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FACING ECONOMIC ADVERSITY: Between Tactical and Strategic Response

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The current global financial crisis is occurring as Singapore approaches its second centennial. While the Republic has gone through several crises before, what helps it to face them with fortitude and resilience is the ability to distinguish between tactical and strategic responses to major economic storms.

TODAY THE financial excesses of subprime loans in the United States have turned into a full-blown global economic meltdown, threatening to undermine world trade through a credit crisis. For the first time in recent memory, banks are refusing to lend to each other. Without the lubricant of finance, trade will grind to a halt, and with it the real economy.

Small city states like Singapore with open economies will feel the impact most. Facing economic adversity with fortitude and resilience is the story of Singapore since its founding in 1819 by Sir Stamford Raffles. Then a junior employee of the British East India Company, Raffles outflanked Dutch attempts to monopolise trade by establishing a colony on the “little red dot” of Singapore.

Though its position was strategic, it was the trade philosophy that mattered. The British out of necessity believed in free trade. The Dutch were more mercantilist. As they governed the 17,000 islands of the Dutch East Indies, they thought it feasible to establish a closed continental-sized market.

Unchanging realities

When I joined the Singapore Administrative Service in 1959 I inherited a steel cabinet full of economic policy files. I found the exchange of correspondence between the British economic advisor in Singapore and his Dutch counterpart in Batavia fascinating. They were poles apart in their approach to trade. Singapore favoured free trade. The Dutch, acting from a position of strength, were mercantilist. In the ongoing ASEAN economic negotiations, the basic positions of Singapore and Indonesia have not really changed.

Singapore in 2009 is just ten years away from celebrating our second centennial. In these 200 years,

we have faced economic adversity with fortitude and resilience. Though we have emerged bruised, we remain standing.

The first great economic event was the great depression of the early 1930s. The Malayan economy, of which Singapore was then a part, was the world's leading natural rubber producer. Rubber prices collapsed. British rubber plantation owners found themselves stuck with excess labour. There were too many rubber tappers to tap the quantity of rubber latex that could be sold. The colonial government established an immigration/emigration fund contributed by employers out of the wages of their tappers.

When the depression struck, the fund was used to meet the cost of repatriating the tappers back to southern India. Our current foreign work permit scheme is of the same genre. This policy gives us flexibility in riding the twists and turns of business cycles.

Population and Other Concerns

In this context, I read with some alarm that our resident population has increased by a million people or 25% in the last ten years. I have the gut feeling that this rate of population increase far exceeds our absorptive capacity. Until the current global economic crisis is over, we ought to think carefully the pace at which we can afford to grant permanent residence to foreigners.

The second great economic event was our political separation from Malaysia in August 1965. When we became an independent nation, even our friends wondered whether we could survive. We had merged with Malaya two years earlier in 1963 to form the Federation of Malaysia. We merged for more economic space. We were striving to form a Malaysian common market but this was denied us by the central Malaysian government in Kuala Lumpur.

Without a hinterland, we decided that our economic prosperity would have to depend on trade and compete with everybody else in the world. We removed all import tariffs. We exposed every Singaporean citizen and enterprise to competition. In effect, we became the world's first global economy.

In 1965, we and Hong Kong were the only developing economies welcoming foreign direct investments. We offered the world low cost literate labour and an infrastructure that worked. But what differentiated us most from other developing countries was that we had, and continue to have, an administration that delivered good governance, free of red tape and petty corruption.

By the mid 1970s, we were able to achieve full employment. As our educational standards rose, we attracted skill intensive and later knowledge based industries such as shipyards capable of building submersible oil rigs, petroleum and petrochemical refineries, pharmaceutical plants, fabricating wafers for computer chips, miniature ball bearings, color TV picture tubes, electronic control systems for cars, and other skill and knowledge intensive products.

In banking and finance, we are the world's fourth largest forex trading centre. We are also developing into an international education hub with two globally-ranked universities, six polytechnics, and a comprehensive school system teaching our young how to think, not just to learn.

As we enter the 21st century, we find that continental countries such as China and India with their vast and deep talent pools have embraced globalisation with gusto and conviction. In the 1960s, they were economic nationalists and dismissed foreign direct investments as a capitalist plot to exploit them. The BRIC (Brazil, Russia, India and China) countries are emerging as formidable low cost high technology countries.

The Perfect Storm

In 2009, the world including Singapore faces the perfect economic storm. Governments and economies can choose to respond in two ways. Singapore can respond either tactically or strategically.

In the great depression of the 1930s, the British colonial administration repatriated thousands of Indian rubber tappers back to southern India. It was a tactical response that was politically feasible because Britain was in charge of British India.

The most daunting economic challenge Singapore had faced was in 1965 when we became an independent country. The prospect of a Malaysian common market vanished with separation from Malaysia. Singapore responded with a bold strategic decision. Against all traditional economic logic, we removed all import tariffs, and freed up exchange controls. We did this out of sheer necessity as there was no way that we could construct a domestic market out of our miniscule size.

Our bets paid off. By offering an honest administration and good governance, we were able to attract multinational manufacturing companies and international banks to establish their regional headquarters in Singapore.

Yet recession struck us after 20 years of success in 1985. It was a recession of our own making. We discovered that our high wage policy introduced in the late 1970s to curb excessive turnover of labour, known as job hopping, was way overdone. High wage costs and an overvalued currency, like a pair of scissors, sliced away our international competitiveness.

The Government decided to reduce employers' Central Provident Fund contribution rate from 25% of basic wages to 10%. The CPF cut was effectively a 15% reduction in the wage bill for the employer. The CPF Scheme was introduced in 1955 by the British colonial administration to provide savings for old age with equal contributions from the employee and the employer, initially set at modest levels of 3% from each side. As our per capita GDP rose, the government increased the CPF contribution rates to enable the Singaporean to buy his own low-cost HDB flat. Public housing in Singapore is financed entirely from CPF savings.

When we realised in 1985 that a 25% employer's rate of contribution was excessive, causing us to be overpriced in world markets, our 15% cut in the employer's contribution rate to 10% proved enough to restore our competitiveness. Within 18 months our economy recovered its poise and grew again.

Jobs Credit a tactical, not strategic response

The lesson that I learnt from the 1985 recession is that our response to any economic crisis should be strategic. By reducing the employers' CPF contribution rate to 10% across the board, we ignited the dynamics to restructure and transform the whole economy. It was not targeted at saving individual jobs or particular industries.

True there were retrenchments but the jobs lost were no longer internationally competitive with or without the CPF cuts. New businesses moved into Singapore. Today our industrial structure is stronger than what it was in 1985. There is more knowledge content in our industries and services. Rising value added sustained higher wages.

The jobs credit scheme in the current stimulus programme is a tactical, not a strategic response to the threat of massive unemployment. By stipulating that an employer can draw on the jobs credit only if he keeps his existing employee in the job, we are in danger of freezing our industrial and business structure into a time warp of redundancy.

As in 1985, I would much prefer that we reduce the employers' CPF contribution rate by 9% equal to

the value of the jobs credit. This would give the employer more flexibility to restructure and transform his enterprise and business. Those who cannot would naturally fall by the way side. This is better than giving uncompetitive enterprises a short reprieve through the jobs credit.

A CPF cut would also apply to the public service and its statutory boards. This would level the playing field for all employers and enterprises. It is not a healthy omen that our young graduates are all rushing to join the public rather than the private sector, unlike the recent past.

Strategic Policies More Enduring

My contention is that that the Singapore Government has to respond to this perfect economic storm with strategic rather than tactical policies. The effects of tactical policies are transitory. Strategic policies pay better dividends in the long term. They are harder to execute. But they endure even in political terms.

Our Minister Mentor has in past economic crises reminded Singaporeans that the world does not owe us a living. This rallied our people who time and again have elected the PAP to be the government.

A final point I would like to make is this: the pivotal role of our foreign reserves is to back the currency. Being a small and vulnerable economy, the convertibility of the Singapore dollar is our lifeline. Using our reserves for “rainy days” is a tactical, not a strategic response to the global economic crisis. Our core reserves should only be used in extremis when we are besieged by wars and conflicts.

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