MASTER FILES
ROOM C-525

0404

NOT FOR PUBLIC USE

# INTERNATIONAL MONETARY FUND

## Minutes of Executive Board Meeting 90/168

10:00 a.m., December 5, 1990

R. D. Erb, Acting Chairman

| Executive Directors | Alternate Executive Directors |
|---|---|
| M. Al-Jasser | |
| G. K. Arora | L. E. N. Fernando |
| | C. M. Towe, Temporary |
| Dai Q. | Zhang Z. |
| | M. Chen, Temporary |
| T. C. Dawson | S. B. Creane, Temporary |
| | M. E. Hansen, Temporary |
| | F. Moss, Temporary |
| | G. H. Spencer |
| | S.-W. Kwon, Temporary |
| | N. Kyriazidis |
| | B. Bossone, Temporary |
| | M. B. Chatah, Temporary |
| M. Fogelholm | I. H. Thorláksson |
| G. Grosche | B. Goos |
| J. E. Ismael | T. Sirivedhin |
| A. Kafka | |
| | J.-F. Cirelli |
| | J.-L. Menda, Temporary |
| | M. A. Hammoudi, Temporary |
| L. B. Monyake | L. J. Mwananshiku |
| | P. Wright |
| | G. P. J. Hogeweg |
| C. V. Santos | |
| A. Torres | |
| A. Végh | |
| K. Yamazaki | K. Ichikawa, Temporary |
| | K. Ishikura, Temporary |

L. Van Houtven, Secretary and Counsellor
C. P. Clarke, Assistant


1. Togo - Enhanced Structural Adjustment Facility - Review Under Second Annual Arrangement . . . . . . . . . . . . Page 3
2. Singapore - 1990 Article IV Consultation . . . . . . . . . . . . Page 25

3. Sierra Leone - Overdue Financial Obligations - Review Following Declaration of Ineligibility - Request for Postponement . . . . . . . . . . . Page 56
4. Dominican Republic - Overdue Financial Obligations - Report and Complaint Under Rule K-1 . . . . . . . . . . . . . . . . . . . . . . . . . . Page 59
5. Namibia - Representative Rate for South African Rand . . . . . . . . . . . . . . . . . . . . . . . Page 59
6. Mongolia - Membership - Committee . . . . . . . . . . . . . . . . . Page 60
7. Ethiopia - Technical Assistance . . . . . . . . . . . . . . . . . Page 60
8. Peru - Technical Assistance. . . . . . . . . . . . . . . . . . . . . Page 60
9. Romania - Technical Assistance . . . . . . . . . . . . . . . . . Page 60
10. Appointment Benefits, Salary Advances, and Family Care Leave. . . . . . . . . . . . . . . . . . . . . . . . Page 61
11. Approval of Minutes . . . . . . . . . . . . . . . . . . . . . . . Page 61
12. Executive Board Travel . . . . . . . . . . . . . . . . . . . . . . Page 61
13. Travel by Managing Director. . . . . . . . . . . . . . . . . . . . . Page 61

<u>Also Present</u>

IBRD: R. Blake, Africa Regional Office. African Department: M. Touré, Counsellor and Director; E. A. Calamitsis, Deputy Director; R. Abdoun, P. H. Mathieu, A. B. Petersen. Asian Department: K. Saito, Deputy Director, J. S. Kahkonen, J. Lin, S. M. Schadler. Exchange and Trade Relations Department: T. Leddy, Deputy Director; M. E. Edo, H. Hino. Fiscal Affairs Department: M. Z. Yucelik. Legal Department: H. Elizalde, P. L. Francotte. Research Department: K. S. Warwick. Treasurer's Department: J. E. Blalock, W. L. Coats, J. C. Corr, P. Fontana, G. Wittich. Personal Assistant to the Managing Director: D. J. Andrews. Advisors to Executive Directors: C. D. Cuong, A. Gronn, Z. Iqbal, J. M. Jones, H.-J. Scheid, N. Toé. Assistants to Executive Directors: T. S. Allouba, G. Bindley-Taylor, B. R. Fuleihan, S. Gurumurthi, L. I. Jácome, P. K. Kafle, P. Kapetanovic, K. Kpetigo, G. Montiel, M. Mrakovcic, G. Serre, Shao Z., D. Sparkes, Tin Win, S. von Stenglin, J. C. Westerweel.

1. TOGO - ENHANCED STRUCTURAL ADJUSTMENT FACILITY - REVIEW UNDER SECOND ANNUAL ARRANGEMENT

The Executive Directors considered a staff paper on the midterm review of Togo's second annual arrangement under the enhanced structural adjustment facility (EBS/90/195, 11/20/90; and Cor. 1, 11/30/90).

The staff representative from the African Department said that, according to preliminary data received from the Togolese authorities, most of the benchmarks for end-September 1990 had been observed. However, temporary delays had been encountered by the authorities in effecting external debt-service payments. At end-September 1990, external debt-service payments of CFAF 0.67 billion, mostly to commercial banks, had been overdue; those arrears had subsequently been settled and, as of end-October 1990, no external arrears were outstanding. At end-September 1990, the benchmark for domestic nontreasury arrears had also been exceeded, as those arrears amounted to CFAF 3.6 billion, compared with CFAF 2.78 billion envisaged in the program. The liquidity difficulties of the Treasury at end-September 1990 had been expected, as the bulk of the phosphate company's contribution to the budget had been received only in October 1990. The staff believed that the benchmarks for end-December 1990 would be observed.

Mr. Santos made the following statement:

> The Executive Board had the opportunity in June 1990 to review developments in the Togolese economy, when it considered the staff report for the 1990 Article IV consultation and the request for the second annual arrangement under the enhanced structural adjustment facility (ESAF). The staff paper before the Board today provides an in-depth analysis of the economic and financial developments that have so far taken place in 1990, and the policies and measures that the Togolese authorities intend to pursue during the rest of the program period.
>
> As indicated in the staff paper, during the first half of 1990 a number of adverse developments, primarily of an exogenous nature, affected Togo's performance under the arrangement. These include the low rainfall experienced at the beginning of the year and the decline in the volume and in the export price of phosphates. In addition, legal and technical problems encountered during the transition to the new tax system for public enterprises contributed to a revenue shortfall during the period under review. As a result, certain performance criteria could not be met on the test dates. However, the nonobservance of these performance criteria has subsequently been corrected, and the Togolese authorities are requesting the necessary waivers.
>
> The unexpected developments in the first half of 1990 and the recent steep increase in oil prices on world markets will

undoubtedly have an adverse impact on the general performance of the Togolese economy in 1990 and beyond. Nevertheless, as a demonstration of their commitment to the adjustment process, the authorities have steadfastly maintained their adjustment efforts and have implemented in a timely manner all the policy measures envisaged under the 1990 program.

In the fiscal sector, when faced with the prospect of a revenue shortfall for the full year, the authorities moved swiftly to reduce expenditures, in addition to the various measures implemented in April 1990. It is expected that the cuts in current and investment outlays would help to contain the overall fiscal deficit--on a payment order basis and excluding grants--to 5.3 percent of GDP in 1990. It should be noted that the authorities intend to increase the retail price of petroleum products in order to partially offset the loss of revenue stemming from the recent increases in world prices. They are considering additional measures in 1991 so as to keep the fiscal deficit within the program target.

In the area of structural reforms, the authorities are encouraged by the satisfactory progress being made. To sustain this, and in the context of the reform of the public administration, three key ministries concerned with economic and financial matters have been selected for reorganization, and measures have been taken to improve the coordination between the Ministry of Economy and Finance and the Ministry of Labor and Civil Service. Furthermore, a medium-term civil service employment strategy, which will be enacted in 1991 in order to promote human resource development, was adopted in September 1990.

As to the reform of the public enterprise sector, the Government has continued its efforts to disengage itself from commercial activities and to rationalize those enterprises that will remain in its portfolio. A new privatization program covering the three-year period 1990-1992, under which 18 other state-owned enterprises are to be affected, has been launched. Already, significant progress has been made in the plans to sell or liquidate six public enterprises selected under this new program. A new public enterprise law allowing for more autonomy and managerial accountability was enacted in October 1990.

Concerning the reform of the banking system, two major banks have been rehabilitated through recapitalization and restructuring. A third bank was liquidated, and studies are under way to determine how the existing cooperative savings and loans structure (COOPEC) could be strengthened.

Consistent with its policy of boosting private investment and promoting exports, the authorities are pursuing their efforts to attract foreign companies to the newly created export processing zone (EPZ). So far, 20 companies have been given permits to operate in the EPZ. In addition, several studies on export promotion and external competitiveness have been completed and their recommendations are under consideration.

The Togolese authorities are continuing to pay attention to the social dimensions of adjustment and have taken steps to incorporate the social impact of adjustment policies into the macroeconomic policy-making process. Institutional mechanisms and working groups have been set up to make recommendations in order to mitigate the adverse impact of these policies on the vulnerable groups of the population.

My authorities recognize that, owing to a number of exogenous factors, Togo's medium-term economic prospects will be somewhat different from the original projections. A slower growth in exports is now projected. Also, as indicated in the staff report and based on the present World Economic Outlook assumption of $26.14 per barrel in 1991, the increase in world oil prices will add an average of CFAF 3 billion to the yearly import bill during 1991-95. While they believe that the measures they are taking will enable them to adjust to these developments, the authorities are concerned about the constraints on their capacity to make further adjustments to the recent oil price increases in world markets. Indeed, with retail prices for petroleum products already relatively high in Togo, there is not much room for increases in these prices. Should the trend in oil prices continue, the tax revenue from this source could dwindle, exacerbating the difficulties being encountered in revenue mobilization. Given the authorities' continued pursuit of strengthened adjustment measures, a case could be made for an augmentation of Togo's access to ESAF resources in the context of the Fund's decision on its response in the wake of recent developments in the Middle East.

The Togolese authorities are grateful to the international financial community for its continued strong support. It is their firm intention to pursue the reform process and they are confident that, barring adverse exogenous developments, Togo will achieve its medium-term economic and financial objectives.

Mr. Al-Jasser made the following statement:

Togo has been making progress toward structural adjustment under the enhanced structural adjustment arrangement. However, economic growth has slowed down, the current account deficit is expected to expand, and the savings-investment gap has become larger than planned for 1990. At this juncture, two basic issues need to be addressed: the causes underlying the nonobservance of performance criteria for end-June and end-September 1990; and the appropriateness of the current program to achieve the overall objectives.

I am in favor of approving waivers for the nonobservance of performance criteria in order to ensure the continuity of the adjustment effort. However, the failure to observe structural performance criteria cannot be blamed solely on exogenous factors. In particular, the accumulation of external arrears and the larger than programmed increase in bank credit to the government implies both delays in responding to adverse developments in the finances of public enterprises and weaker expenditure controls. I am pleased to note that the authorities have tightened expenditure controls for the last two months of the current fiscal year. However, I wonder whether a sufficiently large contraction can be instituted in such a short time to meet end-year targets. Moreover, it is essential that arrears accumulated in the first half of the year are settled fully in the second half of the year.

Turning to the thrust of the overall adjustment program, Togo is likely to continue facing challenges in assigning policy tools to simultaneously achieve internal and external objectives. This will be particularly challenging in the face of the deteriorating medium-term outlook. While the external environment has weakened, the CFA franc has tended to appreciate against the U.S. dollar and currencies of regional non-CFA competitors at a time when the primary instrument of adjustment remains the budget. As the staff stresses, this will need to be supported aggressively by a strengthened structural adjustment policy if economic growth is to pick up along with a stronger external position. The authorities would be well advised to take a fresher look at sequencing adjustment and growth.

In this context, it would seem appropriate to redesign the adjustment strategy to raise domestic savings through a further cut in current expenditures rather than higher taxes. Here, I would disagree with the staff's recommendation for additional revenue measures to achieve the 1991 budget target. At about 24 percent of GDP, the revenue effort is already quite high. Any further revenue effort at a time of economic slowdown would also be inconsistent with the renewed commitment of assigning a larger role to the private sector. I agree with Mr. Santos that it would be inadvisable to further increase petroleum product prices. Such prices are already above comparable world market prices and are significantly higher than those in neighboring countries. Apart from adversely affecting Togo's competitiveness, such a policy would encourage smuggling and weaken the effectiveness of the overall policy stance. Clearly, the budgetary problem should be addressed in an overall macroeconomic framework rather than taxing a captive source, such as petroleum products. I urge the staff to follow this approach. I am particularly interested in Mr. Santos's suggestion concerning augmentation of the ESAF resources available to Togo to compensate for higher oil import costs. Has the staff given any thought to this issue?

The tightened budgetary stance will need to be supported by public sector reforms and further privatization. The authorities have taken encouraging steps toward reviewing the state of the labor market and the modalities of privatization. It is highly desirable that they move expeditiously on their privatization plans and establish conditions that promote private investment, including foreign investment.

Finally, could the staff indicate whether there was any room for using incomes policy, as a complement to fiscal policy, in order to increase competitiveness?

Mr. Goos made the following statement:

I recognize the encouraging progress on the path toward financial viability achieved in the past few years. However, the more recent performance under the present enhanced structural adjustment arrangement offers a mixed picture of program implementation. The Government certainly had to cope with adverse external developments, and it needs to be recognized that they have adopted corrective measures. But the substantial policy slippages in the first half of this year are a cause for considerable concern, especially as they were accompanied by the accumulation of external payments arrears. These developments highlight the need to maintain vigilance and discipline, particularly in the fiscal policy area, where similar difficulties arose under the previous enhanced structural adjustment arrangement. Indeed, fiscal adjustment remains the cornerstone of macroeconomic stabilization.

Therefore, it is encouraging to note that for 1991 the authorities are committed to return fiscal consolidation to the original path of adjustment. In this context, I specifically endorse the staff's recommendation to aim for a sustained increase in public savings--a recommendation, which, unfortunately, is not reflected in the targets for the savings-investment balance or the current account deficit in the later years of the medium-term projections. Therefore, and in view of the repeated slippages in those targets in the recent past, I wonder whether the authorities should not aim at a more ambitious path of fiscal adjustment in the medium term.

While recognizing that domestic energy prices are already at a relatively high level, it is unfortunate that the recent increases in oil import prices are expected to weaken the budgetary position. In this context, I wonder whether the budget could not be protected against such adverse developments by fully liberalizing domestic prices for oil and oil-related products.

Finally, I would be grateful for Mr. Santos's and the staff's comments on the recent article in the Financial Times that provided a rather skeptical assessment of the benefits of privatization and the export processing zone in Togo. Specifically, the article says that "privatization has not... been the rejuvenating force anticipated by the Government," and "has failed either to provide job opportunities or to be a catalyst for new industries." Similar skepticism is expressed about the export processing zone, about which it is believed that government expectations about job creation are "wildly optimistic."

These are, no doubt, sobering perspectives--particularly in the face of an unemployment rate of more than 20 percent in the formal sector--notwithstanding the commendable progress made so far in liberalizing and stabilizing the economy. Without preempting the staff's response, I think it is quite clear that the authorities have little choice but to persevere in the pursuit of macroeconomic adjustment and structural reforms. I wonder, however, whether those efforts should not be supplemented by more active policies of population control, given that the rate of population growth is exceeding 3 percent a year.

With these remarks, I can support the proposed decision and would like to endorse the staff's appraisal.

Extending his remarks, Mr. Goos said that he certainly appreciated the view, expressed by the authorities and Mr. Al-Jasser, that domestic oil prices were already relatively high compared with the prices prevailing in neighboring countries. However, that assertion was not necessarily convincing, because the neighboring countries were also affected by the oil price increases, and it was fair to assume that they would also have to increase their petroleum prices. Consequently, the gap between petroleum prices in Togo and those in neighboring countries would not necessarily increase.

Mr. Ishikura made the following statement:

Togo is continuing its economic adjustment under the Fund-supported program. The performance in the past two years was broadly satisfactory. In 1990, however, adverse external factors affected economic and financial developments. In the first half of this year, while inflation continued at a low level, the real GDP growth rate declined, the current account deficit enlarged, and a persistent fiscal deficit remained. Regrettably, some of the performance criteria for end-June were not met. Nevertheless, I welcome the Government's efforts and progress in many areas of the economy. As Togo will continue to face critical situations in the coming years, the Government should be urged to maintain the adjustment momentum under its enhanced structural adjustment arrangement. I broadly share the staff's appraisal and support the proposed decision. I have just a few comments for emphasis.

First, as regards fiscal performance, I note with concern that the overall fiscal deficit remains large and is anticipated to exceed the program target in 1990, owing mainly to the delay in tax payments by public enterprises and the decline in phosphate exports. I welcome the Government's measures for broadening the revenue base and containing expenditure. However, in the long run, it appears to be necessary to increase tax revenue through brisk economic activity. In this regard, it is important to preserve capital expenditure to expand and maintain infrastructure.

On the monetary front, while the inflation rate remains low, a prudent monetary stance is still warranted. Moreover, the authorities should pursue banking sector reform to establish sound banking management, increase domestic saving, and ensure effective resource allocation. In this vein, I welcome the restructuring of the three banks in difficulty and hope that it will be completed on schedule.

On structural policies, it is commendable that progress has been made in many areas. We also welcome the framework and timetable prepared by the Government for the reform of governmental organizations and public enterprises. These structural reforms, I believe, are the key to growth and development in Togo. As regards industrial structure, on the other hand, while phosphate, cotton, coffee, and cocoa will continue to be the most important products, it is necessary to continue efforts to further diversify the economy in order to reduce the fragility resulting from the reliance on a few products.

In the external sector, recent developments, including the oil price increases and the fall in the volume and price of phosphate exports, have not been favorable for Togo. As uncertainties remain in the medium term, the authorities should take measures to further promote exports and strengthen external competitiveness.

Regarding the exchange rate, as shown in Chart 2 of the staff paper, the real exchange rate index has remained relatively stable over the past five years, and the nominal effective exchange rate has recently appreciated. As in other franc zone countries, prudent financial policy and improvements in productivity should be continued in order to strengthen and maintain export competitiveness.

In conclusion, the environment surrounding the Togolese economy will remain precarious over the program period and for some time to come. The authorities should focus on strengthening the macroeconomic framework in order to reduce vulnerability to adverse exogenous factors. Also, financial stability and credibility are essential if Togo is to attract medium- and long-term foreign capital inflows and maintain access to the international financial market. We encourage the authorities to persevere with the program and wish them every success.

Mr. Moss made the following statement:

Focusing first on the overall economic situation, its fragility--to which the last staff report referred--has clearly been underlined. Indeed, the 1990 experience shows adverse exogenous developments having undermined the economic performance, which otherwise would have been more satisfactory, although the real GDP growth rate would still have fallen short of matching the rate of growth of the population. More worrying still, this poor result was achieved with a commendable overall policy stance by the Togolese authorities. Indeed, as the staff paper notes, credit and monetary policies have been kept appropriately tight, structural reforms have been pursued according to schedule, and the overall stance of fiscal policy has been as programmed.

Nevertheless, exogenous developments are not the only cause for the less favorable outcome in 1990. Being essentially a small open economy, Togo can ill afford not to react in time to exogenous developments in trying to safeguard the competitiveness of its economy. It is precisely in this area that more should, and could, have been done, an issue already raised by Mr. Ishikura.

As the staff paper points out, the nonavailability of the exchange rate as a policy instrument for Togo entails that greater emphasis must be placed on fiscal and structural policies for the country to retain its competitiveness. It seems to me that competitiveness has been more negatively affected during the previous year than is borne out by the staff paper. Although commendable inflation performance has to a large extent offset the recent appreciation of the nominal effective exchange rate, the CFA franc has nonetheless appreciated against some key currencies for the Togolese economy--as Mr. Al-Jasser has noted--not only in the first half of 1990, but thereafter as well. The appreciation against the U.S. dollar is an obvious example, affecting in a negative way the unit price in CFA francs of a number of Togo's major export products--phosphates, coffee, and cocoa; although, on the positive side, this same U.S. dollar depreciation has softened Togo's oil import bill. Perhaps more important still has been the CFA franc appreciation against certain currencies in the region. Apart from affecting Togo's nontraditional exports, this factor seems to make it more difficult for Togo to fully adjust its retail petroleum prices further in line with the recent world oil price rise. I would therefore urge the authorities to step up their actions in both the fiscal and structural areas.

As to fiscal policy, one can think of several other reasons--apart from the competitiveness argument--why further budget deficit reduction is appropriate. It is necessary, first of all, to compensate for the slight slippages that have occurred in terms of the performance criteria for the enhanced structural adjustment arrangement during the second quarter of this year. This constitutes the fastest way of supporting domestic savings, which, following the revision of the import and export figures, appear to be very much on the low side. Budget deficit reduction would also help to close the domestic savings-investment gap, yielding a lower current account deficit. It would also provide a cushion against further adverse external developments, which are almost immediately reflected in government receipts. The question, of course, is how this can be done. While it may not be the right time to go too deeply into this question today, I would like to hear the staff's comments on this, given the interest expressed by earlier speakers as well.

Turning to structural policy issues, I welcome the steps already taken on the road to reform of the public administration and the public enterprises. Regarding the latter, I hope the study on the financial relationships between the government and public enterprises will soon result in policy actions, as it was precisely in this area that slippages occurred in terms of the performance criteria associated with the arrangement. With an eye on competitiveness, I would like to stress the importance of structural measures pertaining to the export sector. Increasing the role of direct foreign investment and steering the economy away from its heavy concentration on a few primary commodities seem to be crucial from a medium-term perspective; in other words, increasing the role of the private sector is a necessity. Some short-term steps have already been taken, such as the creation of the export processing zone, but evidence thus far seems mixed, as Mr. Goos has pointed out. Turning the conclusions of the further studies in this field into effective policy decisions will require further decisive action.

Looking toward the future, I would like to briefly question the staff on three items. First, is it realistic to expect the Togolese economy to rebound significantly as soon as 1991 and to achieve a 4.3 percent real growth rate, given the uncertain external outlook? Second, has the budget revenue shortfall owing to the downturn of phosphate exports in 1990 already been taken into account in the 1991 government deficit projection, since 1991 tax payments will again be based on the 1990 outcome? Finally, how will the increased attention by the Government to the social dimensions of adjustment be translated into budget expenditures?

With these questions, I would like to endorse the staff's recommendation for the granting of the waivers for the nonobservance of certain performance criteria by Togo.

Mr. Cirelli made the following statement:

I have no difficulty in endorsing the staff's appraisal. This review shows that, despite the real progress made so far in establishing favorable conditions for sustainable economic growth, the economic situation in Togo remains fragile and vulnerable to exogenous developments. Within such a context, I am pleased by the Togolese authorities' commitment to pursuing their adjustment program. The staff paper demonstrates, however, that the adjustment process needs to be reinforced in several areas in order to address the less favorable economic developments that occurred in 1990, and I share this view.

First, concerning fiscal policy, for the second consecutive year the overall tax revenues did not meet expectations. As it is reported, this is due principally to delays in the receipts of tax payments from public enterprises, while indirect tax collection produced better results than programmed. I welcome the fact that improvements are foreseeable during the second half of the year in the 1990 transitional arrangement for taxation of public enterprises, and I am pleased by the authorities' renewed commitment to reducing the consolidated deficit on government operations in 1991. As previous speakers have already mentioned, in view of the institutional arrangements of the West African Monetary Union, greater emphasis must be placed on internal financial discipline and, in particular, on fiscal policy; with regard to the latter, actions are certainly required to contain current expenditures.

Second, concerning structural reforms, the progress already achieved is encouraging in many respects. However, every effort should be made to maintain the present momentum, since there is no doubt that developing a stable and stimulating environment for the private sector is essential for the successful outcome of this program, particularly in order to foster productive investment conducive to growth. The fourth structural adjustment program, which is to be adopted shortly by the World Bank, will provide a comprehensive framework for further decisive steps in this area, including human resource development, as well as an action plan for the social dimension of adjustment. Emphasis should be placed on the steady streamlining of public enterprises, as well as on improving the financial sector. On this latter point, I welcome the significant steps that have already been undertaken, especially as regards the liquidation of the agricultural credit bank (CNCA), thanks in particular to the backing of the Caisse Centrale de Cooperation Economique (CCCE).

Third, looking at the medium-term prospects for the economy, I welcome the authorities' intentions to focus their efforts on maintaining the overall competitiveness of the economy. In addition to maintaining producer prices in line with international market prices, the different studies recently undertaken should be pursued in a timely manner, in order to assess the factors influencing the competitiveness of services and manufactured exports. I am optimistic as regards the prospects for the export processing zone following the promotion seminar sponsored by the Overseas Private Investment Corporation; it is my understanding that about 20 enterprises might be interested in the near future.

Finally, given the exogenous developments and, above all, the impact of the increase in oil prices, I also wonder whether increased access to the ESAF could not be considered for the third year, if necessary, as the present access is rather low in comparison with average ESAF access. I share the views of Mr. Santos and Mr. Al-Jasser on this point.

To conclude, the main lesson provided by the staff paper is that, if the authorities had undertaken early corrective actions, they could have avoided the nonobservance of several performance and structural criteria. I do not think that the adjustment program is a matter of considerable concern. However, I must emphasize the necessity for the authorities of ensuring a close monitoring and implementation of the program. However, given their firm adherence to the program's targets, we can go along with the requested waivers and we support the proposed decision.

The staff representative from the African Department stated that it was true that tax pressures in Togo were quite high compared with many other countries, and one could therefore ask whether it might be preferable to reduce current expenditures. However, the authorities had significantly reduced those expenditures during the earlier stages of the adjustment process, and it would be difficult to effect further reductions in current expenditure without affecting the smooth working of Government or making it more difficult to incorporate the social dimension of adjustment into the development process. A World Bank project in the health and education sector, for example, had a built-in condition that expenditures had to be increased in certain areas, which would lead to an increase in current expenditure of about CFAF 0.5 billion in 1991. The staff considered that the authorities should aim to maintain an unchanged level of current expenditure in nominal terms in 1991, which would require cuts in certain areas in order to allow for an increase in expenditures related to the social dimensions of adjustment.

The decline in the volume and price of phosphate exports in 1990 was fully taken into account in the 1991 budget, the staff representative remarked. A further decline was expected in tax payments and profit remittances from the state-owned phosphate agency, from CFAF 4.3 billion in 1990 to CFAF 3 billion in 1991. Indeed, that was one of the reasons why the Government would have to consider additional measures to meet its fiscal target for 1991, and it had reaffirmed its intention in that regard.

Changes in oil prices would obviously affect performance, particularly in 1991, the staff representative continued, and the authorities had indicated that they intended to raise domestic petroleum prices to partly offset the increase in international prices. They would not, however, effect a complete pass-through of those price changes. While there were a number of reasons for that, one obvious reason was the potentially rather serious problem of smuggling from neighboring countries; indeed, there were already signs that some smuggling might be taking place from Nigeria, through Benin. Consequently, the staff had agreed with the authorities that caution should be exercised in judging the degree of price adjustment.

The staff intended to discuss with the authorities a more ambitious target for public sector savings, the staff representative said. In that context, it was important to remember that allowances would have to be made for sufficient current expenditures for activities related to the social dimensions of adjustment. Furthermore, there did not seem to be a serious financing problem in the medium term; it appeared that donors were willing to finance Togo's projected deficit, which was quite small--less than 2 percent of GDP when grants were taken into account.

It was conceivable that privatization efforts might not produce a significant increase in employment, the staff representative from the African Department considered; however, at least initially, employment had not been the authorities' only target. Difficulties were being encountered because enterprises were in serious trouble and were incurring losses. In one sense, there was no alternative but to try to eliminate those losses first. The hope was that the effects of the next stage of the privatization program would be more favorable for those enterprises. The privatization of the textile mills was very encouraging, as the authorities expected that it would result in significant employment creation. In addition, the authorities' projection for 1991 took into account a recovery of the primary sector from its poor performance in 1990 following the drought at the end of 1990. Nevertheless, it was true that the authorities had been too optimistic, and the staff would try to encourage them to be somewhat more cautious in the future when making their projections.

Mr. Monyake said that he supported the authorities' request for waivers. Noncompliance with certain performance criteria had not weakened the program, nor did it indicate a relaxation of the authorities' commitment to maintain their adjustment effort. In fact, their record of perseverance was clear, having moved from an arrangement under the structural adjustment facility (SAF) in early 1988 to an enhanced structural adjustment arrangement, which was underpinned by a comprehensive economic and financial program. The Fund should do everything in its power to help the Togolese authorities continue on the path of economic restructuring, and that included flexibility with respect to performance criteria.

Some important institutional reforms had taken place in Togo, including those relating to the tax system, the operation of public enterprises and state-owned banks, and incentives to promote private initiative, Mr. Monyake remarked. However, the economy remained vulnerable, especially to adverse developments in the phosphate industry--a situation that was further complicated by the increases in the price of oil.

The present review was being held shortly after the Fund had agreed on certain measures to assist those countries that had been adversely affected by recent developments in the Middle East, Mr. Monyake observed. Togo was one such country: the price of gasoline exceeded $3 a gallon, which had had serious implications for both the budget and the balance of payments. With respect to the budget, the main issue was the difficulty--owing to the high level of current domestic prices for petroleum products--of effecting a full pass-through of recent increases in the price of oil. The staff paper suggested that freezing expenditures in nominal terms and implementing additional revenue measures would enable the authorities to achieve the targeted reduction in the deficit. However, it should be kept in mind that such restraint on expenditure, particularly on current outlays, was difficult to achieve. In addition, additional revenue could not be raised without at least some lag. Therefore, at the very least, some augmentation of financing at the beginning of the third year of the arrangement should be considered, which would be consistent with the Fund's decision on assisting countries affected by the crisis in the Middle East.

Mr. Al-Jasser stated that he was surprised to learn that the price of gasoline was $3 a gallon, which was extremely high for a developing African economy, and was high even when compared with international prices. Togo had an economy in which small processing industries, the transportation sector, and the industrial sector were trying to develop. If the staff already considered gasoline prices to be too high for an economy in that stage of development, then it was incumbent upon the staff to make that point when it recommended adjustments in domestic oil prices. In making its recommendations, had the staff considered the impact of such an adjustment on the revenue side of the budget? Similarly, had they taken into account efforts to broaden the revenue base of the economy, by allowing certain sectors--especially transportation, processing, and agriculture, which were reliant on imports like oil products--to grow and thus make it possible for the economy to become more self-sufficient?

Mr. Fernando said that he wondered whether the price of gasoline in Togo was based entirely on marginal cost pricing, and whether it was representative of all retail oil products. Specifically, did that price involve any subsidy on any oil product?

The staff representative from the African Department said that the price of gasoline was indeed about $3 a gallon. The prices of other products were somewhat lower, but were still fairly high; diesel fuel, for example, was about $2 a gallon. Consequently, there was some differentiation in pricing, but none of the products were subsidized, although there was a significant margin for all the products whose revenues accrued to the Government. It was the authorities' decision to increase domestic oil prices, although the staff had agreed with them on the need to be cautious. A gasoline price of $3 a gallon might appear to be high if compared with the price in certain countries; however, when compared with a broad range of other African countries' prices--in Cameroon and Côte d'Ivoire, for example--it was not unduly high. Although European gasoline prices were in the same range as Togo's, those countries were obviously in a different stage of development. Nevertheless, the staff had felt that there was scope for modestly increasing prices, and the Government had shared that view. If international prices persisted at their currently high levels, however, the authorities would have to increase domestic prices further in order to avoid further revenue shortfalls. Under those circumstances, he would agree with Mr. Al-Jasser that prices could not be increased too much without endangering the prospects for production and the transportation sector. Other measures would have to be considered, possibly including some additional financing, as had been suggested by several Executive Directors. The question of increased access for the third annual arrangement under the ESAF was obviously a matter that the staff would consider carefully, taking into account all factors, including financing from other sources.

Mr. Towe noted that the staff paper suggested that the authorities had intended to increase gasoline prices in November 1990; however, he wondered whether that increase had actually been implemented. Moreover, the planned increase in gasoline prices was only 7 percent, and he wondered how much domestic petroleum prices would have to be increased to fully offset the fiscal revenue impact of the increase in the international price of oil?

The staff representative from the African Department responded that, although the authorities had intended to raise gasoline prices in November 1990, that increase had been postponed because of a strike by taxi drivers. The authorities had felt that implementing gasoline price increases while taxi drivers were on strike would be inappropriate; nevertheless, the authorities were committed to adjusting those prices. In order to fully offset the fiscal revenue impact of the recent increases in oil prices, domestic price increases of 15 percent would be required, based on the World Economic Outlook assumption of an average price of $26 per barrel in 1991.

Mr. Towe then made the following statement:

> Like other speakers, we can support the staff's recommendations and the request for waivers. However, the staff paper suggests that Togo's economic performance during the second year of the enhanced structural adjustment arrangement will be significantly worse than expected. In particular, and perhaps most importantly, real output growth for 1990 is now projected to be only 1.9 percent, implying a substantial decline in per capita income. Moreover, the magnitude of the deviations from the fiscal projections during the first half of 1990, and the resultant breach of the quantitative performance criteria, are a cause for some concern regarding the prospects for achieving the revised targets for the year as a whole and, as a result, the adequacy of the authorities' policy response. In this regard, I found the prescriptions of Mr. Al-Jasser and Mr. Goos for further fiscal action to be persuasive.
>
> An important factor explaining the worsening of both the external and the fiscal accounts, as well as the breach of the end-June 1990 quantitative performance criteria, seems to have been the decline in phosphate production. As the staff paper is relatively silent regarding the reasons for the shortfall, I wonder whether the staff could provide further explanation for the fall in the volume of sales. In particular, and in the absence of any other explanation, I wonder whether the shortfall might be connected to the revised treatment of the phosphate agency (OTP) in 1990 for income tax purposes. The staff notes that during this year, the OTP's tax liability is to be estimated on the basis of phosphate sales, rather than profits. Thus, there would seem to be a significant incentive to either underproduce or underreport sales of phosphate.

The substantial fiscal expenditure overruns during the first half of 1990 are a cause for some concern, in that even the amended deficit target may not be achieved. In particular, total expenditure during the first half of 1990 was 1 percent of GDP in excess of the program target, owing largely to higher than expected current expenditures. The staff paper suggests that the excess will be reversed by the end of the year. The April 1990 budget cuts are projected to have a substantial impact during the second half of the year, while net lending to civil servants will be reversed by the end of the year. As a result, the staff projects that the 1990 expenditure target will be met, and that the overage for the fiscal deficit will be solely the result of revenue shortfalls. Nevertheless, I wonder whether the staff could provide further assurances that the program's year-end expenditure targets will be met. In particular, it was puzzling that the late implementation of the April 1990 budget cuts had not already been taken into account in the initial design of the program targets. Moreover, could the staff provide some details regarding the nature of the very large and unforeseen net lending operations to civil servants?

The staff has indicated its expectation that the end-December 1990 quantitative performance benchmark will be met. However, Table 2 of the staff paper suggests that, while domestic bank financing will be as expected, the overall fiscal deficit will be higher than originally programmed, and will be financed by larger net external resources. Would this not imply a downward adjustment in the end-year ceilings and, therefore, a breach of the revised projections?

Mr. Wright made the following statement:

I can join other speakers in expressing my disappointment that, after two years of good performance, growth has slowed in 1990 as a result of exogenous developments. I am also concerned that fiscal slippages have once again emerged, undermining progress in other areas. Given the action taken by the authorities to restrain expenditure, and their reaffirmation of an unchanged budgetary target for 1991, I can agree to the requested waivers. However, this will be the second consecutive year in which the budget target has been missed; all slippages--however they occur--are very damaging to the authorities' credibility, given the central role of fiscal adjustment in the program.

Much of the disappointing growth and the revenue shortfall can be explained by the performance of the state phosphate company (OTP). I would like to ask the staff why the volume of phosphate exports was lower last year? There is a reference in the staff paper to marketing difficulties, but I am not aware of similar difficulties experienced by other phosphate producers, which leads me to wonder whether the shortfalls were wholly exogenous.

Other speakers have referred to the implications of Togo's exchange rate arrangements and, in particular, to the fact that Togo's superior record of price stability, compared with competitor countries, has allowed it to maintain its competitiveness. Nevertheless, the CFA arrangements place the entire burden of adjustment on domestic policies, including structural reforms. Although Togo starts from a better position than some of its CFA franc neighbors, Togo's prolonged use of Fund resources, the obvious fragility of its medium-term prospects, and indications that the present cost structure in the cocoa sector is unsustainable, demonstrate how exacting this exchange rate discipline is.

The staff rightly focuses on the importance of further reductions in the budget deficit, both to increase domestic savings and to encourage the private sector. I note that the authorities plan to freeze expenditure in nominal terms, but--notwithstanding the comments of the staff representative from the African Department--there may be more scope for tighter management of public spending, especially as far as the civil service and defense spending are concerned. This is particularly important given the constraints that exist on raising further tax revenue. Others have referred to the fact that Togo's tax to GDP ratio is already relatively high, and that its ability to raise import duties is constrained by its entrepôt activities. I would be interested to know what measures the staff have in mind. Can the staff reassure me that the administrative problems encountered in the taxation of public companies have now been overcome, so that profits are now being taxed at the appropriate rate, even if profits themselves are lower than expected?

My final comment relates to Togo's administrative capacity--the staff's remark that the authorities could have reacted earlier to the revenue shortfall that emerged this year led me to raise this issue. For this reason, I was encouraged by the measures described in Mr. Santos's opening statement to reorganize and improve coordination between three key ministries. This should go some way toward avoiding a recurrence of the kinds of delays seen earlier this year.

Mr. Spencer made the following statement:

There are just two areas that I would like to comment on in relation to this review. The first relates to the question of external adjustment within an exchange arrangement such as the CFA franc zone. Togo's current account deficit, including official transfers, has averaged 5.6 percent of GDP over the past four years. If official transfers are excluded, the average is 11.6 percent of GDP. Despite this apparent ongoing imbalance, the real exchange rate--as shown in Chart 2 of the staff paper--has remained remarkably stable. Indeed, on the basis of relative output deflators or wage costs, it is apparent that the real exchange rate could well have appreciated over the period.

However, this does not mean that adjustment cannot occur under a fixed exchange rate regime; but it does demonstrate how unconditional official transfers can prevent the adjustments necessary to get an economy onto a self-sustaining path. If official transfers were not so readily forthcoming, then the monetary discipline inherent in the CFA arrangements would actually begin to bite, forcing the fiscal correction and the real wage adjustments necessary to redress the underlying external imbalance.

The second comment I have reinforces other Directors' concerns about the effective degree of fiscal restraint inherent in the present program. The extent of slippage in fiscal policy to date under the enhanced structural adjustment arrangement, and the lack of concrete proposals for further progress next year, tend to reduce confidence in the staff's projections for future reductions in the government deficit. Clearly, the major reason for missing the 1990 fiscal target has been the shortfall in government revenues resulting from unanticipated external events--declines in export prices and volumes of phosphate, low rainfall, and oil price increases. However, there has perhaps been an ongoing tendency under this arrangement for excessive optimism on the fiscal front. Certainly, this tendency was noted by Directors at the previous Board discussion on Togo.

This problem--which is not isolated to Togo--would be reduced if Mr. Goos's proposal for a stronger fiscal program was adopted or, alternatively, if the staff and the authorities were more willing to allow for the historical pattern of risks on fiscal outcomes. The problem would also be reduced if fiscal monitoring and evaluation procedures could be enhanced, so that corrective actions could be adopted more quickly when the fiscal position goes off track.

Notwithstanding these concerns on the fiscal side, I agree with the staff that Togo has made progress, particularly with some of the structural initiatives aimed at improving public sector efficiency over the medium term. For this reason, and in view of the authorities' recent actions to offset the revenue shortfall, we are willing to support the proposed decision.

Ms. Hansen made the following statement:

It is unfortunate that external developments, as well as the transitional arrangements for taxing public sector enterprises, have set back the fiscal program. However, we welcome the corrective actions that have been taken and hope the authorities will do whatever else may be necessary to meet the original end-December benchmarks.

Given the slippages on the fiscal side that have already occurred, and the unlikelihood of a full pass-through of higher oil prices, a stronger fiscal effort will be required.

On the expenditure side, more needs to be done to reduce personnel expenditures. We welcome the agreement on civil service reform and hope the authorities will move aggressively in this area in the coming year. It does not appear, however, that the savings over the medium term will be very great, although we recognize that the balance between personnel expenditures and expenditures on materials and supplies will gradually improve. Currently, personnel expenditure is about twice as high as spending on material and supplies, which must have an adverse effect on the efficiency of government operations.

There is perhaps more scope to widen the tax base. In this connection, one positive aspect of revenue performance has been the increase in import duties, which seems to be the result of a reduction in customs exonerations. This has not only been beneficial for fiscal performance, but it should also help improve competitiveness in the economy by reducing the rate of effective protection for domestic manufacturers and equalizing prices of imported final goods across sectors. We would urge the authorities to do more in this direction and would encourage other countries in the region to follow Togo's example.

On privatization, the progress during the first program seems to have been very slow, with only one liquidation and five privatizations over a nine-year period. We are encouraged to see that the pace is expected to pick up over the next phase of the program, and urge the authorities to maintain this accelerated pace.

Like several previous speakers, we were struck by the treatment in the staff paper of competitiveness. The staff paper makes the point that the real effective exchange rate has remained relatively stable over the previous five years. In judging the degree of competitiveness, however, the critical factor is not the stability of the real effective exchange rate, but whether the exchange rate is pitched at an appropriate level.

The study on the factors influencing the competitiveness of Togo's manufactured exports is a very worthwhile undertaking; this is another area where other countries in the region would do well to follow Togo's example. We also welcome the World Bank study on the elimination of constraints on employment generation and urge the authorities to take the study's recommendations into account when labor regulations are revised later this year.

Finally, we note Mr. Santos's observation that there may be a case for augmenting Togo's access under its enhanced structural adjustment arrangement in the context of the Fund's response to developments in the Middle East. While this chair has indicated its willingness to consider augmentation for countries adversely affected by developments in the Middle East, it does not appear that Togo falls into this category. The balance of payments table in the staff paper suggests that increased oil import costs have only played a minor role in Togo's higher import bill, which I gather is due mainly to an acceleration of the public investment program. Moreover, export performance is now projected to be much better than originally expected.

We support the proposed decisions.

Mr. Zhang stated that the authorities should be commended for the progress they had made under the current arrangement. However, during 1990 the Togolese economy had been adversely affected by exogenous factors, such as low rainfall at the beginning of the year and a decline in phosphate production, which had led to an estimated annual rate of growth of 2 percent, compared with the projected rate of 2.6 percent. The fall in the volume and price of phosphate exports and the recent increase in prices of imported petroleum products had brought about a further deterioration in the country's external position. The current account deficit, excluding official transfers, had reached 12.2 percent of GDP, compared with the programmed deficit of 10.2 percent.

Faced with these unfavorable conditions, the authorities had taken all the necessary measures in a timely fashion, Mr. Zhang considered. It was encouraging to note that the authorities had not only put in place an appropriate transitional arrangement for the newly taxed public enterprises, in order to ensure revenues, but had also taken steps to reduce current expenditure. On the monetary front, the authorities had undertaken significant reforms aimed at increasing the role of market mechanisms and enhancing bank supervision, while maintaining a tightened monetary stance. The authorities had also achieved satisfactory results in the area of structural reform, including reform of the public administration and the banking sector. In addition, they had reaffirmed their strong commitment to take further measures and actions to achieve the key objectives for 1991. Therefore, he endorsed the staff's recommendation to grant the waivers, as requested by the authorities, and supported the proposed decision.

Mr. Hammoudi said that he endorsed the authorities' request for the waivers and agreed with the proposed decision.

The staff representative from the African Department stated that phosphate exports had declined in the first half of 1990; however, following a slight improvement in the third quarter of that year, the authorities had preferred to be cautious with respect to their projection for the fourth quarter of 1990. If phosphate export performance in 1990 were to be somewhat better than projected in the program, government revenues from the OPT would be better in 1991, as those revenues would be based on actual performance--unlike previous years. It was true that other phosphate exporting countries had not experienced marketing difficulties; part of the reason for Togo's poor performance in that respect, however, was related to the poor quality of its phosphate, which contained more cadmium than that of other countries.

Although the current program did not take into account net lending to civil servants, he agreed that those expenditures should have been incorporated, the staff representative said. The lending program--which was related to the twentieth anniversary of the political party--afforded civil servants the opportunity to borrow the equivalent of one month's salary, which would then be automatically deducted from subsequent paychecks, and was therefore self-liquidating. The staff had perhaps placed too much emphasis on the expenditure patterns of previous years and should have been a little more cautious about the measures contained in the 1990 budget, which had not been approved until somewhat late in that year. As the current arrangement was also only approved after the adoption of that budget, there had been some lag in effecting expenditure reductions from the budgeted levels. Nevertheless, the staff would carefully review with the authorities the possibility of reducing certain undesirable expenditures.

It was true that the chart in the staff paper on the exchange rate did not fully capture the significance for Togo of trade with some competitor countries, the staff representative from the African Department said. A large part of Togo's trade with Nigeria and other neighboring countries, for example, was not fully captured in the official statistics; consequently, the weights used in the staff paper did not fully capture the importance of those currencies. Nevertheless, the staff had considered other elements as well, as was evidenced by the references in the staff paper to that measurement problem. While it was perhaps true that in 1989 the staff had been optimistic with respect to revenues, the revenues in 1990 were in line with projections, except for those that could be explained by unforeseen developments. Finally, it was clear that Togo had been quite successful in its privatization efforts: nine enterprises had already been privatized and more than ten had been liquidated completely.

Mr. Wright stated that it was reassuring that the loans to civil servants would be self-liquidating; nevertheless, those loans had been particularly inappropriate under the circumstances, given the expenditures and revenues involved. The nature of the phosphate revenue shortfalls was a central issue, because a judgment of the authorities' policy stance over the past few months depended crucially on whether those shortfalls were considered to have resulted from exogenous factors or from the management of the OPAT, for example. The staff should pursue that issue at the time of the next review of the program.

Mr. Towe asked whether there was a possibility that the authorities might miss the end-December 1990 target for net domestic credit, owing to an adjustment for higher than expected external borrowing.

The staff representative from the African Department replied that the end-December 1990 target for net domestic credit was a benchmark and not a performance criterion. There was a strong case, however, for including in the benchmark an adjustment similar to the one that was associated with the earlier performance criteria on net domestic credit. Therefore, while such an adjustment would be welcome, it was not formally called for in the program.

Mr. Santos noted it was the intention of the authorities to adjust domestic petroleum prices in order to partially offset the loss of revenue stemming from the recent increase in international oil prices. The authorities had made their intention in that regard clear to the staff in late September and early October 1990; however, they had delayed implementation of that adjustment as a result of the strike that the staff representative from the African Department had described. The authorities were concerned that high oil prices might persist; if there were further increases, there would be serious repercussions, although the authorities would try to strike a balance between fiscal consolidation and other objectives, such as the need to boost competitiveness and production.

He agreed with Ms. Hansen's observation that a request for an augmentation of the ESAF resources available to Togo could be assessed only on the basis of the balance of payments need of the country, as set out in the recently adopted guidelines for augmenting ESAF resources, Mr. Santos continued. Accordingly, such an assessment would certainly have to be made by the staff at the time of their discussions with the authorities on a possible third annual arrangement under the ESAF.

It was true that, during the talks that led to the establishment of the export processing zone, expectations for job creation had been very high, Mr. Santos remarked. Those expectations had been modified, however, in light of the authorities' experience in establishing the export processing zone; currently, the authorities' attitude could be described as one of cautious optimism. There was still much to be done in a number of areas, including the microeconomic framework, the macroeconomic environment, fiscal consolidation, and structural measures; with respect to the latter, studies had already been prepared on labor regulations and competitiveness. Progress in those areas would create the prospects for further interest in the export processing zone and would go some way toward meeting his authorities' expectations concerning development and job creation. Finally, he noted both the overwhelming support of Executive Directors for his authorities' efforts and their understanding of the factors that had led to the nonobservance of certain performance criteria and structural benchmarks.

The Executive Directors took the following decision:

1. Togo has consulted with the Fund in accordance with paragraph 2(d) of the second annual arrangement under the enhanced structural adjustment facility for Togo (EBS/90/101, Sup. 1, 6/28/90), and paragraph 26 of the letter of the Minister of Economy and Finance dated May 17, 1990 attached thereto.

2. The letter of the Minister of Economy and Finance of Togo dated November 19, 1990 shall be attached to the second annual arrangement under the enhanced structural adjustment facility for Togo, and the letter dated May 17, 1990 shall be read as supplemented by the letter dated November 19, 1990.

3. The Fund determines that the review contemplated in paragraph 2(d) of the second annual arrangement under the enhanced structural adjustment facility for Togo has been completed, and that notwithstanding paragraphs 2(a)(ii), 2(a)(iv), 2(a)(vii), and 2(b)(i), Togo may proceed to request the disbursement of the second loan under the arrangement.

Decision No. 9599-(90/168), adopted
December 5, 1990

## 2. SINGAPORE - 1990 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1990 Article IV consultation with Singapore (SM/90/215, 11/8/90). They also had before them a background paper on recent economic developments in Singapore (SM/90/220, 11/21/90).

Mr. Ismael made the following statement:

The Singapore authorities have asked me to convey their appreciation to the staff for the 1990 Article IV consultation.

As always, the exchange of views has been frank, amicable, and beneficial. The staff report is again noteworthy for the many common positions shared by the staff and the authorities and leaves us very little to add.

With respect to recent developments and the short-term economic outlook, the expansion in the Singapore economy since 1987 has been extremely rapid, following a period of slack in the mid-1980s. GDP grew by about 10 percent on average in 1987-1989. While the initial recovery was led by exports of manufactured goods, services, and associated investments, the recent expansion has also reflected a turnaround in domestic construction expenditures after several years of decline.

The decline in the contribution of external demand since 1989, particularly in the nonfinancial economy, has been accompanied by the gradual erosion of export competitiveness in labor-intensive industries, arising from an increasingly tight labor market. The unemployment rate has fallen well below previous historical lows, reflecting both the strength of the economic recovery and a slowdown in underlying labor force growth. Despite an increased intake of foreign labor, the labor market was evidently overheated by the first half of 1990, with real wage growth significantly exceeding productivity growth. This contributed to an increase in inflation to 3.5 percent in the first half of the year, well above the average of 1.5 percent in the previous three years.

Since the consultation discussions three months ago, economic statistics for the third quarter of 1990 have become available. The high real GDP growth rate of 8.1 percent in that quarter, following a revised first half growth of 9 percent, suggests that economic growth is likely to be slightly higher in 1990 than expected; GDP growth should be close to 8 percent for the year as a whole. However, business expectations in both the manufacturing and services sectors have been revised downward in the aftermath of the crisis in the Middle East. As discussed during the consultation, the Singapore authorities expect economic growth to decline to about 5 percent in 1991. There is considerably greater uncertainty than normal in the external environment, however, which could significantly alter this forecast.

The immediate effects of the crisis in the Middle East have been most discernible in the figures for inflation. Inflation, as measured by the consumer price index (CPI), is likely to accelerate to between 4 percent and 4.5 percent in the fourth quarter. For 1991, the authorities do not expect average inflation to exceed 4 percent unless oil prices rise significantly above their present levels. Imported inflation should be mitigated by the substantial appreciation of the Singapore dollar that has already taken place, and which has yet to pass through fully into lower domestic prices. Excluding the oil price increases since August, the underlying rate of inflation is expected to decline to about 2 percent in 1991 from about 3 percent in 1990. The decline would largely reflect the elimination of the temporary effects of indirect tax increases since mid-1989. However, inflationary pressures arising from a tight labor market are unlikely to recede significantly unless economic growth falls below expectations.

Concerning the medium-term outlook and the associated policy measures, it is interesting to note that, until recent months, one of the key macroeconomic concerns facing the authorities was the overheating of the labor market and the attendant cost pressures. The prospective slowdown in demand following the outbreak of the crisis in the Middle East is, in this regard, not entirely unwelcome. In determining the appropriate policy response to the inflationary effects of the oil price increases, the authorities agree with the staff's view expressed during the consultation discussions that the direct effects of such increases could be allowed to feed through to higher domestic prices, while the exchange rate should be used to guard against the persistence of inflationary pressure from second round effects, either at home or abroad. While an inflation rate of above 2 percent is probable in the near term, it is not in any sense a target rate. Exchange rate policy would be guided by medium-term expectations, and the authorities are prepared to tolerate some increase in the inflation rate in the near term. The authorities are confident that inflation will not be self-sustaining and will remain lower than that of Singapore's trading partners.

The authorities are in agreement with the staff on its projections for the medium-term outlook. The expected slowdown in the Singapore economy in 1991, although partly occasioned by external developments, is consistent with an expected medium-term potential growth path of 5 percent to 6 percent over the next five years. Economic growth will have to rely increasingly on improvements in productivity. In this regard, the Government remains committed to enhancing the quality and scale of the education system, so as to promote the shift to a more skill- and knowledge-intensive economy. Accelerated efforts at economic cooperation between Singapore and its neighbors--Malaysia and Indonesia--would help facilitate the transfer of labor-intensive activities to these countries and stimulate demand for higher value-added service and manufacturing activities in Singapore. The current focus of these efforts--the promotion of a "Growth Triangle," comprising Singapore, the Riau islands in Indonesia, and the State of Johor in Malaysia--has seen an encouraging response from investors.

With regard to the savings-investment balance, the authorities wish to commend the staff on its special research on savings and investment behavior in Singapore. The staff's findings, that rapid economic growth and demographic evolution account for the bulk of the increase in the savings rate in Singapore since the 1960s, are broadly similar to those of studies done by the authorities. However, the latter suggest a somewhat smaller contribution to national savings arising from government savings than indicated in the staff's research.

Singapore does not target an overall savings-investment balance. However, the authorities are actively looking into ways to reduce the fiscal surplus of the government over the medium term in line with social and economic objectives: government expenditures on upgrading public housing, the development of single-session schools, expansion of tertiary education, and development of the arts and social welfare are being considered. If budget surpluses remain high, the authorities are willing to consider appropriate reductions in tax rates. Insofar as the labor market remains tight, however, the authorities are in agreement with the staff that a loosening of fiscal policy may be inappropriate in the near future.

Mr. Ichikawa made the following statement:

Singapore is one of the most dynamic economies in the world, and its importance to the region, as well as to the world economy, has grown significantly in recent years. As a small open economy, Singapore has benefited from the favorable economic development of the region by pursuing prudent financial policies and appropriate trade and exchange policies. Today, Singapore is emerging as a center of regional economic integration, and I am confident that its role in the world economy will continue to expand, given the sound development of the world economy. Therefore, I would encourage the authorities' continuing efforts to increase their contribution to the world economy through their policy orientation.

With respect to the current economic situation, the new Administration is facing a challenging task of consolidating its gains and applying them toward its medium-term objectives. In this respect, the short-term consideration about overheating and the uncertainties with regard to the crisis in the Middle East add an additional element of complexity to the issue. Nevertheless, in view of the tight labor market situation, maintaining a prudent fiscal and monetary stance is warranted to ensure stable growth over the medium term. Any radical change in financial policies does not seem necessary or appropriate in the near future.

The recent experience following the previous Article IV consultation seems to support this argument. Having fully recovered from the recession in the mid-1980s, the economy continued its strong growth in 1989 and 1990. However, as the staff report pointed out, the contribution of external demand was weakened in this process, owing to the rapid increase in the real wage. While the increase in the real wage partly reflects the authorities' long-term interest in appropriately translating the scarcity of labor into the real wage, it is evident in the short-term framework that vigilance on inflation is needed. In this vein, given the labor constraint and the gradual nature of industrial transformation toward capital- and knowledge-intensive industries, it seems somewhat early at this stage to attempt a rapid economic transformation from export-led to domestic demand-led growth, such as Japan is currently undergoing. Also, it should be noted that the absolute size of the external surplus does not in itself raise an externality problem. Thus, in my view--as I will elaborate later--financial policies at this stage should be governed mainly by concern about maintaining price stability. I hasten to add, however, that it is imperative in the long run to raise the productivity of the economy through industrial restructuring; otherwise, growth prospects will be severely limited by labor constraints, despite capital mobility.

I welcome the fact that inflation has been contained to only 3.5 percent this year--much lower than in many of the major industrial countries--while growth is expected to continue to be strong. In this connection, it is heartening to learn from the staff report and Mr. Ismael's helpful opening statement that the inflationary effects of the crisis in the Middle East will be contained to within about 2 percentage points, owing to the strong position of the economy.

I have a few comments on specific policies. First, on the level of the fiscal surplus, I concur with the staff and the authorities that the current fiscal stance vis-à-vis the medium-term budgetary strategy does not raise immediate concerns about economic activity. Nevertheless, if there is a good prospect that the overheating of the economy will have subsided to an extent that could be managed by monetary and exchange rate policies, the authorities will be in a good position to utilize their fiscal surplus for the long-term interest of the economy. In light of the authorities' long-term strategy to promote knowledge- and capital-intensive industries, those surpluses could well be invested in areas such as education, research and development, and the promotion of public infrastructure.

Second--and in close connection with my previous remarks--the staff report and Mr. Ismael's opening statement developed an interesting discussion on the savings-investment imbalance. In my view, the staff is right to question this imbalance primarily from the domestic perspective. I do not want to go into the question of whether the Government's intervention is significant. However, if the savings-investment imbalance is to continue, concerns may arise from the perspective of market stability. While the imbalance seems to have been mitigated somewhat by capital investment in neighboring countries and off-shore markets, I am concerned that--in view of the possible decline in the growth of the world market in the coming year--the excessive surplus may spill over into domestic property and stock markets, thus distorting the domestic price structure. I would welcome the staff's comments on Singapore's real estate and stock market conditions.

With regard to monetary and exchange rate policies, I commend the authorities' flexible and effective monetary control. In view of the volatile nature of foreign capital flows and the limitations of the domestic money market, flexible use of exchange rate policy is instrumental in monetary management.

In conclusion, Singapore has continued its excellent economic performance and has significantly strengthened its position in the world economy. However, in order to assume a greater role in the world economy and enhance social welfare, the authorities need to appropriately assist the restructuring of the economy while maintaining overall financial stability.

Mr. Wright made the following statement:

As Singapore embarks on a new era, it is worth reflecting that since independence it has enjoyed an average growth rate of 9 percent--giving its population a higher per capita income than those of several EC countries--and, in this respect, is second in Asia only to Japan. The conduct of economic policy has been something of a model, and the main issues that are raised in the concise staff report are of a strategic nature, bearing largely on the thrust of the economic management in the medium term.

Turning first to the immediate policy stance, the staff seems reasonably sanguine that the economy will experience a "soft landing" as policy is tightened in response to the signs of overheating. I fully understand that the openness of the economy imposes serious constraints on the operation of an independent monetary policy, and that the exchange rate is thus the main weapon used to maintain a low rate of inflation; however, I would be grateful for clarification of a few points on the operation of such a policy. How, for example, can an exchange rate appreciation invariably be engineered at will? One has the impression from the staff report that the rate is under fairly continuous upward pressure. It would be interesting to know whether this pressure stems from the current account position, self-fulfilling expectations--which might, of course, one day be reversed--or, as seems less likely, the domestic rate of return. What I am trying to establish is whether an anti-inflationary policy based exclusively on the exchange rate is in fact sustainable in the medium term if it is accompanied--as in Singapore in recent years--by rapid growth of the monetary aggregates. Indeed, to the extent that exchange market pressure is not always wholly accommodated in the exchange rate, the resulting rise in the reserves will contribute to monetary expansion. I also wonder whether there are alternative domestic instruments that the authorities should develop to facilitate domestic monetary control. This possibility seems to be hinted at in the staff report, and I would be very grateful for the staff's comments on this.

The staff seems confident that the external sector will remain strong, despite the loss of competitiveness stemming from the exchange rate and inflation. I would be grateful for reassurance on a couple of points. First, given the limited scope for productivity growth and increased labor supply, what are the prospects for continued growth in the services sector? Second, given that Singapore's capital-labor ratio already exceeds that of the United states, how much further capital substitution can there be? Third, do the current account projections fully reflect the slowdown in the U.S. market, which accounts for 30 percent of Singapore's exports?

Turning now to the intervention in the economy and, in particular, the role of the Central Provident Fund (CPF), Singapore's development to date has been achieved by exploiting its comparative advantage in the international economy, against a background of sound market-oriented policies and an open trade and exchange regime. It is important to recognize, however--and, I think the staff report may understate this to some extent--that there remains considerable government intervention in the economy. Intervention has been both indirect--through incentives, notably in the labor market and via a discretionary tax regime--and direct--through financial intermediation, public enterprises, centralized wage bargaining, and an active fiscal policy. An interesting IMF Working Paper issued earlier this year concluded that, while government intervention may have played a pivotal role in providing the initial impetus for restructuring Singapore's economy, a critical mass of high technology and skill-intensive activities now exists to allow these activities to grow naturally. In other words, now that Singapore has evolved into an industrialized economy, the authorities can afford to withdraw from such close involvement, and I welcome the signs that they are starting to do so.

The first priority should perhaps be to reduce government involvement in the financial sector. Singapore now has a sophisticated and thriving private financial sector--though domestic banking needs to be opened much further to foreign participation. My main concern is with the operations of the CPF and, to a lesser extent, the Post Office Savings Bank.

In the first place, the CPF already behaves very much like a private financial intermediary, financing house purchases, medical insurance, education, and unit trust investments; while deposits with the Post Office Savings Bank enjoy competitive interest rates and tax privileges. A substantial proportion of the private sector's savings is therefore channelled through public sector intermediaries.

Second, there is the question of whether it is appropriate that individuals should be compelled to save such a high proportion of their incomes via the CPF. Involuntary savings via the CPF do not seem to be a close substitute for private savings, and contribution rates appear to be determined as much by the stance of countercyclical policy as by the Government's assessment of its long-term liabilities. I would suggest that provision for retirement would be better encouraged by some broadly based tax relief for savings. The timing of any change to CPF contributions will always be a delicate matter, given its possible impact on overall savings, but in the medium term, the authorities certainly need not be afraid of reforms that could result in some weakening of Singapore's enviably strong external position. They might also consider ways in which the private sector might manage CPF balances. One consequence of allowing savings to be channelled to a greater extent through private institutions could well be to strengthen Singapore's role as a regional financial center.

On a related point concerning the CPF, I have already mentioned the authorities' deliberate policy of raising the cost of domestic labor to encourage more capital-intensive means of production. I am surprised to see that the authorities expect to affect the marginal cost of labor by means of a revenue-neutral switch from employee to employer contributions. I would have thought that the effective incidence of the two contribution rates was in fact nearly the same; if employee rates were not already so high, I would suggest that it would be more fruitful to cut taxes on business costs instead. Perhaps the staff could comment on this matter.

Finally, I would like to turn to the issue of public ownership more generally. I have dwelled at some length on the role of the CPF, but there are other areas of the economy in which government involvement could be reduced. In addition to the usual utilities, the public sector embraces petrochemical and shipping companies and the national airline; although they are efficiently run, there is no obvious justification for them to remain under state control. I wonder whether there are any plans to privatize them.

In conclusion, I hope that by the next consultation we will see signs of a greater willingness to let the development of Singapore's economy be guided by market forces, in line with the authorities' views on the importance of containing the size and role of the public sector.

Mr. Fogelholm made the following statement:

Singapore's economic progress during the last three decades has been outstanding. The surge in national savings is perhaps the most striking feature of this era; from actually being negative at the beginning of the 1960s, the savings ratio has climbed to over 40 percent of GDP in the 1980s, or, to quote the background paper on recent economic developments in Singapore: Singapore "has become the thriftiest country in the world." I will come back to the issue of savings later.

First, let me touch briefly on economic policies and developments. In effect, not much needs to be said, as the economy is presently in a very strong position, owing largely to the active and sound policies being pursued by the authorities. In recent years, the primary focus of economic policymaking has been on containing inflation--and rightly so, I believe. To achieve this goal, fiscal policy has been most restrictive, and the public finances are now in an enviable state, with a substantial budget surplus that may even increase. At the same time, and for the same reason, the exchange rate has been allowed to appreciate. Furthermore, the authorities have kept the pressures in the labor market in check by encouraging a restructuring of the production base and pragmatically using measures regulating the inflow of labor. Finally, the Singapore authorities have pursued economic policies that have resulted in a commendably open regime of trade and capital movements.

The burgeoning Singapore economy is now expected to slow down in the period ahead, with annual growth rates falling to a still impressive 5 percent to 6 percent, which is in line with the estimated growth potential. These developments reflect deceleration of domestic and external demand, and should encourage a shift toward a more neutral policy stance. Indeed, against the background of uncertainties arising from the situation in the Middle East, the staff suggests that fiscal policy should avoid a further withdrawal of stimulus. In fact, I believe that even a somewhat expansionary fiscal policy should not be completely excluded as a policy option. Nevertheless, the authorities should ensure--and I have no doubt they will--that a possible fiscal stimulus takes place in a noninflationary framework.

The discussion of the fiscal policy stance leads me back to the issue of the appropriate level of national savings. During the last 30 years, the remarkable development of savings undoubtedly laid the foundation for the economic achievements, particularly the restructuring of the economy. I read with interest the discussion in the background paper on the level of savings in the Singapore economy. From the viewpoint of maximizing the economic welfare of the population over time, the staff has tried to answer the question of whether the savings can now be considered to be too high. The results are inconclusive, but the staff puts forward several arguments in favor of the desirability of such a high level of savings.

It is, of course, easy and undoubtedly also prudent to encourage a high savings ratio, particularly in a world in which savings are scarce commodities. Nevertheless, I believe it would be appropriate in this particular case to consider whether the policy approach should not be changed in the direction of a more market-oriented determination of consumption versus savings. In an economic environment permeated by reliance on market mechanisms, I am struck by the size of the Government's influence on savings, both directly, through the fiscal budget surplus, and indirectly, through the mandatory contributions to the Central Provident Fund.

Obviously, a sound fiscal position is in itself reassuring and creates confidence. However, it could be questioned whether the totality of government influence over savings decisions is higher than suitable in an efficient and democratic market economy. As the staff notes, the Government's current policies might result in higher total savings than market forces alone would produce. While acknowledging that private decisions can be distortive, I wonder--particularly in light of the high level of savings--whether the authorities should not consider a more market-oriented approach to the determination of savings. This would increase the choices of the population at large in their decisions between consumption and savings.

Over the medium term, such an approach would generally imply that the authorities should shift their emphasis from directly influencing savings to providing and ensuring a macroeconomic policy framework conducive to nondistortive private sector decisions. Such a move would probably enhance not only the efficiency of the economy, but also the welfare of the population. If and when such a policy action is taken--through the reduction of tax rates, for instance--it should, of course, be implemented with due regard to macroeconomic stability.

Mr. Moss made the following statement:

Notwithstanding the fact that Singapore is on the bicyclic consultation schedule, the staff has managed to confine its staff report to a mere 10 pages, while the background paper covers some of the most crucial aspects of Singapore's economic performance and policy in a way that refrains from repeating the content of the staff report. Therefore, I would like to commend the staff for this performance.

In addition to the staff, the Singapore authorities also deserve to be congratulated for another outstanding performance of their economy. Regardless of the brevity of the staff report, it contains several important lessons of sound economic management for a small open developing economy on which I would like to elaborate somewhat, given the fact that the majority of the Fund's membership can be categorized under this same heading.

The first major lesson Singapore demonstrates is that it remains possible for a country to generate a sustained pace of noninflationary growth with its domestic labor force virtually at full employment. Indeed, over the 1987-1990 period, Singapore has recorded an average real GDP growth rate of over 9 percent annually, with an unemployment rate in mid-1987 already below 5 percent; yet, inflation did not on average surpass the 2.5 percent mark during those four years.

How did they manage? A substantial rise in the labor participation rate is not a clue, nor is massive immigration of foreign labor. Instead, sound economic management, along the lines that this institution is advocating for all of its members, has done most of the job. Three key elements stand out in this regard: a monetary cum exchange rate policy geared to price stability; a prudent fiscal policy embedded in a medium-term framework, which nevertheless leaves room for short-term flexibility; and structural policies aimed at allowing market forces to operate and at opening the economy to the outside world. I will refrain from going into any further detail.

The second major lesson that Singapore demonstrates is that unexpected shocks to the economy should be dealt with essentially by reacting swiftly and decisively--notwithstanding the narrow range of policy instruments available to Singapore. Two years ago, we had the opportunity to discuss Singapore's commendable policy reactions to the recession of 1985. At this juncture, I cannot but congratulate the authorities for having steered the domestic economy away from an export-led boom--which would otherwise end in an inflationary bust--by timely policies of exchange rate appreciation and wage increases, which had the result of weakening Singapore's external competitiveness and bringing about a welcome reduction in its current account surplus. The latter took hold, however, only after external demand had been choked off and internal demand had picked up.

Focusing on exchange rate policy in particular, I have a question for the staff. Since the staff report explicitly refers to the Singapore dollar being pegged to the U.S. dollar--in order to induce an anti-inflationary stance--only up to 1985, like Mr. Wright, I wonder how long Singapore can continue its current managed floating policy in order to generate a further effective appreciation of its currency.

Turning to wage policy, I found Table 20 in the background paper to be most revealing, as it highlights the swift change in average labor costs since 1986, which was brought about not only by market forces, but also by the Government adjusting the Central Provident Fund (CPF) contribution rates for both employers and employees. In this regard, I have three questions. First, does the staff feel that the contribution rate for employers could have been raised earlier for countercyclical purposes, whereas bringing about equality in the contribution rates of employers and employees over the coming years--as is the stated intention of the authorities--may now prove to be procyclical? Second, does the staff agree with the authorities that a stable overall contribution rate of 40 percent is needed to generate enough savings for retirement? Third, should one not treat this question more in a general macroeconomic framework, focusing on the overall savings-investment surplus of the economy, an issue already touched upon by previous speakers? The econometric evidence in the background paper, in particular, leads me to believe that the authorities have more room for maneuver in influencing the savings surplus and thereby the current account situation of the country, as half of the change in savings through the CPF is reflected in total savings. In opting for a constant CPF contribution rate of

40 percent, it would seem that the authorities are giving up an additional instrument for influencing the external account, putting more pressure on exchange rate and budgetary policies to do the job.

In asking these questions, I have hinted at the possibility that the Singapore economy, however well it has performed in the past, is not immune to problems. For the coming years, I can distinguish three major issues. First, and probably most pressing, is the risk of a further slowdown of external demand. As the staff report notes, it is still somewhat early to judge the extent of the shift in policies required as a result of the disruptions in the wake of developments in the Middle East. I fully agree with the staff that, for the immediate period ahead, a strong anti-inflationary stance remains the best attitude that can be recommended for Singapore, given the economy's openness and its potential for overheating.

Moreover, recessionary fears should not be overplayed, since Singapore has seen its exports expand most in the markets of those regions where growth of real output is expected to stay relatively strong. Indeed, as Table 38 of the background paper shows, Southeast and Northeast Asia, as well as Western Europe, constituted the strongest growth markets for Singapore, after North America.

In this context, I wonder whether more could not be achieved in cushioning the economy from outside shocks by expanding the scope for regional cooperation. The staff report mentions agreements with Indonesia and Malaysia, but remains silent on the potential of the Association of South East Asian Nations (ASEAN). One is also struck by the rapid pace of expansion of trade with the other newly industrializing economies, against whose currencies the Singapore dollar has exhibited a remarkable degree of stability--as Chart 4 of the background paper shows. Could the staff comment on this issue?

A second major issue, not wholly unrelated to the first, is the question of Singapore's external competitiveness, as determined by wage developments. Will the authorities remain as able as in the past to influence wages, given that the structural nature of the economy is evolving toward more skilled labor in the manufacturing sector and an increasing share for the services sector? Furthermore, with the example of Korea in mind, could political developments contribute to a sudden escalation of wage pressures? I raise this issue deliberately in the form of a question, since it is only perceived as a potential situation at this point in time, but I believe it is important enough to receive attention now.

A third and final issue concerns Singapore's drive to increase the efficiency of its investments, in order to make up for the labor constraint on its economic growth, as the background paper puts it. Here, I would like to stress the important caveat expressed at the end of the special chapter on investment in the background paper, namely, that the rise in investment efficiency remains relatively small so far, which, in turn, increases the possibility of those gains being nullified again if pressures on labor costs and profitability persist.

In this regard, I wonder whether government investment should not change scope slightly in the future, by putting increased emphasis on education--a point already touched upon in Mr. Ismael's opening statement--as well as on research and development, which, although substantially increased, remains at a level below 1 percent of GDP. I also wonder whether, in time, the role of government in investment might decline further to accommodate private investment, echoing in a sense Mr. Wright's observation. It is somewhat striking to me that, although one hears talk throughout the world about privatizing government enterprises as a means of increasing efficiency, this seems to be a nonissue in Singapore--notwithstanding the significant role pla yed in the economy by statutory boards and publicly owned companies.

Mr. Al-Jasser made the following statement:

Singapore represents an extremely interesting case study of how a small and highly open economy sustains an impressive growth rate by overcoming its resource constraints. The authorities have admirably instituted a strategy of economic restructuring that has clearly succeeded. Therefore, they deserve strong commendation and support.

A striking feature of Singapore's economy is the extremely high savings rate. While the absolute level of domestic savings does not have any significant effect on the global economy, the staff alludes to the fact that it may be suboptimal from a domestic perspective. This is based primarily on the argument that the Government intervenes significantly in savings decisions, such as through increasing employers' contributions to the Central Provident Fund.

In my view, government intervention played a crucial role in ensuring a smooth restructuring of the economy toward technology and skill-intensive production. Such a restructuring was essential, given that labor shortages constitute the main constraint on continued rapid economic growth. Consequently, an increase in labor costs was necessary to induce a shift toward more capital-intensive production. More significantly, the authorities' educational and retraining policies have improved the general level of skills in the economy. Investing in human capital is an appropriate strategy for a labor-constrained and resource-poor economy like that of Singapore.

Recent literature on endogenous growth highlights the importance of government intervention for an economy to restructure itself toward high technology and skill-intensive production. This is based on the existence of positive externalities from investments in human capital and the presence of learning by doing.

The relevance of such policies to Singapore is examined in an IMF Working Paper by Bankim Chadha on "Wages, Profitability, and Growth in a Small Open Economy" (WP/90/45, 5/17/90), which clearly shows the potential for government intervention to push an economy onto a high growth path. The author of that working paper shows that the shift in relative wages in favor of low-skilled employees tends to increase employment in higher-paid occupations, thereby moving the economy onto a high growth path based on technology and skill-intensive production activities. However, the authorities also increased average real labor costs, which could have an adverse affect on this process, as it reduces the relative return to capital. In my view, this was also essential, since it would have been politically difficult to alter relative wages without raising the overall wage level. In other words, if the average wage level had not increased, then the absolute wages of high-skilled employees would need to fall. This, in turn, would reduce the incentive to acquire skills. Therefore, the authorities' strategy of shifting relative wages while raising average wages was essential. Furthermore, the potential adverse effects on the return to capital from the latter are more than offset by the increase in the general skill level of labor, which would increase the productivity of investments.

Therefore, government intervention aimed at increasing labor costs, so as to discourage labor-intensive activities, has led to a restructuring of the economy toward technology and skill-intensive products. This, coupled with the ensuing increase in factor productivity, has moved the economy onto a high growth path.

The interesting feature of this strategy to acquire dynamic comparative advantage in high technology production is that government intervention is essential only up to the point where the economy is propelled onto a high growth path. Once this is achieved, the Government need not persist in influencing private saving decisions. Indeed, there appears to be sufficient evidence that the necessary conditions for a high growth path have been attained in Singapore. Consequently, it may now be appropriate to allow national savings to decline.

Such an approach will bode well for the immediate challenge confronting Singapore. In order to combat inflation, the authorities continuously appreciate the exchange rate. Nonetheless, a containment of the increase in labor costs, or even a slight decline, may be helpful, particularly since the exchange rate appreciation and the increase in labor costs have led to a persistent loss in competitiveness.

Moreover, I note from the staff report that the authorities intend to undertake a full pass-through of oil price increases, while maintaining a heavy taxation on oil. This will lead to an increase in inflationary pressures. Consequently, taxes should be allowed to play their stabilizing role by reducing domestic oil prices, so as to reduce inflation and shield the economy from the volatility of oil price changes. This is especially relevant given that government finances register large surpluses. A reduction of oil taxes would also prevent further resort to the exchange rate, which is not a costless endeavor, in order to contain inflation, thereby reducing the pressure on external competitiveness.

Finally, although the savings-investment imbalance is large in Singapore, there does not appear to be much room to increase domestic investment. Consequently, the shedding of labor-intensive technologies and investments in such activities, and their movement to more labor-rich neighboring countries, represent the optimal approach to tackling the savings-investment balance. Such a product-cycle phenomenon is a direct result of Singapore's attempt to adopt sophisticated high technology techniques. It is heartening to note from Mr. Ismael's helpful opening statement that Singapore is cooperating with Malaysia and Indonesia to develop infrastructure and to generally facilitate the shift of labor-intensive manufacturing to these countries.

In conclusion, the economic policies of the authorities are commendable, and I wish them success.

Mr. Dai made the following statement:

At the outset, we would like to commend the Singapore authorities for their success in restructuring the economy and their outstanding economic achievements in the past decade. Despite the effects of the crisis in the Middle East, 1990 has witnessed another year of remarkable economic growth. The Singapore experience in economic development can be a good example for many developing countries. As is the case with some other countries, Singapore lacks natural resources and is vulnerable to external shocks, but Singapore has always tried to prevent itself from being negatively affected by these weaknesses and has managed to maintain strong growth for many years. On many occasions, when we discuss the economic situation of member countries, our focus is on how to deal with budget deficits, external imbalances, low national savings, and unemployment. When compared to these problems, however, Singapore's economic picture is very different. For many years, Singapore maintained strong growth, accumulated surpluses--internally and externally--and accumulated high national savings.

In reviewing these achievements, credit is very much owed to the efforts and skillful management of the Singapore authorities, who have ensured a stable environment for the society and formulated successful policies for the country. First, macroeconomic policies have been flexible enough to adapt to both the changing international environment and the domestic economy. Second, the transformation of the economic structure has been appropriate and efficient, and has been fully based on the specific circumstances of the economy. Third, long-term social stability has been an important factor in the remarkable progress of Singapore's economy.

It is very impressive to note that Singapore has successfully restructured its economy in the right direction toward more capital- and skill-intensive production, and has become a more important business and financial center for the region. This is crucial for further growth over the longer term, given the present situation of full employment and limited labor and natural resources. In this connection, Singapore might do well to expand its efforts in world markets, while simultaneously taking steps to prevent any problems associated with fluctuations in world demand. In addition, an encouraging sign is that the enhancement of investment and regional cooperation is also under way, which will be conducive to potentially sustained economic growth.

The major problem facing the authorities seems to be an overheated economy, characterized by a tight labor market. Present fiscal policies appear prudent and appropriate in easing inflationary pressures, while monetary policies should continue to be tightened. The difficulty of controlling inflationary pressures comes from the rapid accumulation of net foreign assets, which act to increase the money supply. In this regard, we tend to agree that the external and exchange rate policies need to be kept under review and should be adjusted further, if necessary, to contain potential inflationary pressures, as they were during the first half of this year. The labor supply remains a constraint on economic growth over the medium term and, in this connection, we support Singapore's efforts to restructure the production process, with an emphasis on capital- and skill-intensive, rather than labor-intensive, activities. We also agree with the policy of upgrading the quality of the labor force by improving education and training programs.

Before concluding, I would like to say a few words on the issues of higher national savings and the Government's role in economic management. First, I am of the view that, given the specific circumstances of Singapore, it is appropriate to have a relatively high level of savings as a cushion to ensure economic safety and stability. It is hard to speculate whether the current savings rate is an advantage or disadvantage to the economy. If it is not regarded as appropriate, then what is the optimal level for Singapore's national savings rate? Second, the economic development of Singapore is very successful. As we see it, while adopting an open, market-economy system, the Government has played an important and active role in supporting and carrying out its economic development strategy. It would be difficult to say that, because government intervention has been excessive in pursuing prudent financial policies, government intervention has led to a departure from the system based on a market economy. I believe it is reasonable to judge a country's policies mainly on its performance, rather than on other criteria.

The staff representative from the Asian Department said that the appreciation of the Singapore dollar during the previous year and a half had certainly been generated by market forces. The authorities' preference had been to lean against large incipient inflows of foreign assets, but there had still been a sizable appreciation. The authorities had welcomed that appreciation because it had helped to keep the rate of inflation lower than it would otherwise have been.

It was certainly true that the Singapore dollar could remain under pressure to appreciate for some time to come, the staff representative continued. In recent years, the exchange market had begun to display evidence of upward pressure on the Singapore dollar. The authorities' reaction had been to accommodate that pressure, using exchange rate policy to help sustain a relatively low rate of inflation, while not allowing it to disrupt external competitiveness. Whether that policy would be maintained depended on wage and price pressures in the economy. Since 1988, the authorities had recognized that, if left unchecked, overheating in the economy would result in either wage increases or domestic inflation. The alternative had been to allow the value of the Singapore dollar to appreciate in order to directly reduce imported inflation and indirectly contain wage costs by making labor relatively more expensive in Singapore. The change in the exchange rate over the previous two years should be viewed as a change in the equilibrium real exchange rate; however, as it was not possible to determine the equilibrium real exchange rate precisely, it was difficult to judge the scope for further appreciation. In that regard, the Singapore authorities had been correct to monitor market forces carefully, judge the inflationary pressures coming from overheating, and, subsequently, effect a further appreciation, as needed.

Both real estate and stock market prices had been particularly buoyant during 1989 and 1990, the staff representative stated. Nevertheless, real estate prices had not shown signs of overheating as strong as those in many of the other dynamic Asian economies. To some extent, that had been because of the tendency for turnover in Singapore to be relatively low; consequently, there had not been as much scope for large increases in prices in a number of transactions. Real estate prices had also been affected by the fact that the Government had, particularly in the previous two years, released a sizable share of its considerable land holdings, which had certainly helped to dampen any speculative forces. The stock market, on the other hand, followed developments in the major stock markets around the world reasonably closely; consequently, it would be difficult to consider developments in Singapore's stock market in isolation from those in the stock markets in other countries. Nevertheless, during the previous year, the authorities had adopted measures to reduce the amount of stock market purchases that could be financed by bank credit, which had been designed in large part to help stem inflationary pressures.

It was true that the process of capital substitution had advanced considerably during the past decade, particularly since the recovery in 1986, the staff representative remarked. However, comparisons of the United States's capital-labor ratio with that for Singapore were problematic, because of the difficulty of comparing the capital stocks. It was difficult to judge whether there was scope for further change; the process of capital substitution was a structural change and, as structural changes were by definition deviations from experience, one could never know how far it would need to proceed. One could say, however, that growth in financial and business services and the electronics sector--the most capital intensive sectors--was still extremely strong--even through the third quarter of 1990--and it showed absolutely no sign of slowing down. Therefore, there was reason to believe that further restructuring in those areas could proceed.

The recent slowdown in the U.S. economy had been taken into account in the projections for the Singapore economy, the staff representative noted. The staff had been working on the basis of the September 1990 World Economic Outlook projections; however, it appeared that, subsequently, there might have been a further slowdown in the U.S. economy. As the staff report emphasized that Singapore was extremely vulnerable to a slowdown in industrial country activity, the staff's projections would certainly change significantly if the slowdown in the U.S. economy turned out to be more pronounced than had been projected.

The staff certainly agreed with speakers who considered that government intervention in the Singapore economy was widespread; the authorities would probably also agree with that observation, the staff representative said. It was important to remember, however, that government intervention--with the exception of the Central Provident Fund (CPF) contribution rate, which was both fixed and mandatory--tended to take the form of relying on market forces. Indeed, the Government generally accomplished its objectives through market forces, rather than through direct controls. While that tendency did not diminish the fundamental concerns about the desirability of government intervention, it was nonetheless commendable that the Government tended to operate in the least distorting way possible.

The Government had set CPF contributions at the equivalent of 40 percent of earnings on the basis of its assessment of the level of savings that was required to support contributors in their retirement, the staff representative remarked. The staff had, on a number of occasions, questioned the need for such a high contribution rate. However, the staff was not in a position to make an independent judgment on the accuracy of the Government's calculations, which typically depended on a number of complex factors, including demographics and actuarial calculations. Concerning the substitutability of CPF savings for voluntary savings, the staff's econometric work had revealed that about half of any increase in CPF savings was offset by lower savings in other forms. Therefore, there was certainly an element of forced savings in the CPF scheme, although it was a limited one.

The issue of the Government's role in financial intermediation had been raised at the time of the 1989 interim consultation discussions with the authorities, the staff representative said. At that time, the staff had asked the authorities whether the Government's large role in managing the financial wealth of the country could be reduced, specifically with a view to decentralizing management of the CPF balances. Although Mr. Wright had questioned the very existence of the scheme, the staff had had the more modest objective of asking whether all the CPF balances had to be managed by the Government. The authorities' position had been that little use had been made of existing schemes for decentralization. Enterprises could now retain or invest a fraction of CPF contributions, although few actually had done so. The authorities had believed that the lack of enthusiasm for those opportunities was due to the difficulties caused by the turnover of employees through job mobility. Furthermore, employees had generally preferred that companies did not take advantage of the scheme. An additional scheme, which allowed participants to purchase annuities with private institutions upon retirement, with some share of the remaining balances remaining in the CPF, was also used relatively infrequently. The authorities' view had been that, with no major interest shown in those two schemes, there had been little point in considering new schemes. The staff agreed with Mr. Wright that there might be room for considering further alternatives in order to enhance private sector participation in the intermediation of CPF savings.

It had been pointed out that Singapore was one of the few countries in the world in which privatization was not an issue from the point of view of efficiency, the staff representative observed. There were plans, however, for privatization of Singapore's telecommunications enterprise. Those plans were well advanced, and it was likely that shares in the enterprise would be floated on the stock exchange within the next two years. There were also plans to privatize the Singapore Broadcasting Corporation and the Port Authority of Singapore. Essentially, the authorities were interested in privatization because they felt that, at the current stage of the economy's development, the Government did not need to be as actively involved in managing public sector companies as it had been previously.

The shift between employer and employee contribution rates appeared to have affected labor costs, the staff representative stated. Although the staff had not undertaken any independent analysis of that issue, it shared the concerns of others about why labor costs should have been affected. Generally speaking, employers in Singapore had indicated that raising employers' contribution rates and reducing employees' had affected labor costs.

The most publicized forms of Singapore's attempts at regional cooperation had, of course, involved the agreements with Malaysia and Indonesia, the staff representative from the Asian Department concluded. Singapore had repeatedly indicated that it hoped that those agreements would serve as examples for cooperation with other countries, particularly in the Asian region. Those agreements were probably the most natural ones, as the Malaysian state of Johor and the Riau islands in Indonesia were in extremely close proximity to Singapore. Consequently, the use of Singapore's infrastructure and Malaysia's land and labor was a very natural development. Nevertheless, in looking at the extraordinary growth of Singapore's financial and business services, it was apparent that wider cooperation in one form or another was already under way; that cooperation was both explicit, through formal agreements, and implicit, through greater reliance on Singapore as a regional center.

Mr. Wright said that it was worrying that the exchange rate appeared to be somewhat self-levitating; it was particularly worrying given that Singapore was a country with a very high savings ratio and a current account surplus--which had presumably led to the more or less continuous upward pressure on the exchange rate. However, to the extent that upward pressure was reflected in a rise in the exchange rate, it would effect competitiveness; conversely, to the extent that upward pressure was resisted, an accumulation of net foreign assets would develop, with monetary consequences. He was concerned that such a situation might not be viable in the long term. Current conditions seemed to indicate a certain degree of disequilibrium, which was reflected in the excessive rise in the exchange rate--a rise that would ultimately be reversed in any event. There also seemed to be a suggestion that the authorities should be doing more in terms of domestic monetary control, and that action should be taken sooner rather than later.

The staff representative from the Asian Department responded that the Singapore authorities attached little importance to the growth of monetary aggregates, mainly because capital markets were highly open to external markets so that large capital flows could and did occur. Nevertheless, Singapore could limit the growth of its monetary aggregates. Those aggregates, reserve money in particular, were dominated by changes in the net foreign assets of the monetary authority. Singapore could easily accumulate fewer net foreign assets, have a slower growth of its money supply, and a faster rate of appreciation. Currently, there was an enormous demand for the Singapore dollar, which was reflected partly in a relatively rapid rate of growth of money and partly through an appreciation of the Singapore dollar. That trade-off simply reflected the authorities' desire not to allow the currency to appreciate to the extent that it might overshoot, while simultaneously accommodating market forces to the extent that they existed and were perceived to be relatively enduring.

Mr. Wright said that he wondered whether there was such a trade-off in the medium or long term. While he understood the authorities' desire not to allow the exchange rate to rise too far and their decision to accommodate market forces, he also wondered whether the buoyancy of the exchange rate, which stemmed from the strength of the external sector, might ultimately be self-defeating. Whether that buoyancy was manifested in the form of a rise in the exchange rate and a loss of competitiveness or, alternatively, in the form of an accumulation of net foreign assets--with the necessary monetary consequences--a policy that featured an indefinitely firm exchange rate would probably unravel at some stage.

The staff representative from the Asian Department replied that the Singapore authorities did not consider that they had been relying on a policy of continuous exchange rate appreciation. They did not target the exchange rate; they had, however, had a strong preference for a relatively low inflation rate--possibly one that was lower than the world inflation rate. Singapore could only can have a lower inflation rate to the extent that it decided to limit money growth and let the exchange rate appreciate. Accordingly, if there was a constant inflation differential of 2 percent a year, one could expect a constant appreciation of about 2 percent a year. Recent developments, however, reflected an adjustment in the equilibrium real exchange rate, owing to the overheating pressures in the economy and the rapid increase in the demand for Singapore dollar assets.

Mr. Grosche said that he broadly endorsed the staff appraisal. The authorities' strong economic policy performance over previous years engendered confidence that they would be able to tackle successfully the challenges that lay ahead, including the recent increases in oil prices. It seemed that until recently a somewhat loose monetary policy had been offset partly by the large budget surpluses. If those balances were to be reduced over the medium term, as the authorities intended, monetary policy would need to become more restrictive, which would put additional upward pressure on the exchange rate. More extensive recourse to appreciation might be tolerated, providing for the potential, however, for a loss in external competitiveness. Care needed to be taken, therefore, that fiscal policy was not freed too swiftly. In the past, the authorities had reacted to large losses in competitiveness by partially reversing some measures that had increased labor costs. He doubted whether similar action would be the correct response in the future, because such action could hamper the shift toward more capital-intensive production.

It was his understanding that the authorities were considering the introduction of a value-added tax system, Mr. Grosche continued. In principle, he was in favor of such a plan; however, he wondered about the consequences for the budget surplus and an already rising inflation rate. The Government's accelerated efforts at regional cooperation with its neighbors--Malaysia and Indonesia--were welcome. He wondered whether those efforts--which concentrated on infrastructure projects--could be considered as the first steps toward an economic union. Finally, Singapore had demonstrated once again that sound financial policies would be rewarded.

Mr. Bossone made the following statement:

I would like to associate myself with previous speakers in congratulating the authorities of Singapore for the country's continued record of rapid economic progress. The events that have characterized the evolution of the Singapore economy during the 1980s provide evidence of the authorities' remarkable capability to conjugate short-term policies with long-term development objectives.

Since many of the critical issues that have arisen in the context of this consultation exercise have been discussed by other chairs, I would like to add only a few comments on what I view, at present, as a most crucial topic for the Singapore economy--that is, its large savings surplus. I would also like to identify some related policy considerations.

I was very interested in the review of the special issues that were analyzed in the background paper. I have not found convincing, though, the arguments by the staff on the appropriateness of the current savings rate. Looking at the issue from the point of view of the economy's dynamic efficiency, and considering the simple criterion adopted in the staff's study, if it is true that the savings ratio would be suboptimal if--in each year and over a long period of time--profits were less than investments, I would argue that the ratio would still be suboptimal even if profits were persistently higher than investments, as seems to be the case in Singapore. In this case, in fact, the "excess" profits--that is, the difference between profits and investments--could either be consumed, without affecting investments and, therefore, at no expense for future generations, or they could be invested, without diminishing current consumption and thereby benefit future growth. Therefore, the existing gap, to my understanding, signals a rather inappropriate allocation of resources at the aggregate level, which certainly needs to be corrected.

Indeed, this is an important point. Any correction would demand sensitive strategic choices: should the country invest or consume more; and how could larger investment or consumption be sustained without being inflationary? This chair believes that there is scope for acting on a large range of mutually compatible policy options, which would point to the need to preserve the significant long-term growth potential of the Singapore economy, while at the same time recognizing the desirability of using part of the large overall national surplus to enhance the living standards of the population.

I would like to briefly stress a few policy suggestions. With respect to the budget, the public sector should aim to reduce its surplus: investments in infrastructure and, particularly, in the field of education and research and development should be intensified. The prospective introduction of a value-added tax, which is certainly desirable from an efficiency point of view, will have to be considered in the context of a complete review of the structure of taxation of the economy so as to avoid any further unwarranted strengthening of the revenue position of the public sector.

Direct investment abroad should be encouraged. As Singapore consolidates its transformation into an advanced economy and as a robust domestic private sector develops, the country can rely less on foreign capital and more on its own resources. With a current account in structural surplus, Singapore could become a net supplier of capital in the Asian region. The authorities should also consider progressively strengthening their contribution to development and financial assistance. In this connection, this chair appreciates the larger involvement of Singapore in regional cooperation.

Wage policy should fully reflect the scarcity of labor. The current tight wage conditions in the labor market and the good prospects for productivity growth provide margins for some increase in real wages. This, on one hand, would permit workers to share the fruits of their labors, and, on the other hand, would help sustain domestic demand through a larger absorption of imported goods.

This chair fully supports the view that monetary cum exchange rate policy should be geared to containing inflation and would not discourage any tendency to further appreciate the currency.

Finally, at the structural level, two points deserve some attention. First, the development of a government securities market should be accelerated. In fact, the protracted period of business growth and the large government budget surpluses have reduced incentives for the promotion of this important market--the functions of which would eventually become necessary should the economic cycle change direction. Second, Singapore should try to diversify its import and export markets. Current trade flows indicate too large a dependence on the Japanese and U.S. markets, which makes Singapore extremely vulnerable to economic changes in those two countries.

Mr. Menda said that, like previous speakers, he was impressed by Singapore's economic performance over the past three decades. Indeed, a growth rate averaging 8.5 percent a year, the near elimination of unemployment, a very low rate of inflation, and the building up of substantial external assets were all remarkable achievements. However, the overheating of the economy, rising inflationary pressures, and a scarcity of labor--which characterized the present situation--appeared to be the price of success.

In the short run, very high rates of growth and the inflationary impact of the increases in oil prices certainly pointed to the necessity of maintaining a large fiscal surplus in order to avoid any fiscal stimulus, Mr. Menda considered. Neutrality of the budget should be encouraged and, given the limited leeway of monetary policy, should be accompanied by some further appreciation of the exchange rate. Nevertheless, he shared the doubts expressed by Mr. Wright and Mr. Moss concerning the sustainability of such a policy in the medium term. One could not help but wonder whether the continuing buildup of foreign assets, which was linked to persistent external surpluses, was optimal in the medium term from the point of view of economic welfare, and whether it simultaneously complicated the management of monetary policy. In its very interesting background paper, the staff rightly focused on the question of the appropriate level of savings; its conclusion was that there were no economic arguments to support the proposition that savings rates in Singapore--which averaged 41 percent of GNP in the 1980s--were excessive. The staff had noted, however, that the share of labor in value added was significantly smaller than in most other countries. Was that consistent with the structure of activity in an economy in which services constituted a significant share, or was it an indication of distributional problems?

He shared the view of others that the current level of savings would be excessive for any economy, Mr. Menda stated. Furthermore--as noted in the background paper--fiscal surpluses, as well as compulsory contributions to the Central Provident Fund, had strongly contributed to the level of savings. Although he agreed that the situation pointed to the necessity of less government intervention in savings decisions, it also appeared that a reduction in the fiscal surplus was warranted in the medium term. In particular, and in order to support the authorities' aim of shifting to less labor-intensive and more skill-intensive activities, more efforts could be directed toward education, training, and the development of social services. In that respect, some modification in the structure of expenditures, as well as in their overall level, could be warranted.

Mr. Kwon made the following statement:

I would like to join previous speakers in congratulating the Singapore authorities on their excellent management of the economy in the recent past.

After a short hiatus--namely, the economic recession experienced in the period 1985-86--Singapore has enjoyed rapid growth and a steady strengthening of its external accounts. Indeed, all the major economic indicators for Singapore--which should be the envy of many other countries--suggest that the economy appears to be moving beyond its potential capacity. In this regard, it would seem to be entirely appropriate for the authorities to focus their recent policies more on containing the overheating of the economy through the appreciation of the currency, withdrawal of fiscal stimulus, and inflows of foreign workers.

However, such policies do not seem to address the issue associated with medium-term prospects, namely, an expected persistence of surpluses in the government budget and external current accounts. While it is true that the absolute magnitudes of such surpluses are small and hence would not impinge on the global economy, large and prospective current account surpluses raise the question whether the sizable excess of savings over investment serves domestic economic welfare. In this connection, I would join other speakers in commending the staff for its special research in the background paper on savings and investment behavior.

There is no need for us to worry about the high rate of savings as long as it matches investment needs and savings behavior is determined by the principles of the market. In the case of Singapore, however, the scope for increasing the investment rate from its current high level appears to be limited, while government intervention in savings decisions--both through the Government's own savings and through the fixing of a CPF contribution rate--is significant. In this respect, I fully endorse the staff's view that, if large imbalances between domestic savings and investment persist as growth slows over the medium term, some reduction might need to be considered in the Government's direct role in generating savings, by lowering tax rates or increasing the portion of CPF savings that can be used before retirement.

Given the fact that the economy is severely constrained by the labor supply, it would seem to be appropriate for the Government to put more emphasis on promoting the restructuring of production toward more technology- and skill-intensive activities. In this context, I welcome the recent steps taken by the authorities to cooperate with neighboring countries in restructuring their production bases. In addition to this regional cooperation, I am inclined to believe that there is some scope for Singapore to enhance its role in providing financial assistance to needy developing countries.

Ms. Creane said that the authorities should be congratulated for maintaining strong and open economic policies, which had resulted in the benefits that had been clearly described by the staff and previous speakers. She was in broad agreement with the staff appraisal; nevertheless, given that the staff report noted that it expected that "the labor supply will remain the principal constraint on growth over the medium term," she would have been interested in a fuller analysis of the labor market in the background paper. It was true that a brief discussion had been included in the background paper prepared in 1989, and that the movement toward skill- and capital-intensive production was seen as a necessary policy for Singapore's long-term economic future. However, some labor market questions had a shorter policy perspective, such as whether quantitative limits on foreign workers were applied across the board or on the basis of workers' level of skill--which was another exception to the Government's practice of relying on market forces. Therefore, there should have been some discussion in the staff papers of the possibility of allowing moderate increases in temporary immigration, on the basis of skill levels, in order to offset selected labor market constraints. In addition, those papers should have elaborated further on the increasing shift toward price-based controls to limit foreign workers and on the details of the Government's commitment to improving the education system.

She was pleased to note that the staff had followed through on its surveillance role of making policy recommendations concerning relatively large external imbalances, regardless of the size of the country, the absolute size of the imbalances, and whether those imbalances reflected surpluses or deficits. In particular, while acknowledging the strength of the staff's arguments that the current savings-investment disequilibrium was not excessive, she was concerned that that imbalance might become a problem in the future. She agreed with the staff's analysis that the Government's role, both through its own surpluses and through promoting mandatory savings, should be addressed at an appropriate time. In that regard, she was pleased to learn from Mr. Ismael's opening statement that the authorities were prepared to look into the possibility of tax reductions, although in his statement he had not mentioned the CPF. Finally, she hoped that the possible changes to the tax structure that were mentioned in the staff papers, including the planned value-added tax, would at least be revenue neutral.

Mr. Hogeweg remarked that he had been fascinated by the policy of raising labor costs in order to promote growth through a shift toward capital-intensive production. Singapore had an excellent record of implementing policies that were fully in line with Fund advice to its members. However, its policy on labor costs evidently had limited scope for application elsewhere; Singapore's limited labor supply and its high and rising level of education were the determining factors in that regard. It was difficult to judge conclusively whether the rise in labor costs preceded the rise in labor productivity or vice versa, but those rises certainly went hand in hand. That, in turn, might suggest an answer to Mr. Wright's question on the long-term sustainability of exchange rate appreciation and monetary expansion, and whether that process would eventually undermine the strength of the external position, which had initially generated the upward pressure on the exchange rate. It seemed that much depended on the demand for money in Singapore, which in turn depended on growth--in other words, the success of the policy of increasing labor productivity and allowing the price of labor to reflect the true scarcity of labor. It was the full recognition of that reality that made Singapore such a good example for other countries.

The staff representative from the Asian Department said that, in its previous budget, the Government had announced that plans for the introduction of a value-added tax would be drawn up by the end of the current fiscal year--specifically, by the end of March 1991. There were, however, no plans for actually introducing it at the moment; a value-added tax was simply regarded as a contingency plan, and would be introduced when the Singapore authorities felt that it was needed and that its effects on the economy would not be disruptive, particularly for the effort to contain inflation. There was some question whether the value-added tax would supplement or replace the existing tax structure. As there were no plans for its immediate implementation, the authorities had not been in a position to comment on its relationship to existing taxes, although that relationship would presumably depend on the circumstances in which it was introduced.

Available evidence seemed to indicate that the share of labor in Singapore's value added was low, although it was difficult to estimate its exact level, the staff representative observed. It was useful to recall, however, that throughout the first half of the 1980s, the share of labor in value added in Singapore had risen rapidly--even though wages had also risen rapidly during the same period--and that by the mid-1980s, that share had fallen rather sharply, following the recession and a sharp reduction in wage costs. The share of labor in value added was currently increasing, and it was expected to continue to do so until it reached a level comparable with that in other countries. The staff had only briefly discussed labor market issues in the current staff papers, because in 1989 it had prepared a major study of Singapore's labor market policies during the 1980s--which had been issued as both a supplement to the 1989 staff report and, subsequently, an IMF Working Paper. Accordingly, it was felt that the analysis of the major issues had been exhausted, although there remained some short-term issues to be considered, as Ms. Creane had pointed out. In the papers currently before the Executive Board, the staff had chosen to focus its attention as much as possible on the savings and investment picture; however, in future staff reports on Singapore, the labor issue would again become an important element.

There still seemed to be some uncertainty among speakers concerning exchange rate policy, the staff representative from the Asian Department said. Exchange rate policy had to be seen as a response to the overheating of the economy, and, in that sense, the adjustment that had been seen during the previous few years probably reflected a change in the equilibrium real exchange rate. That change could have come about through higher inflation, generated chiefly by higher wage costs, or through a nominal appreciation. In Singapore, of course, overheating was manifested mainly in the labor market, because the economy was extremely open and virtually all goods were tradable. Since 1988, the Government had faced the prospect of rising relative unit labor costs. The authorities could allow that to happen either through higher wage costs and higher domestic inflation or through a nominal appreciation; in either event, a real appreciation of the exchange rate would be the result. As the authorities had a strong preference for a low rate of inflation, they had chosen to rely more heavily on a nominal appreciation. At some stage, though, that process would end; indeed, pressures in the labor market were already beginning to abate. Eventually, overheating and domestic inflationary pressures would be much less intense than they had been in the previous few years. At that point, the pressures for a change in the underlying real exchange rate would cease. The question would then become whether Singapore wanted to have a lower rate of inflation than the rest of the world. If that were the case, the response would simply be a nominal appreciation to offset the inflation differential. That, of course, would not involve a change in the real exchange rate, but would simply require a change in the nominal exchange rate. Experience with other countries seemed to indicate that such a policy could be sustained for a long period. Thus, while the response to current overheating--allowing the real exchange rate to appreciate through nominal appreciation--was not expected to continue indefinitely, further nominal appreciation could be expected to go on as long as Singapore wished to sustain a rate of inflation below that in its trading partners.

Mr. Fogelholm said that the current account item labeled "other," which appeared in Table 2 of the staff report, was not explained anywhere in the staff report, although it was one of the largest items in that table. It would be helpful if future staff reports could be more transparent in such matters.

The staff representative from the Asian Department noted that it had proven difficult to obtain more information on that particular item.

Mr. Ismael stated that he had noted the concerns of the Executive Directors--especially with regard to the medium term--on the role of the Government in the economy, the exchange rate, and whether the latter was sustainable in the long run as a means of reducing or restraining inflation. Some of those issues could not readily be resolved, especially, for instance, the concerns over the extent to which government intervention in the economy should be continued, reduced, or even eliminated. Government intervention in the economy was closely related to the historical growth of the country and the Government's own philosophy of its role, not only in the economic sphere, but also in the political sphere. Nevertheless, while immediate changes were unlikely, the future direction of change was clear, although that process would probably continue to be too slow in the view of many.

The Acting Chairman made the following summing up:

Executive Directors commended the authorities for their outstanding management of the economy, noting that since the recovery from the recession in the mid-1980s, Singapore has enjoyed rapid growth, low inflation, and a steady strengthening of its external accounts. Directors thought that the policies to contain overheating during the last two to three years--appreciation of the Singapore dollar, withdrawal of fiscal stimulus, and inflows of foreign workers--had been appropriate.

Directors observed that, despite the recent oil price increases, the outlook for the Singapore economy appears favorable. Barring a significant worsening in the external environment, growth is likely to fall only to its estimated potential rate of 5-6 percent, and the external current account should continue in surplus. With monetary and exchange rate policies that were generally commended by Directors, the impact of higher oil prices on inflation is expected to be moderate and temporary, and it was observed that it could be offset through a reduction in the taxation of oil.

A number of Directors pointed out that the external current account surpluses would remain large relative to the size of the economy over the medium term. It was recognized that the absolute magnitude of projected surpluses is small, and they should therefore not impinge on the global economy. Moreover, it was noted that Singapore maintained an open economy that is not subject to trade and payments restrictions. Instead, the projected surpluses reflect high private and government savings, with the former stemming in part from rapid economic growth and the large share of the working age population; the high level of government savings was obviously related to budgetary discipline. Several Directors noted that government intervention in savings decisions--both directly, through large budgetary surpluses, and indirectly, through the Central Provident Fund--may lead to savings that are higher than might be generated by market forces alone.

Nevertheless, many speakers raised the question of whether a persistent excess of savings over investment is optimal from a domestic standpoint. Some Directors expressed the view that, as growth returns to potential over the medium term, a reduction in the Government's role in generating savings may be warranted--for example, by lowering tax rates, increasing the flexibility in use of Central Provident Fund savings, and, in that context, through promoting a more market-oriented focus on consumption. Other Directors took the view that in light of the uncertainties in the world economic outlook, a continuation of a strong anti-inflationary stance of macroeconomic policies remained appropriate, while a number of Directors suggested that fiscal surpluses could in the future be usefully channeled to investment in education, research and development, and infrastructure. However, it was also observed that it would be important to avoid the high savings ratio from spilling over into excessive stock market and real estate speculation.

Directors remarked that the labor supply will remain the main constraint on growth in the medium term. Promoting the restructuring of production toward technology- and skill-intensive activities would therefore be of paramount importance to realizing Singapore's growth potential. In this regard, Directors commended the authorities for supporting the restructuring process, by permitting wages to reflect the scarcity of labor and by committing themselves to improving education and enhancing regional cooperation. The cooperation between Singapore, Malaysia, and Indonesia to develop infrastructure and to facilitate the shift of labor-intensive manufacturing activities to the latter two countries was particularly welcomed. More generally, Directors noted the high degree of government involvement in the economy and encouraged the authorities to reduce intervention in the economy, in order to allow for a fuller role for the private sector.

It is expected that the next full Article IV consultation will be completed within 24 months.

3. SIERRA LEONE - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY - REQUEST FOR POSTPONEMENT

The Executive Directors considered a request to postpone the discussion on the further review of Sierra Leone's overdue financial obligations following the declaration of its ineligibility to use the Fund's general resources, effective April 25, 1988.

Mr. Monyake said that the matter of Sierra Leone's overdue financial obligations to the Fund was to be reviewed by December 10, 1990. In August 1990, the authorities had hoped that the next review would be the occasion to present a rights accumulation program for consideration by the Executive Directors. Since that time, however, Sierra Leone had been besieged by an influx of about 200,000 Liberian refugees; as a result, the already difficult economic conditions had worsened, as prices of food and other essential products had risen substantially and scarcities had become more acute. In addition, the retail prices of petroleum products had been raised by two thirds on September 1, 1990--to the equivalent of about $3 a gallon--to reflect higher world oil prices. The presence of a large number of refugees from Liberia, participation in the multinational peace-keeping force in Liberia, higher fuel costs, and the settlement of wage and other domestic arrears had led to an unexpectedly high level of government borrowing from the Bank of Sierra Leone and, subsequently, to an excessive monetary expansion in July-September 1990. Increased oil import payments had also made it impossible for the authorities to make the payments to the Fund that had been anticipated.

The authorities were taking steps to effect payments to the Fund in the coming weeks and to put the budget back on track, Mr. Monyake remarked. The appropriate policy and tax legislation, which was necessary for the implementation of new revenue measures, was to be submitted for parliamentary approval by the end of the week. Additional monetary measures were being implemented to sterilize the liquidity that had been created by government borrowing, and to limit liquidity in the coming months. Furthermore, recognizing the critical need for the generation of foreign exchange from diamond exports, the authorities had agreed on appropriate measures to attract more foreign exchange through official channels, and would implement those measures by January 1991. The authorities planned to visit Washington in mid-December 1990 for discussions with the staff regarding the additional policy measures and payments to the Fund that would be necessary in order to begin negotiations on a rights accumulation program.

The authorities attached particular importance to the forthcoming review of their country's overdue financial obligations to the Fund, and were hopeful that the review would accurately reflect their efforts and intentions regarding policies and payments, Mr. Monyake stated. For those reasons, the authorities had requested a postponement of the review by one month; he proposed that the Executive Board agree to their request in order to afford the authorities a short period in which to strengthen their case. The President of Sierra Leone was fully committed to the reform process and wished to have a program in place in early 1991. The authorities would make every effort toward that end, as well as toward strengthening their relations with the Fund.

Mr. Dawson said that he had some difficulty with the authorities' request. He fully understood the two genuinely exogenous factors that Mr. Monyake had mentioned--the situation in a neighboring country and the increase in oil prices. Nevertheless, postponement of a review of a member's overdue financial obligations could not be considered lightly; while the reasons that Mr. Monyake had given were plausible, they had not been entirely convincing. Before agreeing to a postponement of the forthcoming review, the Board should have a staff report on the extent of policy implementation and the nature of the dialogue with the authorities since the previous review in August 1990. Moreover, if the authorities' request was approved, it might be appropriate for the management to indicate to the authorities that the postponement had been granted on an exceptional basis, and that certain specific measures would be expected prior to the postponed review. At the time of the previous review, the Acting Chairman had explicitly identified the Fund's expectations for the next review; those expectations had not been met. Mr. Monyake's explanations--at least those that were based on exogenous factors--were certainly understandable; however, it was necessary to have a clear understanding of the steps that the Fund might consider at the time of the next review.

Mr. Fogelholm said that he supported Mr. Dawson's suggestions; however, he would be interested to learn the Acting Chairman's views on recent developments in Sierra Leone and his expectations for the forthcoming review.

The Acting Chairman stated that, as in all such cases, the staff expected that the authorities would be prepared to move more decisively in the period immediately ahead; the staff had, however, been disappointed by Sierra Leone's payments record. The staff would need to have further discussions with the authorities to ensure that policies were being implemented and payments to the Fund were being made. Clearly, there was a need for much more decisive action on the part of the authorities. With respect to Mr. Dawson's suggestion, the staff could present an oral report to the Executive Board either at the next Board meeting or on December 10, 1990.

Mr. Dawson noted that the staff had been operating on the assumption that it would have had to issue a written report by December 10, 1990 in any event; however, delaying consideration of the authorities' request until that time would be inappropriate. If there was a sense that the Executive Board was in favor of a postponement, and if there was a clear understanding of the Board's expectations for the postponed review, it would be entirely appropriate for the staff to provide a brief oral report at the next Board meeting.

Mr. Towe said that he supported the authorities' request for postponement of the review. Given Mr. Monyake's explanation, postponement of the review would allow the authorities an opportunity to implement additional measures and hold further discussions with the staff. If the authorities' request was approved, they should clearly understand that the postponement had been granted on an exceptional basis.

Mr. Wright stated that he agreed with Mr. Dawson. It would be very difficult to draw any conclusions on the present matter without first receiving a report from the staff. One way to proceed was to have a relatively abbreviated account of recent developments and the dialogue with the authorities, with a view to actually postponing the formal review for one month. He strongly agreed with Mr. Dawson that, under those circumstances, a communication should be sent to the authorities outlining the exceptional circumstances of the decision. Alternatively, a substantive discussion could be held on December 10, when there should be a more substantive report from the staff and a decision might be taken on the adoption in principle of remedial measures. Such a decision would have the advantage of introducing an element of automaticity into the process of solving the problem of Sierra Leone's overdue financial obligations to the Fund.

The Acting Chairman remarked that he agreed with Mr. Wright; nevertheless, it was essential to first learn from the staff about recent developments, particularly in those areas that were not considered to have been affected by exogenous factors.

Mr. Ichikawa said that he supported Mr. Dawson's proposals. It was preferable to have some form of a staff report on the status of the dialogue with the authorities before considering a postponement of the review. Furthermore, the next review would be more meaningful if there was a clearly developed program in place. He could go along with the proposal for a substantive review in January 1991; however, like Mr. Dawson, he supported the proposal that the management should send a communication to the authorities outlining the Executive Board's concerns.

The Executive Directors agreed to continue their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/90/167 (11/28/90) and EBM/90/168 (12/5/90).

4. DOMINICAN REPUBLIC - OVERDUE FINANCIAL OBLIGATIONS - REPORT AND COMPLAINT UNDER RULE K-1

1. The complaint of the Managing Director dated November 21, 1990 in EBS/90/199 (12/21/90) on the Dominican Republic is noted. It shall be placed on the agenda of the Executive Board for December 19, 1990.

2. The Fund urges the Dominican Republic to become current in its financial obligations to the Fund promptly and to avoid thereby the need for the Fund to take remedial action.

3. Consideration of the complaint in accordance with Rule K-1 particularly affects the Dominican Republic. The member shall be informed by rapid means of communication of this matter and of its right to present its views through an appropriately authorized representative.

Decision No. 9600-(90/168), adopted November 30, 1990

5. NAMIBIA - REPRESENTATIVE RATE FOR SOUTH AFRICAN RAND

The Fund finds, after consultation with the authorities of Namibia, that the representative exchange rate for the currency of Namibia under Rule O-2(b)(i) against the U.S. dollar is the middle rate between the buying and the selling rates for the U.S. dollar, as reported by the Bank of Namibia.

Decision No. 9601-(90/168), adopted November 29, 1990

6. MONGOLIA - MEMBERSHIP - COMMITTEE

The Executive Board, under Rule D-1, decides to establish a committee to proceed with the formal investigation, to obtain all relevant information, and to discuss with the Government of Mongolia any matters relating to its application for membership in the Fund. The Committee shall consist of Mr. Santos, Chairman; Mr. Arora, Mr. Dai, Mr. Dawson, Mr. Evans, Mr. Mirakhor, Mr. Posthumus, Mr. Torres, and Mr. Yamazaki. (EBD/90/204, Sup. 1, 11/29/90)

Adopted November 30, 1990

7. ETHIOPIA - TECHNICAL ASSISTANCE

In response to a request from the National Bank of Ethiopia for technical assistance in the central banking field, the Executive Board approves the proposal set forth in EBD/90/393 (11/21/90).

Adopted November 29, 1990

8. PERU - TECHNICAL ASSISTANCE

In response to a request from the Peruvian authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/90/395 (11/26/90).

Adopted November 29, 1990

9. ROMANIA - TECHNICAL ASSISTANCE

In response to a request from the Romanian authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/90/398 (11/27/90) and Correction 1 (11/28/90).

Adopted November 30, 1990

10. APPOINTMENT BENEFITS, SALARY ADVANCES, AND FAMILY CARE LEAVE

The Executive Board approves the proposal recommended by the Committee on Administrative Policies relating to changes in appointment benefits, salary advances, and family care leave. (EBAP/90/310, 11/28/90)

Adopted December 3, 1990

11. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 90/21 through 90/29 are approved.

12. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/90/308 (11/27/90), EBAP/90/311 (11/29/90), and EBAP/90/313 (11/30/90) and by Advisors to Executive Directors as set forth in EBAP/90/311 (11/29/90) is approved.

13. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/90/314 (11/30/90) is approved.

APPROVED: September 13, 1991

LEO VAN HOUTVEN
Secretary