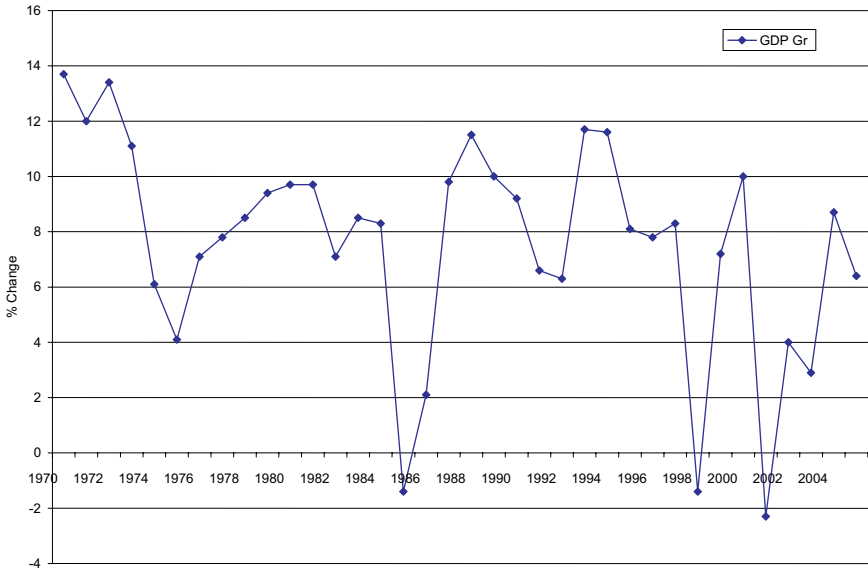

Chapter 1

Introduction: Economic Structure and External Orientation

The rapid evolution of Singapore from a modest trading post under colonial rule into a modern, prosperous, self-confident and sovereign nation is one of the more notable success growth and development stories of the second half of the 20th century. The Singapore economy has experienced one of the highest rates of growth in the world over the past three decades, its Gross Domestic Product (GDP) rising at an annual average rate of about 7.6% during the period 1970–2005. The growth has in turn propelled Singapore's average real per capita income from US\$ 512 in 1965 to its current level of over US\$ 26,982 by 2005, which is one of the highest in the world, surpassing many developed countries (Figure 1).

However, long-term averages hide the fact that the Singapore economy has been fairly fragile over the last five years. Specifically, following the sharp downturn in the global electronics industry and the sluggish regional and global growth, Singapore experienced an acute economic contraction in 2001; the recession was the worst in thirty years. Its impact on rising rates of redundancies, bankruptcies, financial and asset markets, consumer and business sentiment, and the like, have been deep and wide-spread. The depth of the recession was largely due to the confluence of a number of negative factors, including the unfortunate and horrendous events of September 11, 2001, Bird flu and SARS, Tsunami, Middle-East war, oil-shocks and



Source: Singapore Department of Statistics.

Fig. 1. GDP Growth for Singapore Economy: 1970–2005 (2000 Market Prices).

dot.com bubble crash, and it emphasized once again the acute susceptibility of the city state to external shocks. Indeed, the Singapore economy has appeared relatively fragile and much more at risk to boom-bust cycles post Asian crisis.¹ It is only in the last few years that the economy has regained its robustness. The Singapore economy expanded at a strong pace of 8.7% and 6.4% in 2004 and 2005, respectively, with the growth momentum being sustained in 2006–2007.

¹Singapore was one of the few economies in East Asia to have staved off outright contraction that year despite the city state's intensive trade and financial linkages with the other crisis-hit economies. This admirable performance was due to a combination of strong fundamentals of the economy and prompt devaluation of the Singapore dollar (unlike the rigidity of the Hong Kong dollar, for instance). Somewhat less certain was the impact of the set of cost measures including a 10% reduction in the employers' contribution to the Central Provident Fund (a mandatory pension fund, voluntary wage reductions), cuts in nominal wages, government-controlled rentals for commercial and industrial properties and utility charges for electricity and telecommunications (Rajan *et al.*, 2002).

Table 1. Key Macroeconomic Indicators, 1999–2005

	1999	2000	2001	2002	2003	2004	2005
Real GDP (2000 market price & % change)	7.2	10.0	−2.3	4.0	2.9	8.7	6.4
Manufacturing	13.6	15.3	−12.8	8.4	3.0	13.9	9.3
Services	6.0	9.0	1.9	4.0	3.3	7.6	6.0
Construction	−8.8	−1.7	−1.2	−14.0	−9.0	−6.1	−1.1
Share of Gross Value Added (%)							
Manufacturing	23.1	26.8	23.7	25.8	26.3	27.7	27.3
Services	63.6	61.9	64.5	63.5	63.4	63.0	63.8
Construction	7.9	6.3	6.1	5.4	5.0	4.3	3.7
Others	5.1	5.0	5.7	5.3	5.3	5.0	5.2
Employment Share (%)							
Manufacturing	21.0	20.8	18.8	18.2	17.9	17.3	21.4
Services	71.1	65.5	74.2	75.0	75.6	76.3	69.6
Construction	6.9	13.1	6.1	5.9	5.6	5.5	8.1
Others	1.0	0.6	0.9	0.9	0.9	0.9	0.9
Unemployment rate (average)	3.5	3.1	3.3	3.6	4.0	3.4	3.2

Services sector includes: Wholesale and retail trade, hotels and restaurants, transport and communication, financial services, business services, other services.
Source: Thangavelu and Toh (2005).

1.1. Sectoral Growth

At a sectoral level, while the construction sector has remained a drag on the economy, the economic rebound in recent years has largely been due to both non-construction manufacturing and services sectors. The manufacturing sector grew at an average pace of 8.5% between 2002 and 2005, while the services output growth averaged 5%. Within services, the wholesale & retail trade has been growing and double digits. The hotels and restaurants, financial services and transport and communications have also all rebounded in the last few years, hence driving services sector growth (Table 2). The service sector has consistently accounted for over 60% of Singapore's gross value-added, while the manufacturing sector has accounted for about 25%. There is a conscious policy by the government to ensure that both the manufacturing and services continue to form the "twin engines" of growth for the economy.

Table 2. Key Economic Indicators by Sectors (2000 Market Prices — Change in %)

	2002	2003	2004	2005
Total	4.0	2.9	8.7	6.4
Goods Producing Industries	3.9	1.1	10.5	7.7
Manufacturing	8.4	3.0	13.9	9.3
Construction	-14.0	-9.0	-6.1	-1.1
Services Producing Industries	4.0	3.3	7.6	6.0
Wholesale & Retail Trade	8.2	10.6	15.6	10.5
Hotels & Restaurants	-2.4	-8.7	11.5	4.6
Transport & Communications	6.3	-0.7	8.5	4.5
Financial Services	-3.4	7.6	5.4	6.5
Business Services	3.9	-1.0	2.8	4.9

Source: Singapore Department of Statistics.

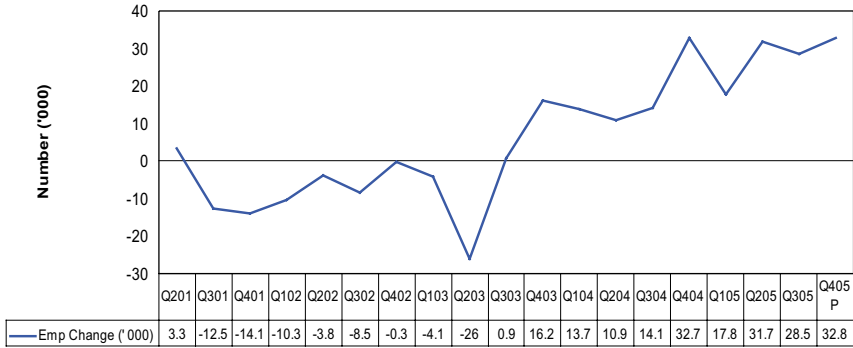
1.2. Employment and Income Distribution

As would be expected, employment growth has lagged economic recovery and unemployment peaked at 4% in 2003. However, the strong output growth since then has been complemented by robust employment growth in 2004 and 2005 (Table 3). The overall unemployment rate has consequently declined to 3.1% in 2005. Notwithstanding this decline in cyclical unemployment, the structural adjustment of the economy to higher value-added activities appears to have contributed to the slower trend growth in employment and a consequent rise in the number of structural unemployed Singapore residents (Figure 2). The economy also relies heavily on foreign workers to augment its labor force as well as to plug gaps in human capital requirements of industry (Figure 3).

Table 3. Labor Market, 2002–2005

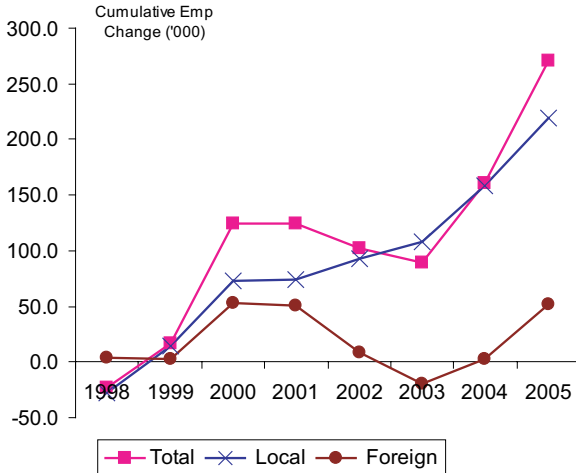
	2002	2003	2004	2005
Labor Force ('000) (As at June)	2,321	2,312	2,342	2,367
Employed Persons ('000) (As at Year-End)	2,148	2,135	2,207	2,320
Unemployment Rate (%) (Average)	3.6	4.0	3.4	3.1
Changes in Employment (Number)	-22,900	-12,900	71,400	113,300

Sources: Singapore Department of Statistics; Ministry of Manpower.



Source: Labor Force Survey, Ministry of Manpower, Singapore.

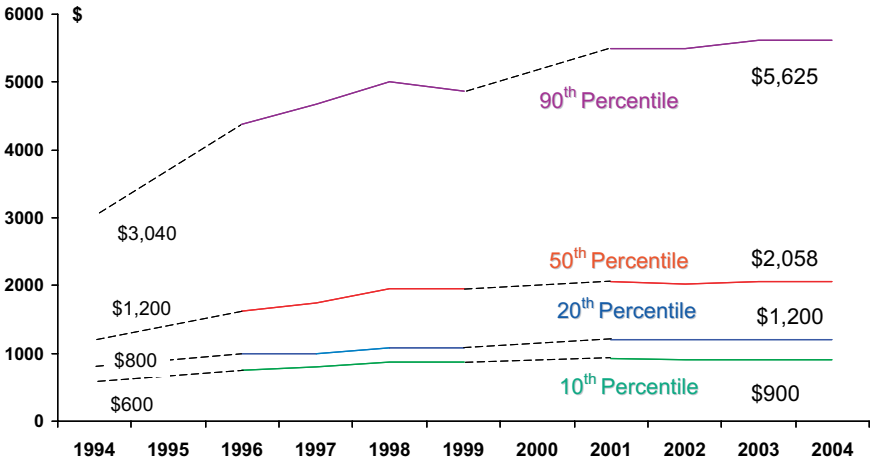
Fig. 2. The Long-Term Unemployment in Singapore (%), 2001–2005.



Source: Ministry of Manpower, Singapore.

Fig. 3. Cumulative Employment Change for Singapore Economy by Local and Foreign Workers, 1988–2005.

The structural changes in the economy have also created new challenges in terms of widening income gap in the economy. The income of lower 20th percentile appears to have stagnated while that of the top 10th percentile has risen markedly. As with many other countries that have embraced the forces of globalization, this widening income gap presents some important challenges that need to be addressed by policymakers (Figure 4).



Source: Report of the Ministerial Committee on Low Wage Workers.

Fig. 4. Gross Monthly Income of Full-Time Employed Residents, 1994–2004.

1.3. Unit Labor and Business Costs

Table 4 summarizes recent trends in unit labor cost (ULC) for the Singapore economy. There appears to be a declining trend between 2002 and 2005. Labor costs form the highest proportion of overall business cost. Consequently, there is a similar declining trend in the unit business cost (UBC) index of manufacturing. However, the cost of services and government rates and fees have been rising, implying the UBCs have not been declining as sharply as ULCs.

Table 4. Indices of Unit Labor and Unit Business Costs for Singapore Economy (2000 base year)

	2002	2003	2004	2005
Unit Labor Cost Index of Overall Economy	102.6	100.8	96.9	95.4
Unit Business Cost Index of Manufacturing	102.5	100.9	97.9	97.7
— Unit Labor Cost	106.6	102.5	95.0	92.2
— Services Cost	99.4	99.9	100.4	102.4
— Government Rates & Fees	89.4	86.5	95.1	96.2

Source: Singapore Department of Statistics.

1.4. Development Strategies

While the openness of the Singapore economy makes it imperative that that ULCs are kept at a competitive level, in the new global economy, comparative advantage is based increasingly on knowledge and creativity than on traditional factor inputs. Entrepreneurship is the conduit between investments in knowledge and economic growth (Audretsch, 2003). There is in fact a fairly new and growing body of econometric evidence which suggests that entrepreneurship is a key determinant of economic growth in a knowledge-based economy. The Singapore government has long recognized the importance of nurturing local entrepreneurship. For instance, the city state's Minister for Manpower, Lee Boon Yang, has noted:

Value-creation through creativity, innovation and entrepreneurship. Second, the new economy is driven by innovation and value-creation. To prosper, we have to become a high value-added knowledge-based economy. To succeed in this environment, you must be creative and entrepreneurial. The ability to generate new ideas, and bring them to market before your competitors, is very important. Singaporeans are disciplined and productive workers. They said we are good at execution but lacking in creative thinking. We must be bolder and more innovative in order to succeed. We must also be more entrepreneurial so as to transform ideas into value. Every good idea has to be developed into marketable goods and services. We need more Singaporeans who are prepared for the risk and rewards of bringing ideas to the market (Lee, 2002).

Accordingly, the Singapore government has forged a commitment to create an environment conducive for entrepreneurial activity and fostering a culture of learning and experimentation. In this regard, it has offered a number of targeted incentives to promote it, especially in the area of high technology (i.e. so-called "technopreneurship").²

While developing local entrepreneurship is of importance, there is also a need to maximize benefits from foreign investments (Chia, 1992). Foreign multinational corporations (MNCs) bring with them

²Ho *et al.* (2002) attempt to define the term "technopreneurship" and discuss steps to facilitate its growth in Singapore.

state of the art technology and access to global networks. Greater attention has been placed on strengthening the base of small and medium local enterprises (SMEs) and create and strengthen strategic partnerships and skill linkages between SMEs and MNCs by promoting local sourcing, sub-contracting and technological and R&D spillovers and capabilities (also see Hu and Shin, 2002).

Since the late 1980s, and especially the 1990s, the Singapore government has undertaken an aggressive strategy of building up its external wing by investing heavily in regional and extra regional trading partners (Yeung, 2000). The government remains committed to developing a breed of world-class companies which have a global reach. The government-linked companies (GLCs) are viewed as the “primary instruments through which the state inaugurates the regionalization drive” (Yeung, 2000, p. 21). The *Business Times* of Singapore (July 2002) makes the following observation about GLCs:

The Singapore GLC, or government-linked company, was a necessary Singapore invention. At a time when the local economy was a fledgling, this breed of corporation helped it to take flight. Since the time Temasek (Holdings) was formed in 1974 as the government’s investment holding arm, it has grown to include 65 major companies, with a myriad of subsidiaries and associate companies in almost every economic sector, with a workforce totaling 150,000. The top 22 GLCs accounted for 13% of the country’s gross domestic product in 1998. The top seven listed GLCs had a market capitalization of \$72 billion as at end-May, or 21% of the Singapore Exchange’s total capitalization.

The government, through Temasek Holdings, has significant equity in many of Singapore’s largest companies in vast areas of the economy including port and marine, shipping and logistics, banking & financial services, real estate, airline, telecommunications and media, power and utilities.³

While acknowledging the world-class technocratic capabilities of the Singapore government, Bhaskaran (2003) suggests that the state’s role in Singapore might have become more of a liability and needs to be rolled back in certain areas. In particular, he argues that the government intervention in terms of its ownership and management of

³See www.temasekholdings.com.sg/.

the majority of land and other critical resources has distorted relative prices, while the domination of GLCs in local economic activity has curbed private sector initiative by pre-empting local business opportunities. In similar vein, the IMF (2000) makes the following observation:

Although the GLCs have been expected to operate on a competitive basis in both domestic and international markets (and indeed most of them have remained profitable, generating large operating surpluses), their overwhelming market power is likely to have crowded out local private enterprises and thus prevented the development of a large and dynamic network of local corporations, contributing to the widely perceived lack of corporate dynamism in Singapore (p. 11).

The Singapore government is clearly cognisant of these assessments. They have recognized that while there was a need for strong role of the state in the early stages of growth to address market failures in the economy, the role of the state in economic development must undergo a transformation as the economy develops and becomes more sophisticated. Accordingly, the government is reducing its direct role in the economy by gradually divesting its stake in GLCs and allowing greater competition in the services sector in particular (Economic Review Committee, 2003; WTO, 2004).

1.5. Free Trade Agreements (FTAs)

The cornerstone of Singapore's economic strategy has been its openness to international trade and investment flows. Advances in the Information systems, Communications and related Technologies (ICT) have significantly shrunk economic distances between nations and markets and is possibly reducing the demand for some conventional roles such as entrepot, overseas headquarters (OHQs) and other hub services and ancillary services. This, along with the fact that Singapore is probably the most open economy in the world (with a trade to GDP ratio of about 250%) with few natural resources, implies the need for the city-state to be particularly aware of and responsive to the powerful forces that are transforming markets and dramatically changing ways of doing business, so as to remain

“ahead of the game”. This is especially so as the competition for investments, export markets and skilled labor intensifies as more economies embrace open door trade and investment policies and some of Singapore’s hub roles are duplicated by lower cost regional rivals.

In an effort to ensure sustained growth of Singapore’s exports, the city state has attempted to aggressively source preferential trade accords (“free trade agreements” or FTAs in common parlance) with a number of countries in Asia and elsewhere. FTAs are not an entirely new component of Singapore’s commercial trade strategy which in turn is the cornerstone of the city state’s larger international economic policy. While being among the most ardent of supporters of the global trading system, Singapore has actively pursued a second track to liberalization via the regional route in the 1980s and 1990s. Regionalism has hitherto involved both the Southeast Asian region via the ten-member ASEAN (Association of Southeast Asian Nations) grouping and the larger Asia and Pacific region via the twenty-one member APEC (Asia Pacific Economic Cooperation) grouping. However, indications are that the regional financial crisis 1997–1998 has held up the pace if not commitment by some of the ASEAN members to trade liberalization, while APEC has become rather unwieldy and appears ill-equipped to handle substantive trade and investment liberalization issues effectively. Accordingly, Singapore policy makers have underscored the need to explore alternative liberalization paths, i.e. a third track. Sourcing of trade pacts on a bilateral basis — bilateralism for short — has become an integral part of Singapore’s new commercial trade strategy (Rajan and Sen, 2002; Thangavelu and Toh, 2005).

As of November 2006, apart from the ASEAN Free Trade Agreement (AFTA), Singapore has signed trade agreements with Australia, European Free Trade Association (EFTA), Jordan, India, Japan, Korea, New Zealand, Panama, Trans-Pacific SEP (Brunei, New Zealand, Chile, Singapore), United States of America (USA). Singapore is also negotiating bilateral agreements with Bahrain, Canada, China, Egypt, Mexico, Pakistan, Peru, Sri Lanka, Kuwait, Qatar and the United Arab Emirates (UAE). On a regional

basis, Singapore through ASEAN is negotiating agreements with ASEAN's full-dialogue partners, viz. China, Australia and New Zealand, India, Japan and Korea.

Singapore's choice of partners as part of its trade strategy of bilateralism may be broadly divided into two groups. The first group, which includes the US and Japan, are major established trading partners, constituting some one third of the city state's total merchandise trade. These economic giants are also major investors in the city state as they are in Southeast Asia at large. Bilateral trade accords with these two economies are best seen as a formalization of the *de facto* extensive and deep linkages that already exist. Entering into broad-ranging trade agreements with them is not only a means by which Singapore might gain greater market access (with Japan in particular) but is also a way of avoiding the possible imposition of protectionist measures in the future (with regard to the US in particular), as well as managing future trade tensions, including establishing orderly dispute settlement mechanisms. Being among the first few countries to establish trade accords with these two and other economically significant economies also ensures that Singapore is not discriminated *ex-post* in the event that its "trade competitors" form such pacts with third countries. The second group of countries with which Singapore is attempting to formalize or has formalized trade accords, including India, Australia, New Zealand and the EFTA countries, individually do not account for more than 3% of either Singapore's total exports, domestic exports, or total imports. The aim here is to seek out new markets and sources of and opportunities for investment.

1.6. Structure of the Book

Chapter 2 offers a brief overview of Singapore's FDI regime and FDI patterns. Chapter 3 addresses the emerging trade patterns of the Singapore economy and outlines relevant trade policies. Chapter 4 discusses recent initiatives undertaken by the city-state pertaining to trade and investment related infrastructure. Chapter 5 considers Singapore's trade policies and issues relating to the services sector

focussing on the city state's multilateral and bilateral commitments. As will be apparent, deepening economic relations with India has dominated the story of Singapore's growing economic engagement with South Asia. Accordingly, Chapter 6 considers the specific case of Singapore's bilateral economic relations with India which have been blossoming in recent times and is a good case-study of intensifying East and South Asia economic linkages in general. Chapter 7 highlights some policy challenges and implications for the Singapore economy going forward.