence in the economy, establishing adequate infrastructure and network incentives, and continuously encouraging the transition to more sophisticated industries and services, Mr. Msadek commented. Such policies had enabled Singapore to attract substantial external capital flows, mostly in the form of direct investment, and to develop into a major industrial and financial center of the region. However, they had also made Singapore heavily dependent on a relatively free world trade and vulnerable to external crises.

He concurred with the staff's analysis of Singapore's current policies and medium-term prospects, Mr. Msadek said. Although real growth should remain relatively strong, a slowdown was projected by the staff for 1985 as a result of developments in world demand, low capacity utilization in manufacturing, and depressed private construction activity. In contrast to the situation in 1982, when a stepping up of public investment had enabled Singapore to cushion the effect of the global recession on its economy, the decision not to take countercyclical measures in 1985 was appropriate and reflected the limited scope for further increases in public investments as well as the authorities' cautious economic policies. It also seemed to signal a less dominant role for the Government in Singapore's development in future. That shift away from public investment should be carried out prudently and should be limited to direct investments; the Government had played an effective role in Singapore's development in the past, and its continued contribution was crucial in the ongoing effort to upgrade and restructure the economy.

The development of Singapore as a major financial center had limited the ability of the authorities to pursue an independent monetary policy, Mr. Msadek continued. Still, they had been successful in achieving their main long-term monetary objectives, including a strong and stable currency, without encouraging underlying inflationary pressures. The traditionally prudent stance of fiscal policy, with budget surpluses having been recorded since 1968, had played a major role in that regard. On the other hand, while the maintenance of a strong currency was needed to sustain confidence in the economy and reduce the impact of world inflation on domestic prices, it created pressure on external competitiveness and should therefore be kept under review, particularly given Singapore's dependence on international trade. The authorities seemed not to be concerned about the real appreciation of the currency, which should help to accelerate the transition toward high-value-added industries, but close monitoring of the impact of the exchange rate over the medium term was clearly in order.

The authorities' concern about restrictive trade practices could not be overemphasized, especially given the correlation between the countries' economic development and the condition of world trade, Mr. Msadek remarked. As noted by the staff, the effects of protectionism on Singapore were compounded by the threat of substantial reductions in foreign investment flows, which might increasingly be redirected toward protected markets.

Mr. Clark commended the authorities for the way in which they had managed Singapore's economy in recent years. Their success was well illustrated by an average growth rate over the past five years of 8.5 percent, an average inflation rate of about 5 percent, and an average unemployment rate of less than 3 percent. At the same time, the current account deficit had been reduced substantially, and the overall balance of payments had remained in surplus. Those impressive achievements were the result in large part of the pursuit by the authorities of a cautious fiscal policy, coupled with a commitment to a liberal trading system and a readiness to accept foreign direct investment and utilize incentives to encourage productivity.

Singapore should play a role in both the region and the global economy that was befitting its success, Mr. Clark continued. With the same per capita income as Italy (US$6,500), Singapore should strengthen its commitment to multilateral and bilateral development assistance. It was disappointing in that respect that the authorities felt unable to take up their quota increase under the Eighth General Review of Quotas; as a result, Singapore's quota remained below the level warranted by its economic importance. Having voiced that concern, he could endorse the staff's appraisal of the Singapore economy, although he would suggest that the next Article IV consultation report on Singapore include an analysis of the impact of Singapore's policies on neighboring economies and on Singapore's major trading partners.

Remarking on the economy's medium-term prospects, Mr. Clark observed that there had been a sizable increase over the past five years in the ratio of public expenditure to GDP. If that trend were to continue, and if growth, for whatever reason, were to falter, the present healthy fiscal balance in Singapore could be eroded, and taxes or contributions to the Central Provident Fund might have to be raised, to the detriment of production incentives. In that regard, he had been encouraged by Mr. Jaafar's statement that "the aim is to stabilize expenditure at the current level or even to lower it somewhat."

The maintenance of stability in the financial sector was essential, in view of the severe credit risks still arising with many loans, Mr. Clark commented. He thus welcomed the measures taken by the authorities to encourage the orderly growth of the financial services sector in Singapore; in particular, the announcement in early January of tighter controls on the financial futures market and proposed amendments to the Securities Industry Act, together with guidelines for the operation of merchant banks, seemed appropriate. Singapore was increasingly in competition with other Asian financial centers. Hence, and given their good overall experience so far, the authorities would no doubt wish to maintain the highest standards of banking supervision, to maintain adequate levels of bank management expertise, and to aim for steady rather than spectacular growth in the sector.

With the decline of current account deficits in the Asian region, the role of the Asian dollar market in channeling funds to deficit countries had apparently leveled off, Mr. Clark observed. According to the staff, the Singapore authorities hoped to expand Singapore's share of Asian dollar market lending to other regions, a move that would of course involve competition with the major financial centers in the Far East, Europe, and North America. And that, in turn, might make it more difficult to sustain Singapore's past growth rate as an international financial center.

Agreeing that scope existed for developing oil refining capacity in Singapore, Mr. Clark considered that the refineries should be upgraded in such a way that they were able to cope more flexibly with different kinds of crude oil. Without such flexibility, Singapore was likely to be vulnerable to competition from other refining centers in the region.

With regard to potential impediments to Singapore's further success in the medium term, Mr. Clark expressed concern about the staff's external current account projections. It was clear that Singapore's growth prospects depended heavily on continued growth in the United States; the authorities would therefore be wise to consider the possibility that the staff's projections for real GNP in the United States through the end of the decade might be overoptimistic. Finally, the concerns he had mentioned were in no way intended to detract from the general commendation of the Singapore authorities' sustained pursuit of sound macroeconomic policies.

The staff representative from the Asian Department recalled that a number of Directors had asked how the large and growing role of the public sector in Singapore, the level of contributions to the Central Provident Fund, and the accumulation of international reserves were related to the good performance of the Singapore economy. Those elements should, in his view, be evaluated in a historical context. At the time of its independence, Singapore had been a small and insecure country with larger and far more successful neighbors, a position that demanded a struggle for survival. Many observers at the time had felt that Singapore would not survive; and it was perhaps that very attitude that had created a strong bond between the politicians and the population in Singapore and had fired their determination to succeed. Those factors had allowed the authorities to do in Singapore what could not be done in other countries. The population had accepted large increases in contributions to the Central Provident Fund, and those increases had been reflected in an accumulation of reserves that was, in essence, the counterpart of resources generated by the Central Provident Fund. To that extent, it might be said that the resources of the Central Provident Fund were not government controlled; they were private savings invested abroad by the Government, which acted as an intermediary.

Development expenditures undertaken by the Government covered mainly basic needs, such as housing and infrastructural support, the staff representative noted. The provision of adequate housing for a large portion of the population had always been considered a desirable objective and had thus been given priority. Thanks to a rapid increase in revenues, adequate housing had already been provided to a large part of the population, and expenditure in that area was beginning to level off, as a result of which the authorities were predicting a decline in public expenditures as percentage of GDP in future.

A growing portion of government resources had also been spent on training that was directly related to Singapore's success in other areas, including the upgrading of industries, the staff representative observed. In that respect the statutory boards were run much like private businesses and were in fact profitable. Of course, investments exceeded revenues, and the corporations borrowed, mainly from the Government, at nearly market interest rates, a development which appeared to overstate the role of the Government in Singapore's economic success. Another indicator of the size of the public sector was the fact that the Government employed only about 10 percent of the labor force in Singapore.

Commenting on the impact of Singapore's high wage policy on profitability and competitiveness, the staff representative remarked that the Government had recognized that comparative advantage had been changing and called for a move toward high-technology industries and away from labor-intensive exports. To give an incentive to that shift, the authorities had implemented a high wage policy. As a result, there had been a loss in competitiveness in those areas that had been essentially labor intensive; and, indeed, some industries--such as textiles and traditional wood processing industries--were actually being phased out. At the same time, there had been movement toward high technology exports, and investment in the industries producing those exports had been buoyant. Furthermore, the authorities felt that the diversification of the economy should not be limited to manufacturing production but should encompass movement from manufacturing production to internationally tradable services in which they felt Singapore had a comparative advantage. In the end, the authorities considered that the high wage policy had been appropriate because it had helped them to achieve their diversification aims.

The authorities wished to describe their exchange rate policy as linked within margins to a basket of currencies, the staff representative noted, and, as indicated in SM/85/7, they looked at such a relationship in determining the exchange rate. However, their use of the maximum margin most of the time had led to some nominal appreciation of the rate. Of course, the real rate had also appreciated significantly because the domestic rate of inflation had been lower.

Some Directors had wondered whether the Singapore authorities had adequate control over the banks in the Asian dollar market, the staff representative recalled. In fact, the staff had the impression that the authorities were very much in control, to the extent that some of the banks were even complaining that the reins were too tight. The practice of "round tripping," which arose from a discrepancy between reserve requirements on different types of deposits and involved banks switching from domestic to foreign liabilities and back again to avoid reserve requirements on the former, did in fact create a problem, not so much in confidence as in monetary management. The authorities had indicated that they had managed to bring the practice under control through moral suasion and fines, and data available to the staff suggested that they had been successful in their effort.

The public debt had been increasing, the staff representative observed, although it had been reflected in an accumulation of net foreign assets. So long as the authorities continued to accumulate reserves, he doubted that the increase in the public debt would create a problem over the medium term. As to the current low level of treasury bill rates, he noted that treasury bills were essentially held by discount houses to fulfill statutory reserve requirements of financial institutions; they were not being used as a monetary management tool.

Concerning Singapore's reputation as an aggressive manager of reserves, the staff representative pointed out that the large amount of reserves accumulated was at present being managed in part by a new institution--the Government of Singapore Investment Corporation--which had hired foreign consultants. However, while the reserves were being managed much like a large portfolio, he had the impression that the investments were relatively conservative.

The mission had been privy to extensive information on the petroleum industry, as the current Managing Director of the Monetary Authority and next Minister of Finance of Singapore had previously been the Chairman of the Shell Group in Singapore, the staff representative observed. The accepted view seemed to be that the oil industry had a good future in Singapore and was in a position to continue to play the role of a balancer of supply and demand in the region. Oil, shipped in large tankers from the Middle East, was refined in Singapore and distributed throughout the region to satisfy specific needs. Large investments had been made to upgrade the petroleum refineries to make them capable of satisfying diversified needs.

Finally, on the projections for growth in the U.S. economy, the staff representative from the Asian Department remarked that, before the staff mission had left for Singapore, the Research Department and the Western Hemisphere Department had agreed on an estimate of U.S. growth for 1985 of 4 percent. The authorities in Singapore had considered the projection to be on the high side, a view supported by the data in the latest World Economic Outlook exercise. For that reason, the staff had used a projection of 3 percent for growth in the U.S. economy in 1985.

Ms. Bush observed that the latest U.S. Government forecast was for a growth rate nearer to 3.5 percent in 1985; however, the Singapore authorities and the Fund staff should be complimented for their effort to be conservative.

Mr. Jaafar said that he wished to reaffirm the position of his authorities in certain areas. First, on expenditures, he noted that the ratio of public sector expenditure to GDP had risen strongly over the years, although it was likely to stabilize or even to decline somewhat as various large infrastructure projects--such as the mass rapid transit system and public housing project--matured. Besides, the ratio of revenue to GDP had also been on the rise and revenues exceeded expenditure. On other matters, he was happy to hear that Singapore's assumptions for the rate of growth in the United States in 1985 might be on the conservative side. As for the level of reserves, the authorities considered US$10 billion to be adequate insulation--given the openness of the economy--against external shocks.

The authorities were deeply concerned about the uncertainties for exporters that had been created by nontariff barriers, Mr. Jaafar remarked. Tariff barriers, although cumbersome, were easier to deal with, often requiring only some additional effort to raise the level of competence and productivity; nontariff barriers were more frustrating and damaging economically, particularly since they were so difficult to anticipate. Also of concern were the adverse effects of protectionism on direct foreign investment. Those effects were reflected worldwide in the trend toward directing investment to countries where trade barriers could be circumvented. The matter must be dealt with because direct foreign investment was crucial to Singapore's development.

The Chairman made the following summing up:

Executive Directors broadly supported the appraisal in the staff report for the 1984 Article IV consultation with Singapore. They congratulated the authorities for Singapore's remarkable success in achieving rapid economic growth over the years, which had been accompanied by price stability and a strong external payments position. The unusually high level of savings, prudent financial management--including the remarkable feature of continuing budget surpluses--the provision of appropriate incentives, and continuous efforts on the part of the authorities to increase productivity and restructure the economy had been instrumental in achieving those outstanding results. By maintaining financial stability and an open economy, Singapore had been able to attract substantial foreign investment over the years, which served as an effective vehicle for the transfer of technology. Directors noted with approval the authorities' intention to stabilize government expenditure or even to lower it as a proportion of GDP over time.

Directors observed that Singapore had been able quickly to respond to and benefit from the upturn in world demand since mid-1983. In that connection, it was pointed out that Singapore's ability to take advantage of the strong external demand for high-technology goods was the fruit of the authorities' continuous efforts to attract such industries. With the expected weakening of external demand, economic growth in Singapore was expected to slow to about 6 percent in 1985, still an impressive rate of growth.

Commenting on medium-term prospects, Directors noted that, as the basic needs in housing and infrastructure were met, the scope for relying on those traditional domestic sources of growth would become increasingly limited. Because Singapore's dependence on the international economy could increase in the future, it was all the more important for the authorities to persevere in their efforts to upgrade the economy to adapt to the changing pattern of external demand and comparative advantage. In that context, mention was made of the development of Singapore as an international financial center. Also, noting the strong reserve position of Singapore, some Directors remarked on the importance of seeing Singapore participate perhaps more fully in multilateral financial institutions.

It was observed that, in conducting their exchange rate policy, the authorities had pursued the twin objectives of mitigating the impact of external inflation and protecting competitiveness. The authorities' policy of maintaining a strong and stable currency had helped sustain confidence. Directors shared the authorities' concern over the adverse impact of the resurgence of protectionist tendencies in the world and expressed concern that those tendencies might have affected foreign direct investment in Singapore, which was so essential to the economy.

It is expected that the next Article IV consultation with Singapore will be held by June 1986.

5. CLASSIFICATION OF COUNTRIES

In response to a request by Directors to place on the agenda of the Executive Board a proposal for the classification of countries in certain Fund documents (SM/85/8, 1/3/85; and Cor. 1, 1/17/85)--that had been submitted earlier for approval on a lapse of time basis--the Chairman sought the views of the Executive Directors on the appropriate timing for such a discussion.

The Deputy Director of the Research Department noted that the staff was in the process of preparing papers for the world economic outlook exercise. Before completing its analysis, the staff needed to be clear about the classifications of countries that the Board would find acceptable and, in that respect, a decision must be reached quickly about whether to continue with the existing classifications or to incorporate new ones of the sort proposed by the staff in SM/85/8. In defending the proposal, he observed that the staff felt a responsibility to present its analysis in a manner that would best illuminate the problems facing countries; and some flexibility in grouping countries was necessary for that purpose. He saw no difficulty in maintaining the existing classification system, so long as it was understood that, in addition, the staff might group countries somewhat differently to deal with different developments or issues.

The Secretary remarked that, assuming an early discussion of SM/85/8 was considered desirable, the agendas of January 23 or January 25 could accommodate an additional item.

Mr. Malhotra wondered whether it was really necessary to act quickly to decide on a change in classification, especially given the difficulties that a highly flexible subgrouping might cause with respect to interyear or time series comparisons. His feeling was that the staff paper (SM/85/8) was lacking an elaboration of the impact that any given classification might have. In view of that concern and of the fact that the illustrative groupings mentioned in the paper needed further clarification, his preference was for a more detailed paper that could be considered in depth over a longer period of time, before any major changes in classification were adopted.

Mr. Pickering commented that his authorities were in sympathy with many of the staff's recommendations and with the desire for simplification and flexibility. The current classification system had been agreed following protracted discussions in December 1979, and he was certain that the staff was not surprised that its present paper had given rise to some concerns.

He could go along with the two operating principles set out in SM/85/8, namely, to avoid discussing changes in the general purpose breakdown between industrial and developing country groupings and to limit discussion to the specific statistical presentations in IFS, the World Economic Outlook papers, and publications of the Bureau of Statistics.

His authorities wondered whether the developments that had led to the establishment of special analytical subgroupings in the 1970s had changed to such a degree that those subgroupings were no longer relevant, Mr. Pickering remarked. Perhaps it would be useful to hold a discussion, based on the staff paper, on the strengths and weakenesses of the existing subgroupings. Also, assuming the staff's proposal was adopted, he wondered how long the staff intended to maintain statistics on the existing subgroupings. He had some concerns similar to those of Mr. Malhotra about how any new subgroupings would be defined and what they would reflect; perhaps it would be appropriate to hold a separate Board discussion to see what nongeographical subgroupings would best help analyze recent developments in the world economy. In that respect, he would be happy to discuss EBM/85/8 as early as Wednesday, January 23, although he suspected that such a discussion would give rise to calls for a further staff paper and a more extensive discussion at a later date.

The Deputy Director of the Research Department remarked that the objectives in SM/85/8 had been modest. A number of questions that could legitimately have been posed about the classification of countries had not been included in the paper; rather, the staff had addressed itself simply to the inconveniences presented by the breakdown between oil countries and non-oil developing countries, a breakdown that at present cut across a number of problems that the staff wished to analyze. When those subgroupings had first been adopted, it had been suggested by the staff, and widely endorsed by Executive Directors, that analytical subgroupings should be employed flexibly in order to illuminate problems. In fact, those subgroupings had not been changed for the past five to six years, even though that had perhaps not been the intention of the Executive Board. The existing subgroupings were not without meaning, but there were certain anomalies within them that made analysis difficult.

The new system of data management enabled the staff to group together statistically any countries that it wished, so that it would not be impossible to generate data on a number of bases, the Deputy Director of the Research Department continued. The staff, of course, felt a responsibility to present only the data that could be meaningfully and reasonably absorbed by a reader, but it would be a simple matter to reconstitute data for given subgroupings for comparison purposes.

Following further brief discussion, it was agreed that the matter of classification of countries would be placed on the agenda for discussion on January 23, 1985.

5. TONGA - MEMBERSHIP - EXPRESSION OF INTEREST

The Chairman informed the Executive Directors that on January 16 the Fund had received an application for membership from the Kingdom of Tonga. A constitutional monarchy that had become fully sovereign in 1970, Tonga had expressed interest in membership in 1979 when an initial staff visit had been made to the country. Between 1979 and the receipt on January 16 of Tonga's application for membership, no other formal expression of interest in membership had been tendered. Under normal circumstances, management and staff made every effort to give advance warning to the Board of a potential applicant's interest in membership; unfortunately, that had not been possible in the case of Tonga.

The Executive Directors took note of the Chairman's remarks.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/85/7 (1/16/85) and EBM/85/8 (1/18/85).

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/85/11 (1/15/85) is approved.

APPROVED: October 24, 1985

LEO VAN HOUTVEN
Secretary