

Report of the ECONOMIC COMMITTEE

THE SINGAPORE ECONOMY: NEW DIRECTIONS

EXECUTIVE SUMMARY

INTRODUCTION

For two decades, Singapore enjoyed continuous high economic growth, almost regardless of the state of the rest of the world. Despite two oil crises and global recessions, the Singapore economy grew, robustly and apparently inexorably. A bad year meant GDP growth of 5%. A boom year meant 15% growth.

2 This performance continued into the first half of the Eighties. From 1980 to 1984, real GDP growth averaged 8.5% p.a. This enabled Singaporeans to enjoy further rapid increases in living standards; our per capita income level is now ahead of all other developing, and even some developed nations of the world. Our companies prospered, and we attracted record levels of foreign investments. We continued to educate our population, construct our infrastructure, and build our nation.

3 The period of easy growth is now over. The recession of 1985 and 1986 is a turning point in our economic development. Even after we overcome this recession, economic growth will not rebound to its previous average of 9%. Internally, we have finished doing all the easy things which can be done to foster growth. Externally, international trade is no longer expanding as exuberantly as it used to, and worse, the trading environment is becoming increasingly hostile. From now on, growth will be harder to achieve.

4 The Economic Committee was formed to examine the longer term problems and prospects of the Singapore economy, identify new growth areas, and define new strategies for promoting growth. As the Committee studied the problem, it quickly realized that it also had to address the present recession. The recession could not be brushed aside as a cyclical difficulty which would eventually disappear by itself. On the contrary, the recession was a manifestation of fundamental problems. These had to be corrected, and policies changed, not only to overcome the recession, but also to set the correct direction for the longer term growth of Singapore.

5 This report therefore first deals with the causes of the present recession, and the policy changes needed to tackle them. It then looks at the future position for Singapore in the world economy, and the new directions we should pursue to attain this goal.

CAUSES OF RECESSION: EXTERNAL FACTORS

Global Demand Conditions

6 A convergence of external and internal factors has made this recession the most severe on record. Low petroleum prices have affected oil refining and petrochemical industries around the world. With lower volumes of crude being shipped between the Middle East and both Europe and Japan, fewer supertankers are needed, repair facilities are in less demand, so shiprepairing and shipbuilding also do badly. These industries, which account for 25% of our manufacturing sector, all suffer from excess capacity, and face long term difficulties which will persist after the recession is over.

The United States

7 The rapid escalation in the US growth rate, from 8% in the first quarter of 1984 to 2.3% in 1985, has hurt exports and slowed growth in all the Newly Industrializing Countries (NICs). Singapore was especially badly hurt, because an important part of our trade with the US is in computer peripherals and electronics, a sector where there is temporary overcapacity, and is in a slump of its own.

The Region

8 Apart from the US, regional economic problems have also affected us. We are not a commodity producer, but our neighbours are. Low and falling commodity prices have severely reduced the export earnings of all other ASEAN countries, and slowed their growth. The prosperity and ebullience of the petroleum boom

have ended. Our trade with them has fallen, and their tourists visiting us have declined. This is a problem not shared by the other NICs.

CAUSES OF RECESSION: INTERNAL FACTORS

9 We can do little about external factors, except to adjust to their consequences. The internal factors, however, we can deal with. They are :

- the loss of competitiveness due to the high costs of doing business in Singapore
- the construction slump and its ramifications
- the problem of oversaving in a slow economy

More generally, rigidities in our economy have become apparent. Business confidence has been shaken by the recession; beyond a point, this lack of confidence itself becomes an impediment to recovery.

Loss of Competitiveness

10 We have allowed our operating costs to rise: rentals, interest costs, statutory board charges, and particularly wage costs, including CPF. In the five years since the controversial wage correction policy, wage costs rose twice as fast as productivity. The largest increases occurred after 1981, after the three-year wage adjustment was supposed to have ended.

11 Some have argued that this was due to a very tight labour market, which would have made it impossible to hold down wages anyway. But part of the reason for the tight market was the high level of domestic demand, resulting from the construction boom, including the greatly accelerated HDB housing programme. Also, successive high NWC recommendations must have raised the expectations of the population. The rapid rise in wage costs was therefore not entirely beyond our control.

12 As a result, we became less competitive compared to other NICs. Company profit margins were steadily eroded. Both MNCs and local companies were affected. Local companies have been more seriously hurt, because wages are a larger proportion of their total costs, and they have found it more difficult to upgrade their operations. When the recession came, the companies had little margin to cushion themselves, and many were pushed into the red.

Construction Slump

13 Even while the construction boom lasted, we should have been alarmed that a third of our economic growth each year was derived from construction, as this trend obviously could not be sustained. Now that the boom is over, the construction slump has brought us even more severe problems. It is not just a matter of supply of properties exceeding demand. More significant is the contraction of aggregate domestic demand, resulting from the lower tempo of construction activities. This alone has contributed 2% points to the drop in GDP in 1985, and is likely to contribute a further drop in 1986.

14 Also property loans by banks, and loans secured using property as collateral, are at risk if property prices collapse. Banks will tend to cut back credit lines as the value of the collateral drops, squeezing otherwise viable companies. Worse, banks with large property exposures may find themselves with a portfolio of non-performing loans. A collapse of the property market could affect the integrity of the banking system. Further, the drop in investments in construction leads to an imbalance between our high national savings rate and lower domestic investment rates, with multiplier contractionary effects on the GDP.

Savings and Investments

15 As our GDP grew, our savings rate also rose, and capital formation increased sharply, making further growth possible. This should have been a virtuous cycle, but unfortunately there was a flaw. The higher investments were not going into productive machinery or equipment. Such investments stagnated in terms of dollar value, and even declined when measured as a proportion of our GDP. The increases were channelled into construction projects, such as infrastructure, housing and commercial developments. Infrastructure and housing are necessary and productive forms of capital, but there is a limit to the amount of infrastructure and housing the economy needs. Beyond a point, additional empty hotels or office blocks do not yield an economic return. The high construction investments therefore could not be sustained indefinitely.

16 Meanwhile our savings rates have not declined in step, because public sector savings do not adjust quickly to the state of the economy. Taxes are based on last year's income, while CPF contributions are a fixed fraction of an employee's wage. Net CPF contributions currently amount to \$2 bn a year, a significant share of the public sector surplus. The CPF contribution rate therefore not only affects labour costs; it also has significant fiscal policy implications. At present rates of contribution, the CPF is a strong contractionary fiscal influence.

17 We are therefore trying to save more as a nation than we can reinvest in the economy. This is oversaving. In the long run, the position can be sustained if we can sell overseas what we do not consume or invest domestically; in other words, if we can run an export surplus like Japan. In the short run, if we cannot export this difference, the net result will be undesired accumulations of inventories, whether of properties or of goods. The consequent shrinkage of domestic demand is a major contributory factor to our recession.

Rigidity

18 In general terms, our domestic problems stem from rigidities in our economy. We have been slow to adapt to changed circumstances. For example, our wage costs cannot be reduced to fit leaner times, because we have not built into our wage structure the mechanisms of adjustment. Some Singaporeans still prefer to remain unemployed, rather than to accept less well paid or harder jobs, because they have not realized that times have changed. This lack of flexibility aggravates our problems, and only makes the adjustment, when it inevitably comes, that much more severe and unpleasant.

POLICY CHANGES

19 It is therefore clear that the Singapore economy cannot be left to recover on its own. Unless fundamental changes in policy are made, the decline will continue. The government has already announced some measures to reduce costs and taxes over the last few months. These were steps in the right direction, but not the complete solutions to the problem. The Economic Committee therefore recommends that a comprehensive set of policy changes be implemented as soon as possible, to deal with the internal problems which have been identified. These changes are consistent with the longer term developmental needs of the economy.

Costs

20 Cost-cutting measures so far have consisted of wage restraint on the part of the unions, a property tax rebate, removal of a variety of levies and minor taxes, and reduction of some statutory board fees. These have not been sufficient. Despite the full cooperation of the unions in restraining wages, average wages still rose by 3% in 1985, exceeding productivity growth. Far from regaining our competitive position, on the present course, we are becoming less and less competitive. More rigorous measures are necessary. The Committee recommends the following:

21 **CPF.** The problem of high wages should be tackled directly. As a large component of wage costs is CPF contributions, it recommends reducing the rate of employers' contributions to CPF by 15% points, from 25% to 10%, for two years in the first instance. This will immediately reduce wage costs by 12%. Take home pay will not be affected, but for households using their entire CPF Ordinary Accounts to meet mortgage payments, the government should make special arrangements to enable them to reschedule their housing loans. Meanwhile, the government should study the appropriate long term rate of CPF contributions, one both adequate to meet the objectives of the CPF Scheme, and sustainable from the point of view of economic growth.

22 **Wage Restraint.** In order that this cost savings not be eroded by timescale increments and collective agreement annual adjustments, there should be no net increase in average wage costs after the CPF cut. This severe restraint should continue for two years. Even after economic recovery, wage increases should as a rule not exceed productivity increases.

23 **Wage Reform.** To prevent wages from again getting out of line in a future economic boom, employers and unions should work together urgently to reform wage structures, move away from fixed payment systems, shrink timescales, and introduce variable payment systems wherever possible.

24 **Other Costs.** At the same time, the government should continue to reduce other costs within its control. Statutory board charges have already been reduced, but statutory boards should continue to pass on to the public any further savings resulting from higher efficiency or lower fuel prices.

25 The effect of these cost-cutting measures will be a temporary drop in the standard of living of Singaporeans. This is unpalatable but inevitable. It is the only way companies can regain their profitability, Singapore can prosper, and our incomes can rise again.

Property Market

26 The excess supply of properties will take time to be absorbed. The government should avoid doing anything to aggravate the situation, such as by selling further parcels of land, or letting out its vacant properties at rock bottom prices. Should there be further drastic falls in property prices, the government's priority should be to insulate the banking system and the rest of the economy from the possible repercussions. The Property Market Consultative Committee under the Ministry of Finance is studying the problems in detail, and will make specific recommendations to help solve them.

Savings and Investments

27 **Reduce Savings Rate.** Since capital formation is bound to decline in the short run, there is no alternative to letting the national savings rate decline temporarily. The CPF cut, justified above as a cost reduction measure, will do just this. The 15% point cut in CPF contribution rate will mean a reduction of \$1.5 bn per year in contributions to the CPF. The other tax cuts proposed will also help. In addition, the government should seek suitable public sector projects to embark upon, such as tourism-related projects or rebuilding and improving our older schools. The purpose is not to give money away, but to take advantage of the slack capacity to build something necessary, worthwhile, and yielding at least an indirect economic return.

28 **Increase Investment Rate.** In the longer run, we must find ways to raise the amount of capital formation, particularly in machinery and equipment. The fact that such capital formation did not increase even when the economy was doing well and investment funds were readily available, shows that the problem is not lack of funds, but the difficulty of identifying additional productive opportunities to earn a return. Several ways to make investing more attractive are to reduce corporate tax, introduce investment allowances and influence interest rates downwards.

29 **Corporate Tax.** The Committee recommends an immediate corporate tax rate reduction, from 40% to 30%. This will improve the return on capital. It will bring our rate in line with our competitors, most of whom are around 30%. It will also be a major step in restoring business confidence. A further reduction of the corporate tax rate to 25% should be considered as soon as the revenue position permits.

30 **Personal Income Tax.** The maximum rate of personal tax should also be reduced to match the corporate tax rate as soon as possible. It is undesirable to have a differential between the two rates, as this allows well-off individuals to form companies to enjoy write-off of expenses and thereby pay lower taxes. A higher rate of personal income tax also places a heavier tax burden on wage earners than on the self-employed. Lower personal taxes will reward enterprise, and leave investible funds in private hands rather than with the government.

31 **Investment Allowances.** The Committee recommends that the government introduce an across-the-board investment allowance of 30% on investments in machinery and equipment. This will give companies an incentive to invest their surpluses, thus raising the amount of capital employed per worker, instead of distributing the surpluses as dividends or keeping them as liquid funds overseas.

32 **Interest Rates.** These have been declining, but are still relatively high in real terms, compared to other countries, because of the very low rate of inflation in Singapore. Interest rates are not subject to government control, but influencing them down further will encourage greater investments. It should also reduce the cost of doing business, as interest charges on loans and overdrafts are a significant component of business costs.

Exchange Rate

33 The Committee is of the view that the Singapore dollar exchange rate should be set by market forces, but the impact of the exchange rate on our export competitiveness and tourist costs should be taken into account. The dollar should, as far as possible, be allowed to find its own appropriate level, one which reflects fundamental economic trends.

34 Rather than attacking the problem of high costs through the indirect means of changes in the exchange rate, the Committee feels that it is better to confront this difficulty squarely by reducing CPF contributions and holding wage costs down. The conclusion that Singaporeans have to accept a lower standard of living for a time is best put across directly, rather than through the disguise of higher inflation brought about by a lower exchange rate.

PRESENT POSITION

35 The previous section proposed measures to revive the economy from its present malaise. Provided we make these decisive policy changes, and provided the external factors, particularly the US economy, are favourable or at least neutral, the Singapore economy should resume its growth by 1987.

36 This growth will start from a high base, in GNP per capita terms. The standard of living of Singaporeans is almost as high as that in some developed countries. But a country's development cannot be measured only by its standard of living, or by its per capita GNP. These are only the manifestations of growth, not its driving force. The driving force lies in factors such as the education level of the population, and the maturity of the structure of firms in the economy. In terms of both of these factors, Singapore has a long way to go.

37 **Education.** Though we have made great strides in raising our standard of education, our average education levels are still far behind developed nations. This is because the wastage from our education system in earlier years was large. Many dropped out of school prematurely. They are still in the workforce, and will remain in the workforce for many years to come. To catch up with the developed countries, we have to upgrade these workers through adult education programmes such as BEST, and educate new entrants into the workforce year by year. It will take us two decades.

38 **Structure of Firms.** The economy has grown, because many multi-national companies have set up plants in Singapore, and local companies too have expanded. But in manufacturing we are still predominantly a production base. Our base of local companies has not yet achieved the strength and diversity other countries have. Only now are MNCs starting to move some of their development and engineering activities to Singapore.

39 **Other NICs.** Relative to the other NICs, we are less far ahead than comparing per capita incomes would suggest. A large part in the difference in per capita incomes arises because South Korea and Taiwan have rural agricultural sectors, which Singapore does not. The difference between Singapore and Seoul or Taipei is much smaller. Singapore does have competitive advantages: political stability, better infrastructure, and a better business environment. But this is partly offset in the other NICs by the ready availability of a large pool of rural manpower.

40 Overall, Singapore has reached a developed country's income level before having become a developed economy. This position cannot be sustained. Either we catch up in terms of full development as quickly as possible, or our income levels will be hard to maintain. How we catch up will be influenced by the trends in the world economy and in our region.

TRENDS

Stiffer Competition

41 When Singapore first began industrializing in the Sixties, our competitors were the other developing countries in general. We had obvious advantages. By the Seventies, the Asian NICs became our prime competitors. Now, we are also competing with the developed nations. MNCs seeking investment locations are comparing Singapore with Britain, Spain, and even some states in the US. We have to compete in terms of costs of production, investment incentives and proximity of markets. Compared to these countries, our advantages are not so obvious. The competition is now much more intense. To preserve our position, we must build on our strengths and develop new advantages.

Slower Trade in Goods

42 Trade is vital to Singapore. Our imports and exports amount to three times the value of our GDP. Two thirds of the goods and services we produce are exported. No other economy in the world is as dependent on exports as ours.

43 Protectionist pressure will continue, as the developed countries will continue to be plagued by high unemployment rates and politically-difficult structural adjustments. As world trade stagnates, growth in the developed countries will slow, and new export opportunities will grow scarcer. We must therefore expect continuing problems with our exports.

44 **Market Investment.** More worrying still is the effect of protectionist barriers on the pattern of international investments. To avoid problems of tariff and non-tariff barriers, capital-exporting countries such as Japan are increasingly resorting to market investment. They are establishing factories in the countries where the goods will be sold, such as the US and Europe, not in the countries where the goods can be most economically produced, such as the NICs. As a result, it will be harder to attract investments to Singapore.

Opportunities in Services

45 Counterbalancing the slowdown in international merchandise trade is the growth in trade in services, such as banking, insurance, tourism, engineering, consultancy and professional services. World service trade has in recent years been growing twice as fast as merchandise trade. The trend is likely to continue.

46 This trend is important to Singapore. Our comparative advantage in exporting services is greater than our advantage in exporting goods. We have comprehensive transport and telecommunication links to the rest of the world. We have a well-educated, English-speaking work-force. Together with manufacturing, services will clearly be a leading growth sector in future.

Regional Uncertainties

47 In geopolitical terms, the Asia-Pacific region is one of the most vibrant but also more volatile regions in the world, containing a constellation of young, rapidly-growing, self-confident, and well-organized economies. Whatever the difficulties of the world economy, the Asia-Pacific countries are likely to perform better than the developed countries.

48 However, the growth prospects of South East Asia itself seem more uncertain. The ASEAN economies have hitherto prospered under rational economic policies, but are now buffered by low commodity prices. Their downturn has affected us. As the longer term outlook for commodity prices is hazy, we cannot avoid losing some of the traditional sources of our prosperity.

One Certainty: Smallness

49 Superimposed on these trends is one constant factor: Singapore's small size, with all that this implies - lack of a domestic market; continued dependence on the fragile international trading system; total absence of natural resources, except for our strategic location; and a relatively small talent pool. These are disadvantages, which we must overcome. These trends and this constant together define the limits of what we can achieve in the 1990s.

FUTURE POSITION

50 By the 1990s, our present niche as merely an offshore production centre for the developed world will have been eroded. Even if we overcome protectionism, competition for this niche will intensify, as other NICs progress and encroach on us. We must find a new niche.

Developed, With An Edge

51 Singapore is not likely to overtake many more countries in terms of GNP per capita. But we must catch up with the industrialized countries in maturity and level of development of our economy. By the 1990s, we must aim to become a developed nation. We must aspire to be as good as any developed country in terms of education and skill level, range and sophistication of our economic activities, capital invested per worker and productivity per worker.

52 But Singapore must be a developed economy with a margin of advantage. If all factors are merely equal, Singapore will not be an ideal place to locate a business. We are far away from export markets and susceptible to trade disruptions. The same might be said of Switzerland, but Switzerland is surrounded by

Europe, which serves as a hinterland beyond its borders. This is not true of Singapore. We have neither a domestic market nor a hinterland.

53 To be competitive, we must compensate for these disadvantages by offering something more. We must offer the opportunity of a higher rate of return, and a more conducive environment for business, than the OECD countries. Singapore can prosper only if businesses can prosper in Singapore. Otherwise businesses will move elsewhere, even those which are locally owned, and our economy will shrivel up.

54 **Higher Returns.** This means that while aspiring to become a developed economy, we can never afford to pay ourselves as much as people in OECD countries. Even while pursuing higher-wage, higher-skilled industries, we are still constrained by a ceiling. We have to price ourselves below the developed nations, and not too far ahead of our competitors, such as South Korea and Taiwan.

55 Because of our political stability and good infrastructure, Singapore workers do command a premium over workers in the other NICs. We therefore need not be paid only what they are paid. But the premium is finite and small. If we let the gap in wages widen, when we are in fact not improving faster than them, then we will again price ourselves out of the market.

56 **Conducive Environment.** However, it is not just a matter of Singaporeans being paid less than American, European or Japanese workers. Our entire economic environment must be more favourable to business and enterprise. Businesses must be able to start up faster, cooperate more harmoniously with their workforce, and take for granted the entire range of prerequisites of economic growth discussed below.

Our Future Position

57 Singapore's position in the global economy, therefore, is to be economically as developed as the West, and yet more competitive. Our future lies in being plugged into the international network of trade and communications, not in disconnecting ourselves in a vain effort to insulate Singapore from the influences and disturbances of the outside world.

58 **Beyond Manufacturing.** As an industrial centre, we must move beyond being a production base, to being an international total business centre. We cannot depend only on companies coming to Singapore solely to make or assemble products designed elsewhere. We need to attract companies to Singapore to establish operational headquarters, which are responsible for subsidiaries throughout the region. In Singapore such headquarters should do product development work, manage their treasury activities, and provide administrative, technical and management services to their subsidiaries. Then it becomes worthwhile for them to establish a plant in Singapore, to produce goods or services for export.

59 **Exporter of Services.** Singapore should become a major exporter of services. Services account for an increasing share of our GDP, and our service exports have been growing as quickly as world trade in services. Scope for growth is still huge. We need to promote not just Singapore-based activities like tourism or banking, but also offshore-based activities, like construction firms building hotels in China, and salvage firms operating in the Middle East. We have started to do this, but there are many more opportunities, in China and elsewhere. For example, we have expertise in hotel management, air and sea port management, town and city planning. These skills should be systematically marketed.

60 **GNP, not merely GDP.** If we succeed in becoming a base for regional operational headquarters of MNCs, and in becoming an exporter of offshore services, our affluence will not depend only on what we can produce in Singapore. It will also depend on what we earn from abroad. Our offshore activities will be extensions of our domestic economy. With income streams from abroad, Gross National Product, rather than merely Gross Domestic Product, will be the measure of our success. Singaporeans must seek opportunities wherever they can be found. The more widely and keenly we can spot opportunities overseas, the more secure and broadly based will be our well-being.

61 This is the way to exploit our advantages to the full, open up greater entrepreneurial opportunities to Singaporeans in new areas of business, and provide skilled, challenging and rewarding employment for Singaporeans.

FUNDAMENTALS

62 To reach this happy state of affairs, we must adhere to the fundamental requirements of economic growth, and interpret them practically in working strategies and specific policies. The fundamentals are generally well understood in Singapore.

Good Government

63 There must be good government, both in the sense of being stable and having popular support, and in the sense of carrying out rational, wise policies. This is a **sine qua non** of progress.

Efficient Infrastructure

64 The government must provide a comprehensive and efficient net of infrastructure, so that businesses can use the network of services at reasonable cost, and concentrate on their main line of business.

Education

65 Our population should be educated and trained to its fullest potential, since this is the only way to mobilize the talent available to the nation and apply it to productive use.

Free Enterprise

66 The economy must be based on the principles of free enterprise, as this is the efficient, flexible way to organize production and meet economic needs.

Flexibility

67 One more fundamental -- flexibility -- is not so well understood. We live in an unpredictable and constantly changing world. The trends in the world economy are beyond our control. We survive and prosper by anticipating dangers and foreseeing opportunities, by moving quickly away from one and towards the other. Fortunately, being small, we can also be nimble, able to shift directions and set a new course with our entire population before larger nations can do so.

68 Growth means change. The economy grows by restructuring, by finding new areas of activity, and by doing old activities in new and better ways. It grows by keeping up with new technology; by absorbing new techniques, and discarding obsolete modes of production; by shifting people and resources away from old declining sectors into new growing ones. None of this is possible without flexibility.

69 Flexibility is needed in all areas of the economy. Government policies need to be flexible, and adapt rapidly to new and unanticipated circumstances. Economic institutions such as wage structures need to be flexible, so that they can cope with good years as well as bad. Private enterprise must be flexible, able to adjust to changing markets and altered environments. The people must be flexible, willing to learn new skills, do new jobs, take up new challenges.

70 Without flexibility, we will never ride out storms and dangers. Because of the long years of prosperity, its importance has been somewhat neglected. Some examples of rigidities which have set in were given earlier. This tendency to rigidity must be constantly combated.

STRATEGIES

Resource Allocation

71 These fundamentals of policy are essential prerequisites for successful economic growth. Assuming these preconditions are met, whether growth takes place then depends on one basic factor: how resources are allocated in the economy.

72 An economy grows if the society sets aside resources for productive investments, which increase the capacity of the economy to produce wealth. This is the way to build up our capital stock, turn over obsolete investments, keep up with advances in technology, and continue to restructure our economy.

73 To do so, income must be saved, and not completely consumed, because investments have to be

financed out of savings, or else by borrowing from abroad. At the same time, investments have to be productive. They must yield a good return. Unproductive investments generate no growth; they merely waste resources.

74 From this point of view, there are three requirements for economic development: a high national savings rate, maximum opportunities for productive investment, and correct selection of investment projects to commit resources to. The strategies outlined below are meant to achieve these goals.

Maintain a High Savings Rate

75 Singapore has a high national savings rate because both the private and public sector are net savers. In other words, each household and each firm puts aside some of its income, and at the same time the government and the statutory boards run surpluses instead of deficits. In contrast, in the US, households spend nearly all (97%) of their disposable income, and the federal government is in chronic deficit, so that few resources are left over for investment. In Japan, households are very high savers. The government usually runs a deficit, but enough resources remain for Japan to have one of the highest rates of capital formation in the world. Nevertheless, the government deficit leads to a troublesome accumulation of public debt, which must eventually be repaid out of tax revenues. Compared to the two countries in these areas, our position is much better.

76 Thus while it is necessary temporarily to lower our savings rate in this recession, in the longer term we must remain a high savings economy. In fact, even with the CPF and tax cuts recommended, Singapore's savings rate will still be high by world standards. This means in the long term the public sector should continue to run moderate surpluses, and private savings too should continue to be encouraged. It is because we have put aside savings in high growth years that we have some leeway to manoeuvre in coping with the recession.

77 Given time for the economy to make the necessary adjustments, savings can exceed investments, as is the case in Japan, without contracting the economy. The Japanese manage this by running a balance of payments surplus. The excess of savings over investments appears as an export surplus. With the foreign exchange thus accumulated, the Japanese are investing overseas, either in financial assets or in physical investments, giving them a further income stream, and adding to their GNP.

78 It is difficult for us to expand our exports quickly to deal with this recession, but there is no reason why we should not eventually run an export surplus and become a net capital exporter. This is why GNP rather than GDP should be our measure of success.

Create a Conducive Business Environment

79 The best way to create opportunities for productive investments is to ensure a conducive business environment. This Report has already identified such an environment as an essential edge we must have over the developed countries. For purposes of investment promotion, this is much more important than any special tax concessions or training grants which EDB may offer investors. A conducive environment comprises several ingredients.

80 **Competitive Costs.** The costs of doing business in Singapore must not be higher than operating costs in other competitive locations. Wages must be competitive, rentals must be affordable, utilities and statutory board charges must not be out of line.

81 **Low Taxes.** Taxes too are a significant component of business costs. The most important taxes in this context are income taxes, on both corporate and personal income, and property tax. It is the after tax income which determines whether an investment is worthwhile. To be competitive, we should try to bring our tax rates down across-the-board, as far as our revenue needs permit.

82 An alternative to low across-the-board tax rates is to have higher tax rates, but to give discretionary tax concessions to particularly desirable companies. This is to some extent the present system, with corporate tax set at 40%, but with companies which meet certain criteria enjoying pioneer status, which means 5 to 10 years of zero tax. If we accept that the government should as far as possible not back specific companies, but should leave the private sector to decide what projects to invest in and which areas to go into, then it must follow that across the board low rates are preferable. We should move in this direction, even if for practical reasons we may be unable to abandon selective tax incentives completely.

83 **Friendly Regulations.** A conducive environment does not mean anarchic freedom for businesses to do

as they please. Regulations and controls are necessary to maintain the rules and preserve order. However, these regulations must be the minimum necessary to prevent abuse and sharp practice. They should not grow into an impenetrable thicket of restrictions, each one well meaning, but taken as a whole making it difficult for existing enterprises to thrive and impossible for new ones to take off. Given the tendency of regulations to accumulate in every bureaucracy, however efficient and well-intentioned, some way to monitor the regulatory environment and clear the undergrowth from time to time will be necessary.

84 **Good Work Attitudes.** Cooperative and cordial labour management relations enable energies to be channeled constructively into production and growth, rather than destructively into conflict and confrontation. To investors, absence of industrial strife, and mutual trust and confidence with workers, whether unionized or not, is worth a great deal.

85 Another element of good work attitudes is the willingness to be flexible in meeting job requirements. In this respect we have to try to develop a significant edge over more advanced countries. As people in the developed countries reach higher standards of living, non-material desires grow more important. Leisure becomes more precious than extra income. People prefer to work fewer hours a week. They avoid jobs which require them to work unsocial hours, such as third shifts. As a result, businesses have to leave expensive machinery idle, and earn lower returns.

86 These may be rational preferences for them, but for us they represent an opportunity, provided we can forgo the same desires. If our workers and managers are prepared to work 44 hours a week, instead of 38; if we are willing to do third shift duties, and keep plants open 24 hours a day, then Singapore will have something special to offer an investor.

Depend on the Private Sector

87 While Singapore has always been a free enterprise economy, the free enterprise has not all come from the private sector. The government, through government-owned companies, has directly invested in some sectors of the economy - SIA, DBS Bank, defence industries. By and large, these companies have thrived and prospered, in fair competition with the private sector. They have contributed significantly to the growth of the economy.

88 However, now that the companies have succeeded, the government should have no parochial interest in them. Provided they continue to be profitable, well-run companies, it makes no difference to Singapore whether they are owned and managed by the government or by the private sector. To the government, the advantage of selling off these companies, for a fair price, will be that civil servants can be freed to concentrate on their primary jobs of administering the country, instead of diverting their energies to running the companies. It will also put an end to complaints from the private sector about special treatment and unfair competition, which will arise no matter how correctly the government companies are dealt with. The government intention to divest itself of these companies is therefore a wise one.

89 The wider question is the extent of the government's role in promoting economic development. Should it go beyond the traditional functions of a **laissez faire** government, providing defence and law and order? Certainly it should also provide infrastructure for businesses and education for the people. It also needs to promote general areas of economic activity, for example by pushing the productivity movement to improve work attitudes, or identifying services as a promising growth sector to support. But should it start individual businesses, using public funds, which it feels are necessary to complement the economy? Should it try to identify winners to support?

90 The Economic Committee's view is that it should no longer do so, except where there are special reasons, such as national security, to act. Existing government companies broke new ground when they were established, in unfamiliar areas where the private sector had no expertise. The economy was small, and there were many such opportunities for starting businesses. Nobody else was in a position to take them up, but the government could see them, and had the resources to develop them. The government was therefore justified in building up the Temasek, Sheng-Li, and MND companies as it did.

91 Circumstances have now changed. The economy is larger, and the private sector is more developed. If there is an opportunity to start an enterprise, someone in the private sector will do so. If nobody does, it is probably because the possibility has been looked at and found unattractive. If the government is to step in where the private sector has turned away, it needs to know something which the private sector does not. But the

government is unlikely to have the detailed and omniscient grasp of all sectors to identify which project to put money on, even if it knows which general areas should be promoted. New investments, and with them the impetus for growth, have to be the responsibility of the private sector.

92 The government plays a major role in providing a conducive business environment, and creating investment opportunities. But exploiting these opportunities and identifying the best ones to take up must be left to the private sector. This does not rule out the possibility of the government taking part share of a risky private sector project, to help to spread the risk and finance the investment. Nor does it mean that the private sector will never make mistakes or miss opportunities. From time to time, these are bound to happen. But leaving it to them, rather than deciding everything centrally within the government bureaucracy, is a more flexible way to match up our resources and our opportunities. They have to spot the next wave, leap for it, and carry the economy along with it.

Promote Offshore Activities

93 The need to promote regional operational headquarters and to export offshore services has already been discussed. These activities are especially sensitive to the tax regime, as they involve remittance of funds from overseas. If such remittances are heavily taxed, not only will the funds simply be parked overseas, but the activities themselves will follow. It is therefore crucial for us to change our tax rules to encourage such transfers, and develop these new areas of growth.

94 While we need to encourage remittances of funds to Singapore, we also need to become exporters of capital. If we seek investment opportunities only within the Singapore economy, the scope will be large but ultimately limited. The limit is set by how many new activities the economy can absorb, whether it is worthwhile displacing existing investments which are still yielding returns in favour of new ones, and how quickly the society can accommodate the changes which accompany economic development.

95 But the limit also depends on how many productive investment opportunities we can create. This is why foreign investments in Singapore are crucial to us. They create opportunities which we would not otherwise have. It is not so much the money they bring to Singapore which matters. Economic development in Singapore has never been constrained by lack of investible funds. What matters is the knowhow, the technology, the markets which foreign investors bring. Without these, we may have the funds, but we would still be unable to invest them productively.

96 After having done our utmost to create new investment opportunities in Singapore, we may still not be able to invest all our savings domestically. In the short term, this creates the problem of oversaving. The longer-term solution is for us to invest abroad, and exploit opportunities not in one country, but in many.

97 In a way, the Singapore economy is already doing this. The foreign exchange reserves managed by MAS are our investments abroad. It is not possible for most individuals or even many companies to invest directly overseas, or manage funds abroad, although one important class of companies must do so -- the regional operational headquarters. Nor is that necessary. Indirectly, the banking system can do that for them. The net effect is the same -- we will become exporters of capital.

Nurture both MNCs and Local Companies

98 The role of Multinational Corporation (MNCs) in our economic growth is well recognized. They have brought with them capital, technology, management expertise, and markets, and provided well-paying jobs for our people. This is true as much in services as in manufacturing.

99 MNCs will continue to be vital to us. But even if we pursue an MNC strategy, we will still need good local companies. MNCs need a capable and reliable complement of supporting industries to function. They cannot economically do everything on their own. These industries must be local companies.

100 Local companies are also important in their own right. They account for 30% of our domestic exports. They predominate in the commerce sector. They also reflect our ability to look for new opportunities and embark on fresh ventures ourselves, rather than simply be employees in other people's ventures. In a downturn, local exporters scramble harder and look further for markets than MNCs, who may cut back production because demand for their products in other markets is already met by subsidiaries there.

101 Local companies must therefore be an important part of a mature structure of firms. They must be a healthy, self-reliant component of our economy, contributing their fair share to GNP. They may need some help to reach this state. But we should not only worry about the existing local companies. We should also be concerned with the continued germination and growth of new companies, i.e. entrepreneurship to assure us of a vibrant local sector. This Report therefore recommends specific measures to assist local companies and to promote entrepreneurship in Singapore.

SPECIFIC POLICIES

102 The Report makes many detailed recommendations for changes in specific policies, and identifies many possible areas of growth. Four of its recommendations are of greater importance than the rest: wage reform, tax reform, upgrading of business efficiency and productivity, and promotion of services. These are discussed below, except for promotion of services, which is covered in the next section.

Wage Reform

103 The shortcomings of our existing wage system have been widely debated, and are generally acknowledged: steep and long timescales, fixed payments, over-reliance on National Wages Council recommendations. Reform is urgent, if we are not to run into the same problems again. Granted that the changes are difficult to make, and will take time, it is all the more necessary to start soon.

Tax Reform

104 If the government is not to go into business itself, nor to rely on selective case-by-case administrative measures to manage the economy, then the most important means left to influence its course is to use taxation.

105 Tax policy must support the fiscal and economic development policies of the government. Tax changes are therefore necessary, to improve the business environment, promote offshore activities, and encourage entrepreneurship. Their details are complex, but the principles are clear. We should move away from corporate and personal income taxes as a major source of revenue, replacing them with indirect taxes to make up the revenue loss. Where tax changes are used to promote enterprise, broad incentives are preferred to individual special schemes. While tax rules should not be used as a hidden form of subsidy, neither should taxes lie so heavily on a particular sector that otherwise viable business is choked off.

Business Efficiency and Productivity

106 Raising productivity has always been an important focus of economic restructuring. If wages are not to rise faster than productivity in future, it becomes even more crucial that poor productivity performance should not hold back our standard of living.

107 We have made some progress promoting productivity consciousness amongst our workforce. It is a basic requirement for upgrading, because an uncooperative labour force can so easily nullify any effort by management to raise output and streamline operations.

108 However, productivity consciousness alone is not enough. Given good work attitudes, a larger influence on the performance of a firm is the competence of its management. This is not a problem with large firms, particularly MNCs, which have modern managements. However, it is a problem for many smaller local firms. We should therefore move beyond promoting worker productivity, to upgrading management productivity, or the overall business efficiency of firms. Success in doing so will yield large returns, and help workers in these firms to earn the wages which they deserve.

REVIEW OF SECTORS

Services

109 Our greatest potential for growth lies in the areas of banking and finance, transport and communications, and international services. They have been growing rapidly, and given positive support, should continue to do so. The government must promote services actively, the same way it successfully

promoted manufacturing. It should depend not only on the growth of local Singapore companies, but also on attracting international service corporations to set up in Singapore. The EDB should be given the task of attracting such companies, in coordination with the respective ministries and statutory boards responsible for individual professions and sectors. MTI should be given overall responsibility for promoting services. Suitable incentives, including taxation of income from international services at a lower rate, will speed the shift towards a service economy.

Manufacturing

110 Though manufacturing will grow more slowly, it must remain a core component of our economy. The depressed industries will need time to restructure. Meanwhile, EDB should aggressively increase its efforts to bring home new manufacturing investments. While existing plants have to upgrade their operations, manufacturing productivity is increased even more by the introduction of new high quality investments.

Commerce

111 This is the sector with the most urgent need to raise productivity. Value added per worker in many firms, particularly local retail businesses, is generally low, and unless the firms make a determined effort to upgrade themselves, many will have difficulty continuing. The success of some companies who have introduced modern management shows that the task, though difficult, is not impossible.

Construction

112 Given the state of the property market, it is unlikely that construction will show significant growth over the next few years. A period of consolidation is inevitable.

CONCLUSION

113 Our future growth will depend on our ability to find and exploit new opportunities. This Report identifies a few major areas, for example in international services and banking and finance. However, it is impossible to forecast all the developments which will take place in the next ten years. Therefore more important to Singapore than any static list of niches is the ability to spot new trends and growth opportunities as they emerge. How well we do so will determine how successfully we prosper.

114 If we deal with the present recession correctly, we should be well-placed to grow from a stronger and more secure foundation when the recession is over. Thereafter, barring a major global recession, our growth rate will depend on how quickly we can upgrade ourselves. Through higher productivity, larger capital investments and improved business efficiency, we should be able to grow about 4-6% p.a. over the next ten years.

115 This is lower than the 8.5% p.a. average growth in the first half of the Eighties. Slower growth implies that we must lower our expectations. In particular, wage increases, even in the long-run, cannot exceed the expected productivity growth of 3-4% p.a. This may not seem impressive, but it will require sustained effort. If we can maintain it, by the 1990s, we will become a developed country.