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Headline: Singapore's competitiveness at risk

High wage costs and a strong currency are putting the economy at risk, while productivity gains have not materialised.

Singapore's competitiveness at risk

EYE ON THE ECONOMY

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FOR THE STRAITS TIMES

SINGAPORE'S disappointing second-quarter growth of 2.1 per cent compared with the same period last year has raised concerns about the impact of economic restructuring. When compared with the last quarter, growth even dipped 0.8 per cent.

At the same time, productivity performance has been dismal.

After rising by 2.2 per cent in 2011, productivity dropped by 1.4 per cent in 2012 and another 0.2 per cent last year.

Government officials repeatedly emphasise that the productivity drive will take time to bear fruit. But the short-term effect of rising pay without productivity increases can only mean higher costs and prices. And this will have an impact on the cost of living and the viability of firms, encouraging some firms to leave the country.

The situation is reminiscent of that in the early 1980s, when wages were artificially raised in the hope that firms would be motivated to look for ways to increase productivity. During that period, Singapore also had an over-valued exchange rate because the Singapore dollar was closely tied to the over-valued US currency.

Recognising how the strong US dollar was damaging industry in Detroit, then President Ronald Reagan belatedly pressured Germany and Japan to revalue their currencies substantially at the Plaza Accord of September 1985. But that was too late to prevent the serious recession we experienced in 1985 and 1986.

According to the Bank of International Settlements, the real effective exchange rate of the Singapore dollar is higher today than it was in the 1980s.

An over-valued currency penalises the tradable sector and favours non-tradable ones.

It is therefore no surprise that asset markets here, especially real estate, reached bubble conditions.

The Monetary Authority of Singapore's (MAS) traditional defence of a strong Singapore dollar policy is built on balancing imported inflation against export competitiveness. The MAS believes a strong currency does not hurt manufacturing as the heavy reliance on imported components – which are cheaper when our currency is strong – helps hold down costs.

But this leaves service exports in the cold – and subject to the vagaries of a strong currency – because they are typically much less reliant on imported inputs. The negative effect of an over- valued currency on service exports like tourism and medical care was very evident in the aftermath of the Asian Currency Crisis of 1997 and 1998. We saw inbound tourism form East and South-east Asian countries dry up. Singapore's private hospitals and clinics were also adversely affected.

The MAS needs to modify its exchange rate policy in the light of Singapore's increasingly service-oriented economy, especially because costs are now much more wage driven.

Strong dollar, weak exports

THE export figures in 2013 to our top 10 export destination countries may be telling a story.

Singapore's non-oil domestic exports to South Korea fell 25.3 per cent. They also fell 25.5 per cent to the European Union, 9.8 per cent to Malaysia, 9.7 per cent to Japan, 7.6 per cent to Indonesia, 6.7 per cent to Thailand, 6.6 per cent to the United States, and 5.3 per cent to Hong Kong.

Perhaps this has to do with the fact that the Singapore dollar rose 22.1 per cent against the rupiah, 17.9 per cent against the yen, 12.6 per cent against the Australian dollar, and 3.6 per cent against the ringgit and the baht.

On the other hand, the Singapore dollar barely fell against the Taiwan dollar (-0.9 per cent), and declined by 3.4 per cent against the Hong Kong and US dollar, the Korean won (-4.5 per cent), the British pound (-5.3 per cent), China's renminbi (-6.2 per cent), and the euro (-7.5 per cent).

The MAS may need to reconsider its currency-basket weighting system in the face of these major currency re-alignments.

Singapore has not benefited much from the US recovery. The EU is still in the doldrums, while Japan is vigorously re-structuring, beginning with aggressively weakening the yen via quantitative easing. China is re-balancing its economy towards domestic demand and services. The US is also regaining competitiveness due to shale oil and gas, lower wages and a resurgent industrial policy.

Some US multi-national corporations have left Singapore, and more are planning to do so.

Meanwhile, the recent Indian elections may translate to a vigorous manufacturing drive by the Modi government. And, if it can straighten out its politics and policies, Myanmar, with abundant resources and cheap labour, may prove to be a big draw for foreign direct investments.

How should Singapore re-position itself in this rapidly changing external environment? How seriously are we taking the productivity drive – as policymakers, and as business leaders and workers?

After all, an ageing population means a less productive economy. Can we overcome the constraints of demography?

A service-oriented economy is less productive because many personal and social services are not capable of productivity increases. What are we to do to mount the productivity ladder?

Are we aware that de-industrialisation led to the jobless growth phenomenon in the US and Europe, with the exception of Germany, Sweden and Switzerland which have wisely kept manufacturing thriving?

Are we being too ambitious in reaching out to high-end manufacturing and phasing out lower-end ones too quickly?

Are we mindful of the fact that every manufacturing job generates at least two service jobs? In fact, the Boston Consulting Group (in an April report) puts the multiplier at four. Former Intel CEO Andy Grove has reiterated the OECD Observer observation that manufacturing remains central to Organisation for Economic Cooperation and Development economies, in terms of productivity and income growth, and for innovation. Ten jobs created at Intel supported 31 jobs elsewhere.

Perhaps we should pause in the helter-skelter drive towards the holy grail of higher productivity and higher wages, and ask: Is it realistic to push so hard? The combination of a strong currency and high wage costs is dangerous for Singapore's future and endangers our ability to create good jobs for young Singaporeans.

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