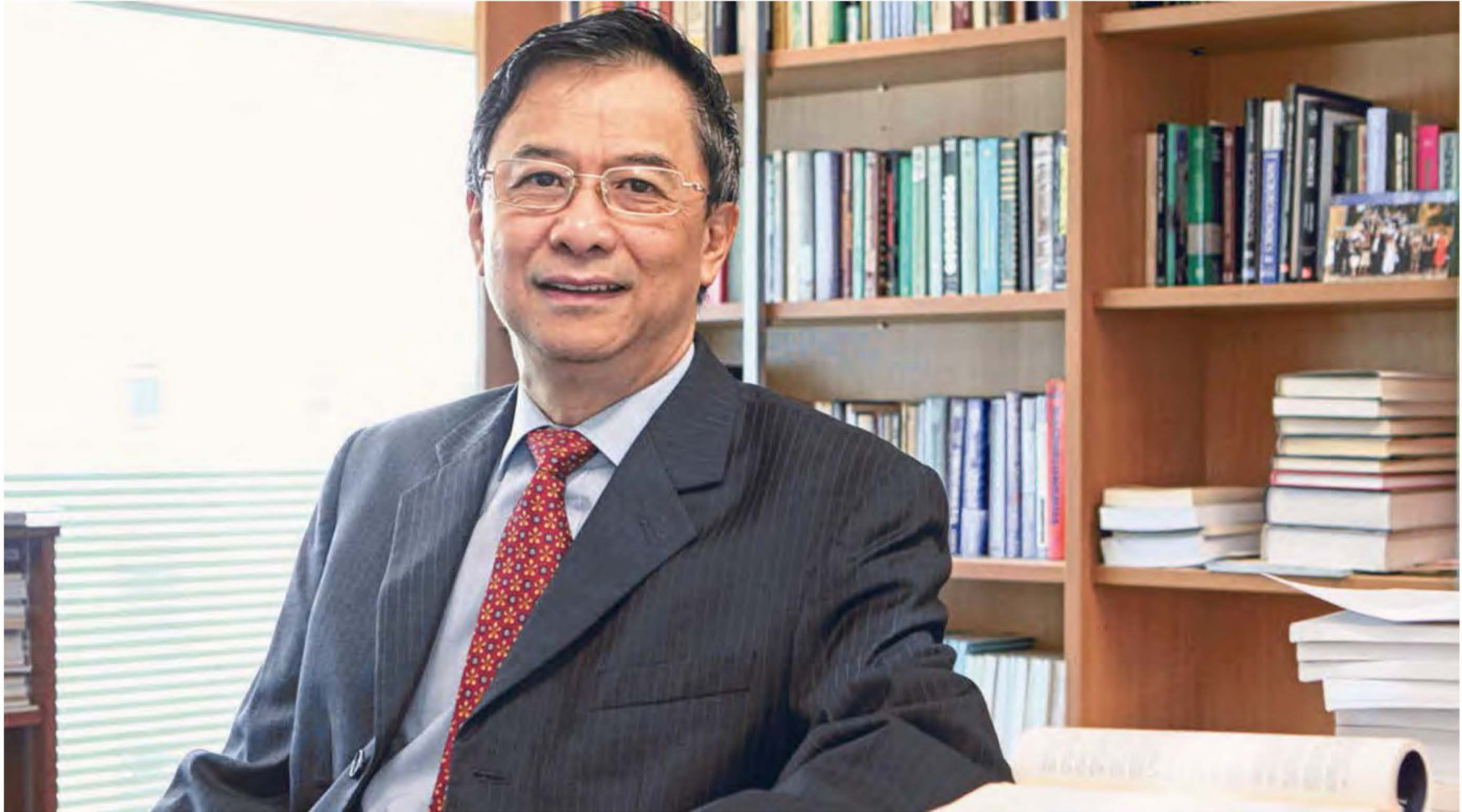


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What drives the Singapore economy

Foreign investment was, and will be a significant stimulus for the Singapore economy, said SMU economist

In order for Singapore to keep growing, it needs to remain open to foreign investment from multinational companies (MNCs), said Hoon Hian Teck, Professor of Economics at the Singapore Management University (SMU). This was his conclusion after looking at government expenditure and national statistics on savings and investment.

MNCs, due to their efficiency and productivity, have contributed to higher wages for the broad swathe of Singaporeans in the past, and are likely to do so in the future, he said.

"In any line of production, there are some productive companies, some unproductive companies. The very productive ones are able to go abroad. If MNCs were able to come here, it's because they were efficient. So we need to tap these advantages," he said.

One way in which Singapore citizens can utilise the opportunities arising from the presence of MNCs is to make use of the government subsidies to boost their capabilities, like the recently announced SkillsFuture initiative to give cash grants for professional development courses.

Looking ahead, Singapore needs to be wary of growing calls for Singaporeans to be in senior positions of foreign MNCs and in various industries, he said. "You don't want to go the direction of saying, 'I'll welcome you only if you give our Singaporeans positions at the top.'"

Three big questions

The question of how Singapore can sustain its growth going forward is one of three big questions about Singapore's past and future that occupy the mind of Prof Hoon, who is also Associate Dean of Faculty Research at SMU's School of Economics.

He obtained his doctorate from Columbia University in 1990 and conducts research on macroeconomics, international economics, and trade and growth.

The first question, said Prof Hoon, is about Singapore's past and future sources of growth. The second is how Singapore has fought recessions in the past and how it will do so in the future. The third is how to tackle the issue of income inequality.

On the first, Prof Hoon pointed out that growth was

driven by foreign investment. Total investment as a proportion of the economy was double that of the US in the 1970s and 1980s, before declining in the 2000s to levels more similar to the US. At the same time, investment was not driven by the domestic government spending beyond its means.

"We knew that Singapore explicitly ran budget deficits in the first three years, from 1965-67, then maintained a balanced budget or a small budget surplus thereafter," Prof Hoon said.

Thus, one conclusion from the data was that foreign investment played a significant role in driving Singapore's growth. What also helped was good infrastructure, where a steady supply of water and electricity was provided. Workers also cooperated with companies. Singapore, even without an educated workforce, attracted investments in industries such as textiles and basic electronics.

"It was our MNC policy that opened the door to standard off-the-shelf technology, that raised our standards of living, created jobs, and caused wages to go up," Prof Hoon said.

Meanwhile, investment by foreign firms was also important in helping Singapore recover from the global financial crisis. The share of foreign direct investment within total investment grew from 40 per cent in 2010 to 63 per cent in 2011 and 73 per cent in 2012.

Singapore started at just over 30 per cent of the US GDP per capita in the 1960s, but by the 2000s, it had surpassed the US. At the same time, Singapore businesses and households, together with the government, continued to save more and more over the years.

Savings as a proportion of the economy rose above investment's share from the mid-1980s and has remained since. "Our past tells us what we must retain as sources of growth to go forward," Prof Hoon said.

Another conclusion from the data was that Singapore did not have to fight recessions with government spending to stimulate demand. Rather, it was through supply-side policies – cutting worker costs through the Central Provident Fund (CPF) system – that increased Singapore's international competitiveness and contributed to the eventual recovery, Prof Hoon said. In the future, however, cutting wages will be harder "if the focus is to provide

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retirement adequacy".

In the recent Budget, the government boosted CPF contribution rates for older workers and announced that it will pay out more interest on a portion of their CPF savings.

Going forward, Singapore will have to fight recessions by drawing on its reserves and tinkering with its exchange rate policy, Prof Hoon said. For example, this was implemented in the 2009 Budget when a wage subsidy called Jobs Credit was given to businesses to encourage them not to fire locals. Jobs Credit was financed by drawing billions of dollars from Singapore's reserves. The government returned the money it withdrew in 2011, after an economic rebound.

Recessions for small open economies like Singapore are fought by lowering costs, said Prof Hoon.

"You can't run away from that. If you don't, the burden will be heavier on some individuals, this will result in higher job losses," he said. "So you spread the burden around. Everybody holds down their wage increase, so they can still contribute to the CPF for retirement adequacy."

Tackling inequality

"Our focus has to be on the ITEs (Institutes of Technical Education), and people not feeling good about themselves."

An interesting tidbit from historical data was that economic growth was not at odds with social equity.

From 1978 to 2000, income inequality actually fell, when one compares the earnings of highly skilled workers like professionals, managers and executives (PMEs), with low-skilled workers like cleaners and factory workers. A PME was earning 3.6 times the wage of a low-skilled worker in 1978, and that ratio declined to a low of 2.4 times in 2000 before rising back to over three times in 2008.

Since 2000, the forces of technology and globalisation have meant that those with a tertiary education would be better rewarded. Singapore will not only have to invest in education to narrow the income gap, but also to create new success stories for people to look up to, he said.

On the latest effort to encourage Singaporeans to

build up their skills throughout life, Prof Hoon said: "I wouldn't be too sceptical. It's about creating a new narrative so that over the next 20 years, one can genuinely say, this guy had never been to university, he went through a different route, but he's doing pretty OK."

A widening wage gap will cause social strains, Prof Hoon said. Singapore recently raised taxes on its top earners, and some commentators have described the move as a "Robin Hood" budget – robbing the rich to help the poor.

But the comparison is misleading, he said. Robin Hood illegally took what belonged to others. But people should look at the issue from the lens of how an ideal society would be where people reap the rewards of being able to specialise in their areas of comparative advantage, he said.

High-income earners have benefited from living in such a society, he argued. "Just take a look at other societies where security cannot be taken for granted and your property rights are not assured, then you will understand... so you need to play your part in contributing to it, to pay for this social compact, this composite good."

Ultimately, Singapore needs to boost not just the people at the lowest end, but also retain the ability for business and innovation to grow the pie, he said. "The empirical literature is clear that if you have the efficient businesses come over, they are able to offer better-quality jobs, with better pay."

Singapore has managed to grow its standard of living from a third of the US' to surpassing that in the last 50 years, partly because the right institutions were in place. There was also an early commitment to open the economy to the flow of goods and services, of capital, and of labour, Prof Hoon said.

"I think it is important that we retain that commitment as it will give Singapore the competitive edge in creating a bright future."

This is a monthly series by the Singapore Management University. Next month's feature will look into how social attitudes towards globalisation and cosmopolitanism play a role in environmental sustainability.