

ETHOS



Civil Service College
Singapore



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EDITORIAL

There is still some debate about where culpability for the economic crisis should lie, and whether it could have been prevented at all, as recent writings by Paul Krugman and Martin Wolf contend (page 11). Buoyed by years of seemingly illimitable growth, corporate and public institutions in highly sophisticated economies pursued aggressive policies based—as it turned out—on risky, unsupported and less than prudent assumptions about the future. For this failed gamble, the world is still paying a price whose final sum has yet to be fully determined.

Equally striking are the signs of danger which were already evident before the storm. In the general exuberance leading up to the crisis, cautionary voices such as economists Nouriel Roubini and Raghuram Rajan were roundly ignored—they have since turned out to be mostly right. ETHOS, marking the 10th anniversary of the Asian Financial Crisis in October 2007, noted familiar structural weaknesses in financial practice and regulation in the US sub-prime loan crunch—a precursor to the full-blown economic pandemic to come. Yet there was an unspoken belief among sophisticated Western economies that they could not possibly fall as

thoroughly or as quickly as those in the developing world. Where it occurred, this institutional inability to imagine, anticipate and plan for a volatile future with unintended consequences surely amounts to a profound failure of governance.

Ironically, the downturns of the late 1990s and early 2000s may have stiffened the economic resilience of some countries. In the case of Singapore, they led to the development of new policy approaches and operational capacities such as the Workfare Income Supplement scheme and the Finance Ministry's countercyclical fiscal strategies. These policy instruments and capabilities—along with decisive new measures announced in the 2009 Budget—have become invaluable assets in the fight to mitigate the economic tsunami's negative effects (page 20), to which an open economy like Singapore's is particularly vulnerable.

Viewing the crisis through the lens of economic history, Bradford DeLong (page 27) suggests that while the US will still recover from the recession as the world's economic hyperpower, it ought to put in place institutions and policies in preparation for a world in which other giants will eventually dominate. Indeed,

the Ministry of Trade and Industry's Economics and Strategy Division has considered several ways in which the global economy might evolve after the crisis abates (page 48).

Singapore has a confident chance of tiding over the economic tsunami relatively intact. But it would serve us well to start looking at new opportunities which might have opened up since the crisis. Prices and rents have declined; labour has become more available, and more willing to try new ventures. Some market barriers to entry have been reduced. Smaller local enterprises—particularly those which have been prudent in recent years—may find new breathing space to grow. New industries, such as green tech, may be on the rise as traditional sectors shift priorities. It is possible that public investment in fresh fields, at relatively lower cost and with the added benefit of economic stimulus in a downturn, may reap enduring dividends in the post-crisis future.

Significantly, this is already the counter-crisis strategy of some developing nations, who remain cautiously optimistic at a time where most of the world's advanced nations are devoting tremendous resources to economic firefighting. Relatively unscathed economies such as Oman and Brunei, having husbanded their resources during the boom years of

high oil prices, have stepped up the diversification of their economies, markets and asset base. Once the recovery takes hold, they aim to be better poised than the competition (page 31).

Times of crisis test the mettle of the public service, and none more so than a crisis which has so dramatically restored the public sector to a place of leadership and prominence in economic life. It is perhaps fitting that we begin this issue of ETHOS with veteran public servant Peter Shergold, who highlights five key qualities that civil servants need to meet national challenges—and national expectations—in difficult times (page 5). We close with Bryan Caplan's insights into Singapore's policy-making environment where necessary but tough policies are carried time and again through the democratic mill (page 65).

I wish you, as always, a productive read.

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Peter Shergold

Leadership at a Time of Crisis

Five key qualities are demanded of civil servants at a time of crisis, argues Professor Peter Shergold, a distinguished public service veteran and Senior Visiting Fellow at the Civil Service College.

For civil servants, crises come in various guises. Often they are political, born of the heady swirl of public policy debate, governance and individual intrigue played out in the harsh glare of the media spotlight. Sometimes they take the form of cyclones or hurricanes, raging forest fires or rising floods. Unfortunately, in the modern era, crises can also come unexpectedly and brutally in the form of a terrorist attack.

To a significant extent, public

perceptions of the capability of governments, and of the capacity of the civil servants who support them, are forged in the crucible of disaster. The faltering response to Hurricane Katrina, as much as an unpopular war in Iraq, undermined support for the presidency of George W. Bush.

On occasion, crises are more profound and long-term in their nature. The global financial collapse, and the worldwide economic recession that has followed, represents just such a moment.

For Singapore, whose extraordinary prosperity has been founded on globalisation, the implications are particularly confronting. As Singapore's export markets plummet, and property prices plummet, the challenges to government will increase. The repatriation of large numbers of overseas workers will afford some protection, but there can be no doubt that unemployment will rise and the pressure on social services increase.

Economic downturn—of a dimension, depth and length that was unforeseen—will call for new responses. Around the world, it will be a testing time for governments and for the civil servants who serve them. It will demand public administrations with innovative ideas, responsive to new directions and committed to their effective implementation.

What are the qualities of leadership that will be called for at such a time? My reflections are informed, in part, by my readings; in large measure, they reflect my own experience during the five years I was the Secretary of the Department of the Prime Minister and Cabinet in Canberra, and in particular my involvement in the Australian government's response to the Asian tsunami, the Bali and Jakarta bombings and Queensland's Cyclone Larry.

DEALING WITH CRISIS: FIVE ESSENTIAL QUALITIES

As I look back on such events, I have come

to identify five essential qualities that are required of civil servants at a time of crisis. Some were clear at the time, while others have become apparent to me only with the wisdom of hindsight. A number of these characteristics I have already written about.¹⁻⁹ Others were articulated for the first time in a leadership chat held as part of the Governance and Leadership Programme¹⁰ dialogue during my visit to the Singapore Civil Service College. My views have been informed and modified by the comments and questions that arose in that engaging encounter.

The first quality is **collegiality**. The great challenges of contemporary public policy—from the immediacy of economic crisis to the prospect of long-term environmental catastrophe—inevitably cross the constrictive structures of government administration. Indeed a hallmark of the response to crisis is the need to ensure that central, line and operational agencies are working harmoniously. Bureaucratic territoriality reduces timeliness, complicates process and weakens collective ownership of decisions.

Collegiality is a culture
of cooperative creativity,
not an excuse for
drawn-out process.

Of course, the qualities of teamwork (empathic listening, treating all participants with respect and ensuring that a diversity of views and perspectives are considered) can actually serve to impede the decisive action called for at a time of crisis. This must be avoided. Speed is essential. The goal is to work openly together, across horizontal demarcations, in the search for the best whole-of-government outcomes.

Teamwork, especially when it is underpinned by the adrenaline that accompanies crisis, can generate innovation. While shared experience can ensure that past mistakes are not repeated, its primary purpose is to identify new approaches for the future. That is where the structured interplay of different ideas can prove its worth. A cross-government, team-based approach should produce outcomes greater than the sum of its organisational parts. Collegiality is a culture of cooperative creativity, not an excuse for drawn-out process.

Execution is the second essential leadership quality required of civil servants. Once government has made its decisions, it is the job of its public administrators to deliver them with vigour and commitment. A brilliant policy, poorly executed, is probably far more damaging to governments

than having no policy at all. That is why I placed much greater emphasis on project management skills when I led the Australian Public Service. It is also the reason I set up a Cabinet Implementation Unit in the Prime Minister's Department to oversee and report on the manner in which policy decisions were being delivered.

The ever-present danger is that new approaches are embraced and then discarded before they have had sufficient chance to work.

The third leadership quality on which I set high store is **persistence**. Ministers love to announce new initiatives. Civil servants enjoy mastering the latest acronyms. Training courses like to exhibit their cutting-edge credentials by showing familiarity with the latest mantras of management gurus.

There is nothing inherently wrong with any of this. Better to have civil servants understand that ongoing organisational change and political ambiguity is an inherent feature of their working environment than to have them believe that the goal of "best practice" can be reached and turned into a comforting status quo—especially at a time of crisis, the dimensions and directions of which are never precisely known.

The ever-present danger, however, is that new approaches are embraced and then discarded before they have had sufficient chance to work.

The good civil servant has the resilience to overcome administrative obstacles and to extract every last dollar of value from the policy hand they have been given to play. Persistence in the face of adversity is a quality that serves leaders particularly well at a time when the exigencies of crisis management twist and turn the normal processes of government. Thought and planning need to be balanced with action and implementation. Civil service is as much perspiration as inspiration.

A fourth quality, and one whose significance I have only slowly come to appreciate, is **authenticity**. During the two decades I was an Australian “mandarin”, the role changed significantly. The quasi-monopoly which characterised the working relationship between Secretaries (or Director-Generals) and their Ministers a generation ago has been transformed. The Westminster tradition has been made over. Ministers now appoint their own politically-sympathetic advisors. The lobbying of industry, unions and professional organisations has become more skilled. Not-for-profit organisations are now more important as contracted deliverers of government

services, a development which (on balance) has probably increased the persuasiveness of their advocacy. Policy think-tanks have emerged. In short, the making and outsourcing of public policy implementation has become increasingly competitive.

The civil service requires leaders who have the good sense and emotional intelligence to bring their complete self to the development and delivery of public policy.

Exciting opportunities are presented by the emergence of “network governance”. Civil servants need to collaborate with a growing array of state actors. They need to be able to negotiate, with goodwill, in an environment of asymmetrical power (for the civil service remains a centrally positioned, well-resourced and highly influential player). The situation demands well-honed communication and facilitation skills, leaders who are able and willing to manage relationships rather than simply ensure compliance with contracts.

I now appreciate that collaborative leadership requires something more. Extolling the values of work-life balance, I failed to recognise adequately the

important relationship between the two spheres and the manner in which it could define the quality of personal leadership. Civil servants have whole lives: they are parents and community volunteers, with wide-ranging hobbies, interests and enthusiasms. They are an integral part of the networks that create civil society.

Far too often the experience that they have gained outside the civil service workplace is inadequately applied to their management behaviours within it. The value of “life” goes unrecognised even by themselves. Many times have I seen civil servants talk about the rising cost of aged care, the inadequate provision of mental health services or the morale-sapping impact of unemployment without ever explicitly recognising the real-world knowledge that they have of these issues. My view is that when the going gets tough, authenticity is vital. The civil service requires leaders who have the good sense and the emotional intelligence to bring their complete self to the development and delivery of public policy. Evidence-based decision-making is not just a matter of book learning, Internet searching or formal training. It means using one’s own life to imagine standing in the shoes of others.

Finally, the civil service requires leaders who want to be civil servants. **Pride in vocation** is important. It means

understanding (and conveying to others) the value of maintaining traditional values within high-performing public administrations. Crises are nearly always accompanied by increased political pressure. At such times, there is a need to preserve values such as public accountability, the honesty and integrity of decision-making, appointments based upon merit and always acting with propriety within the law.

Civil service is a tough job. It is not easy to give advice fearlessly at a time of crisis when the political stakes are rising, or to deliver policy decisions uncomplainingly when that advice has not been accepted. It takes a clear understanding of the foundations of democratic government if one is to serve faithfully elected officials with whose views one might privately disagree.

The ability of civil service leaders to shape public policy comes at a personal cost. To a considerable extent, their influence is wielded behind closed doors. Their public voice needs to be carefully modulated. It requires leaders able to serve successive ministers with equal dedication. For all these reasons, the civil service is not a job for everyone.

Yet, at moments of crisis—when the articulation of national interest will often be contested, but when the failure to act decisively will always prove fatal—civil service has its distinctive

rewards. It is a job that has meaning and purpose. It involves the provision of public value, not shareholder gain, with benefits delivered to citizens, not consumers. How well it is done affects, to a lesser or greater extent, the future well-being of society. At a time of crisis, the burdens of responsibility are heavy but the opportunities for satisfaction are greater still.



Peter Shergold is the Macquarie Group Foundation Professor at the Centre for Social Impact in Australia. From 1988 to 2008, he was a senior public servant in the Australian Public Service, including being the Secretary of the Department of the Prime Minister and Cabinet from 2003 to 2008. He is also a Senior Visiting Fellow at the Civil Service College, Singapore.

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10. The Governance and Leadership Programme, organised by the Institute of Policy Development, Civil Service College, is an intensive milestone programme for officers who are already Directors or Heads-of-Departments. The objective of the Programme is to allow participants to gain a deeper insight to Singapore's fundamental realities and principles of governance and how they play an integral part in the formulation and implementation of public policies, including public consultation and policy communication. Participants discuss issues on public sector excellence, including leadership and management in the public service.



Book Review

He Ruimin

Krugman, Wolf and the Roots of the Financial Crisis

Author : Paul Krugman
Title : The Return of Depression Economics and the Crisis of 2008
Published by : New York, NY: W. W. Norton, 2008

Author : Martin Wolf
Title : Fixing Global Finance
Published by : Baltimore, MD: Johns Hopkins University Press, 2008

Two heavyweight observers of global economics have weighed in with their views on the global financial crisis. Amid a rash of books seeking to contextualise, describe, and offer solutions to the current economic tsunami, the recent tomes of Nobel Laureate Paul Krugman and respected commentator Martin Wolf offer two refreshing yet differing insights on the most pressing economic dilemma of present times.¹

Both Krugman and Wolf are economics professors who bring a sound understanding of economic theory into their analyses. Both comment on economics for major newspapers—Krugman for the *New York Times*, and Wolf for the *Financial Times*. However, the transatlantic difference shows. Krugman has penned a macroeconomics

primer suitable for those without deep training. Informal, lucid and free of academic footnotes, *The Return of Depression Economics* employs simple metaphors such as the “Baby-sitting Coop” analogy to explain recessions and policy responses. In contrast, Wolf has put forward a decidedly more sombre and intellectually ambitious volume, based on a series of academic lectures, that requires more effort to take in but which ultimately provides a more sophisticated analysis of international capital flows.

CONTEXTUALISING THE CRISIS

Both Krugman and Wolf started working on their books before the onset of the current crisis: their books offer a broader perspective of recent economic history.

Krugman surveys a string of recent

financial crises, including Japan, South-east Asia, Britain, Sweden, Russia and Latin America, and argues that almost all of them can similarly be traced to asset booms, imperfect regulations, and moral hazards—which eventually led to over-borrowing and defaults. Wolf notes, the current crisis notwithstanding, that these problems have been especially prevalent in emerging markets, which tend to have weaker governance and macro-economic foundations.

Both authors observe that banking and currency crises have become more frequent since the 1970s, due to financial globalisation and the resultant upsurge in international capital flows. Wolf argues that there are limits to accountability, trust and safeguards when investing across borders. At any hint of a crisis, international investors are more likely than domestic financiers to pull their money out. Krugman describes why investors fleeing from a particular market are likely to simultaneously pull out from emerging markets altogether, thereby causing self-fulfilling contagion effects. Separately, Krugman also highlights the role of hedge funds in exacerbating crises through speculative attacks.

Krugman and Wolf also agree that financial crises translate into economic crises at great cost and with dire results. While the consequences would differ across countries, they are likely to

include unemployment, poverty, lost output, increased public debt, and some degree of social and political unrest. With more frequent economic shocks in future, my sense is that governments will have to learn to mitigate these social consequences in a cost-effective way.

Banking and currency crises have become more frequent since the 1970s, due to financial globalisation and the resultant upsurge in international capital flows.

HOW THE CRISIS CAME ABOUT

Both Krugman and Wolf note that low interest rates played a significant role in creating the housing asset bubble that triggered the current crisis. However, they attribute responsibility differently. Krugman puts the blame squarely on former Federal Reserve Chairman Alan Greenspan for his failure to raise interest rates in order to rein in irrational exuberance in the financial markets.

In contrast, Wolf takes a wider “Savings Glut” view that is consistent with the general thrust of his *Financial Times* columns. Wolf suggests that the current crisis is a consequence of previous emerging markets crises. The painful outcomes of these crises encouraged many emerging economies

to avoid borrowing, keep exchange rates down, sustain strong currency positions, and accumulate official reserves. These resulted in a global savings glut that the US, as borrower and spender of last resort, was compelled to absorb and consume. Under these circumstances, the US Federal Reserve had to pursue an expansionary monetary policy to generate adequate domestic demand in order to avoid deflation. Hence, the low interest rates.

There is general consensus on the subsequent mechanics of the crisis, which parallel previous market failures. Investment banks and other non-depository institutions engaged in hazardous securitisations that rendered the entire financial system vulnerable. Sub-prime lending, foreclosures and a credit crunch followed, while cross-border investments transmitted the crisis overseas.

WAS THE CRISIS INEVITABLE?

However, Krugman and Wolf disagree on the crisis' inevitability. Accusing government officials of malign neglect, Krugman argues that investment banks and other non-depository institutions could and should have been prevented, by government regulation, from engaging in such risky behaviour. Wolf takes a different view, arguing that risky

lending is an inevitable consequence of an expansion in credit as banks search for higher returns. Ironically, Wolf, British born and trained, largely absolves the US of blame for the current crisis. I tend to agree with Wolf. In boom times, it is extremely difficult for any central banker to detect and ease an asset bubble, particularly in a low inflationary environment.

To overcome the immediate recession, Krugman recommends getting credit flowing through internationally-coordinated recapitalisation and direct lending to the nonfinancial sector; complemented with Keynesian-style fiscal spending. Although Krugman's book was published in the early days of the current crisis, these remain sensible suggestions. Wolf has made similar recommendations in his columns. Countries like South Korea and China that have successfully eased credit and enacted fiscal stimulus have seen some positive results.

GLOBAL FINANCIAL REFORM

Krugman's and Wolf's differing viewpoints on the culpability of regulators and the inevitability of the crisis are not mutually exclusive. However, they lead to different priorities regarding the longer-term reform of the financial system.

If, as Krugman believes, the crisis

was partially caused by regulatory failure, then a new regulatory regime may be necessary. Krugman proposes that “anything that has to be rescued during a financial crisis, because it plays an essential role in the financial mechanism, should be regulated when there isn’t a crisis so that it doesn’t take excessive risks”. However, I am skeptical that this will ever work. The multinational nature of these financial institutions complicates regulation. Due to the multiplicity of interests present, international institutions like the International Monetary Fund (IMF) are comparatively better at treatment than prevention. While countries agreed to “closely coordinate” regulation at the April 2009 G-20 meetings, this falls well short of a viable replacement regime.

If, on the other hand, the current crisis is fundamentally a result of an unsustainable and undesirable global financial system, then regulatory reform alone is insufficient. (Krugman recognises the dangers of financial globalisation but does not offer solutions in his book.) Hence, while recognising the merits of financial regulation to mitigate inevitable crises, Wolf argues that these must be complemented by macroeconomic reforms. These include sound exchange rates, monetary, and fiscal policies within each country; and a restructuring of the IMF and other

international groupings globally. Wolf concludes that a better-balanced global flow of funds will occur only if emerging economies feel that it is safe to accept large net inflows of foreign capital. We are starting to see this shift. Given comments in March 2009 by Chinese Premier Wen Jiabao expressing “worry” over the safety of US Treasury holdings, it is clear that emerging countries have come to realise the potential downsides of parking the bulk of their current account surpluses in the US. In time, they will take these lessons to heart, and are likely to re-adjust their macroeconomic policies out of self-interest. This will lead to global rebalancing in the long run.

REMINDERS FOR SINGAPORE

The perspectives found in Krugman’s and Wolf’s books offer longer-term lessons for Singapore. Here, I discuss three of them.

First, currency and banking crises across the world are likely to recur with increasing frequency for some time to come. While they may not be global recessions, we can expect regional crises to spill over to tiny and connected Singapore. Singapore’s small domestic market and dependence on the global economy make it particularly susceptible to knock-on effects from such crises. This may lead to higher frequency fluctuations in our economic

performance. Policymakers must thus continue to look ahead, and respond early, decisively, and effectively to changes in the global environment, while remaining cognisant that their policies may inadvertently exacerbate the very fluctuations that they are attempting to smooth.

Second, in our drive to become a financial services hub, we have to maintain an active and forward-looking regulatory regime while avoiding over-regulation. Risk Assessment and Horizon Scanning (RAHS) methodologies, predominantly employed for security risks today, may yield insights for financial regulation. Tighter regulation of domestic financial institutions by other countries may also affect Singapore's attractiveness as a hub.

Policymakers must remain cognisant that their policies may inadvertently exacerbate the very fluctuations that they are attempting to smooth.

Third, while Singapore remains too small to generate sufficient domestic demand for our industries, the inability of the US to sustain current account deficits indefinitely suggests that we must constantly seek new export markets for our goods and services,

without neglecting existing ones. Our capital investments must also continue to be diversified across geographical and asset classes, particularly in view of the heightened risk of a depreciation of the American dollar. 

He Ruimin is a Research Economist in the Economics & Strategy Division, Ministry of Trade and Industry. A Naval Officer by training, he was formerly an Operations Officer on board the Singapore Navy frigate *RSS Intrepid*. He holds a PhD in Economics and a Bachelor's degree in Electrical Engineering and Science, both from the Massachusetts Institute of Technology. The views expressed in this article are his own.

NOTE

1. Krugman is the 2008 recipient of the Nobel Memorial Prize in Economic Science for his work on the new trade theory, and a Professor of Economics at Princeton. Wolf is a Professor of Economics at Nottingham.



Opinion

Manu Bhaskaran

It's Not Over Yet

A quick and painless recovery is unlikely, as delayed effects of the economic crisis kick in.

There is now growing optimism about economic prospects. We have seen economic news improving in recent weeks, not just in the US but in China and other parts of Asia as well. This has been complemented by signs that governments are making headway in getting their financial sectors back on track. In the US, “stress tests” have been carried out and produced results that were better than expected, implying that most major banks in the country can return to solvency with a manageable amount of capital raising. All this good news has sparked off a sizeable rebound in global equities. The question is—how sustainable are these improvements in the global economy and their subsequent stock market rallies?

UNDERLYING ECONOMIC CONDITIONS REMAIN FRAGILE

Despite some definite progress, my view is that there is still a lot more bad news to come.

First, the best economic lead indicators we have—those that predict what will happen to global economic activity in six to nine months—tell us that output will continue to fall for some time more. The Organisation for Economic Cooperation and Development has composite lead indicators for all the major economies of the ~~world~~^{world}; ~~significantly~~^{significantly} their indicators point to high risks of further downside for all the countries they look at, including China.

Second, the financial sectors of major economies such as the US and Europe remain in a parlous condition. Even with the gradual recovery in credit markets, financial sectors remain some distance away from re-starting their critical function of providing capital and liquidity on a sufficient scale to support economic growth. Vital parts of the financial resolution—re-capitalisation of the banking sector and disposal of bad assets—are progressing but only slowly.

Third, if economic activity is going to continue to fall and if financial sectors

have not returned to strength, then we are likely to see more financial stresses. As unemployment continues to rise in major economies and as cash flows in the business sector remain constrained, bad debts must rise. In the US, the outlook for commercial real estate looks particularly bad. The International Monetary Fund (IMF) has estimated that the global crisis will induce financial sector losses of US\$4.05 trillion in the US, Europe and Japan, of which only about a third has been recognised. Of this extraordinarily large amount, US\$2.7 trillion of losses are expected to be in the US ~~alone although~~ some economists are estimating US losses at US\$3.6 trillion. The scale of these likely losses throws some cold water on the optimistic findings of the US bank “stress tests”, suggesting that more financial stresses are likely as we move to the end of this year.

If emerging market risks rise, investors will become warier of Asian emerging markets, even if their fundamentals are better.

IMPLICATIONS FOR ASIA

In essence, the global recession is unfolding in such a way as to produce more shocks which could hurt Asia. One

area of concern is the emerging markets in Europe and the Middle East. Several countries in the Baltic region as well as south-eastern Europe are on the brink of a crisis. While timely intervention from the European Union and the IMF will probably help prevent a crisis on the scale of the Asian financial crisis, we are likely to see considerable financial stress in these economies. Since western European banks have been the major lenders to these economies, there will also be knock-on effects on the more developed countries of Europe. If emerging market risks rise, investors will become warier of Asian emerging markets as well, even if their fundamentals are better.

In addition, we should also expect delayed effects on the rest of the world, especially in developing countries. For instance:

- As the recession spreads, major importers of foreign workers such as Dubai, Taiwan and Malaysia are cutting back on visas for foreign workers. Consequently, remittances sent to families in countries such as India, Pakistan, the Philippines, Indonesia and Bangladesh are likely to fall in the later part of 2009. For Bangladesh and the Philippines, the consequences could be very worrying since remittances support around 10% of GDP.

- Another example of a lagged effect is the impact of falling commodity prices. Currently, many rural households have not cut back their spending very much because they still have savings from the commodity boom to live off, but this buffer is eroding quickly.
- Another example would be the effect of corporate sector adjustments to the slowdown—hotel and tour operators are cutting prices and so are pressing their workers and suppliers to cut wages and prices as well. In manufacturing, workers are being laid off; in China, Thailand, Indonesia and other countries where rural-urban migration is substantial, remittances from urban migrants to their families in the rural areas are likely to fall, causing rural demand to slow.

As the economy stabilises, the costs of policy responses to the crisis will become more evident.

LOOKING FORWARD: CAN THERE REALLY BE AN EASY EXIT FROM THIS CRISIS?

Several aspects of the current slowdown make a comfortable exit from the crisis more difficult.

First, unlike the downturns in 2001–2002 or 1990–1991, this is not a normal recession in the large economies. This recession is the product of a massive blow-out in the financial sector and is global in scale; hardly any reasonably sized economy is immune to its impact. Detailed studies of previous economic slowdowns show that those caused by such financial shocks take a much longer time to turn around.

Second, simply because of the sheer magnitude of the financial crisis we have faced, the policy responses have also been commensurately massive. The risks were so great that policymakers were prepared to take measures that go well beyond what they would normally consider to be prudent. As the economy stabilises though, the costs of these gigantic policy responses will become more evident. The deterioration in fiscal positions in major economies will be difficult to reverse. The monetary expansion has been of unprecedented scale as well—removing this monetary accommodation at the right time and pace will involve much skill. The risk of failure here is a surge in global inflation. If the US policymakers do not move as quickly as their counterparts, the implications for the US dollar would be very bad.

This means that, even as the global economy recovers, new risks will

emerge. For policymakers in Asia, the implications are clear—expect and be prepared for more shocks. 

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Jonathan Pflug

Extraordinary Times, Fundamental Principles:

The 2009 Budget and the Ministry of Finance's Approach to Countercyclical Economic Strategy

Four key principles anchor the bold anti-recessionary measures in Singapore's 2009 Budget.

On 22 January 2009—a month earlier than convention dictated—Singapore's Minister for Finance introduced an extraordinary Budget, designed to address “a time of grave economic crisis”.¹ In response to the gravity of the global financial crisis, the Government put forward a S\$20.5 billion Resilience Package. The size of the Budget—with the Basic Balance amounting to a deficit of 6% of

GDP—is unprecedented in the history of independent Singapore.²

SAVING JOBS, LOOSENING CREDIT: TWO EXTRAORDINARY MEASURES

Along with initiatives to help individuals and households, as well as direct Government spending to pump-prime the economy, Budget 2009 focuses primarily on helping Singapore's businesses weather the downturn

Two Extraordinary Measures

The **Jobs Credit scheme** provides businesses with a cash grant based on the wages of Singapore and Permanent Resident (PR) employees, set at 12% on up to the first S\$2,500 of wages per month. Structured as four quarterly payments, the payments are based on the preceding three months' wage bill but only for workers employed at the end of the period. Calculated using CPF contribution data, the scheme requires no additional application and paperwork on the recipient firms' part.

The **Special Risk-Sharing Initiative** (SRI) has two major components: a working capital scheme called the Bridging Loan Programme (BLP), where the Government shares 80% of the default risk on loans of up to S\$5 million; and a trade finance module, in which the Government shares 75% of the risk on trade financing across two programmes. In order to leverage on banks' relationships with businesses and their credit assessment expertise, the SRI operates in partnership with participating financial institutions.

brought about by the crisis, while building competitiveness for the long term. Underpinning the Government's assistance to businesses are two unique measures: the **Jobs Credit scheme**; and the **Special Risk-Sharing Initiative** (SRI).

As with any recession, preserving jobs remains a key Government priority. Prior to the Budget speech, Credit Suisse analysts estimated that up to 300,000 jobs might be lost during the downturn, with 100,000 of those jobs held by Singaporeans. In order to save jobs, the Jobs Credit scheme offers incentives for companies to retain existing workers and to employ new ones, where their business warrants.

Singaporean banks have remained well-capitalised and relatively unburdened by toxic assets. However, when we were looking at the issue at the time of the Budget, we saw that the credit contraction that began on Wall Street rapidly degenerated into systemic risk aversion across banks worldwide, including Singapore. In order to help viable companies receive the financing they need to stay afloat and grow, the SRI provides a suite of measures in which the Government takes on a significant share of the risks of bank lending.

DIFFERENT STRUCTURES, SHARED BASIC PRINCIPLES

Since the two measures target different objectives, they are structured quite differently.

The Jobs Credit scheme addresses the fundamental need to mitigate the effect of a sharp downturn by alleviating business costs through a fiscal injection. With the Jobs Credit scheme, the Government provides significant direct assistance to businesses, with no additional administrative burden on recipients.

In contrast, the SRI addresses the need to unfreeze credit chokepoints across diverse loan types, for diverse uses across the entire supply chain. As such, the SRI comprises a suite of credit measures intended to cover a whole range of business activities. Some of these measures could also be relatively complex and require close collaboration amongst financial institutions, recipient companies and the Government.

Nevertheless, both policies are based on common fundamental principles that reflect the Ministry of Finance (MOF)'s countercyclical economic strategy:

- **Act with impact:** Unprecedented circumstances require responses of unprecedented scale;
- **Act with a long-term view:** Achieve *balance* between short-term needs and long-term goals;
- **Act with efficiency:** Build on established infrastructure for *timely* intervention, with minimal administrative burden to participants;
- **Act in partnership:** Move cohesively with all *stakeholders*, public and private.

Act with impact:
Unprecedented circumstances require responses of unprecedented scale

The impact of the ongoing crisis is unprecedented in its swiftness and scale. The global financial system acted as a transmission mechanism for the psychological panic that followed the collapse of Lehman Brothers in September 2008, which then rapidly affected business operations in the real economy. At the same time, all the major regions of the world experienced economic decline simultaneously—making this the first truly global recession in the post-war period.

In view of these unique challenges, the scale of the new Budget measures had to be correspondingly bold. In formulating the Jobs Credit scheme and the SRI, the Government has decided to err on the side of impact instead of caution.

The 12% wage offset provided by the Jobs Credit scheme is generally equivalent to a 9-percentage point Central Provident Fund (CPF) contribution rate cut.³ When compared against the 14.5% prevailing employer contribution rate for most workers, this translates into a 62% reduction in the employer's share of CPF contributions.⁴ However, unlike CPF cuts, the Jobs Credit scheme does not undermine workers' retirement savings or their ability to service their mortgage payments through CPF. Never in the

past has the Singapore Government stepped in to replenish employees' CPF contributions in conjunction with a CPF cut to lower business costs. Since its introduction, the Jobs Credit scheme has generally been welcomed as a vital cash-flow boost.⁵

The Government needs to help companies find breathing space to ride out temporary dislocations in demand. At the same time, businesses must still have incentive to restructure and adapt to changing circumstances.

The SRI schemes also represent an unprecedented level of risk-sharing in terms of Government credit measures. With 80% risk-share on unsecured working capital loans of up to S\$5 million, the new Bridging Loan Programme under Budget 2009⁶ is the most generous Government loan scheme available that does not require any collateral. At the time, MOF also felt that 80% risk-sharing was as high as we could accommodate for a broad-based scheme while still aligning the banks' interests and objectives with ours.

Act with a long-term view:
Achieve balance between short-term needs and long-term goals

Economic crises lead to a reshuffling of the deck that creates an opening for

Singapore and Singaporean companies to improve our competitive positioning. In such an environment, the survival instinct prompts resilient businesses to review business models, improve products and explore new markets.

However, anti-recessionary business measures can be a double-edged sword. By intervening in the marketplace to limit the impact of any downturn, governments may also blunt necessary market adjustments.

Landmark measures such as the Jobs Credit scheme and the SRI must balance short-term needs and long-term goals. On the one hand, the Government needs to help companies find breathing space to ride out temporary dislocations in demand. At the same time, businesses must still have incentive to restructure and adapt to changing circumstances.

In order to achieve this subtle balance, it is vital for programmes of such generous scale to be temporary. Hence, the Jobs Credit scheme and the SRI have definite end dates articulated upfront, although there is a possibility of limited extensions. The Jobs Credit scheme has four payments over the course of one year. Loans can be issued under the SRI schemes within one year, while a four-year cap on the loans' tenure makes the initiative essentially self-terminating after five years.

Companies have shared anecdotes on how the Jobs Credit scheme has positively shaped their employment strategies for the downturn.⁷ Some companies who have been less affected by the downturn are even using the injection of funds to reinvest in future growth⁸—for instance, by hiring more staff, or investing in training and new equipment.

The time-limited nature of the SRI schemes may also have prompted participating banks to respond positively. In the first month since the SRI and other enhancements to Government credit schemes was launched, SPRING Singapore, our enterprise development agency, reported a record of 729 loan approvals under Government schemes, up from 411 in January and almost three times the monthly average in the previous year.

Act with efficiency:
Build on established infrastructure for timely intervention, with minimal administrative burden to participants

Given the suddenness of the downturn, the disruption to Singapore's economy would have been worse had the Government not acted decisively. Even prior to Budget 2009, the Government had launched major initiatives as early as November 2008 in response to acute and rapidly developing shocks to the economy.

The speedy implementation of the Jobs Credit and SRI schemes was made possible only by building on established processes and mechanisms, such as the CPF system, to minimise working lag time.

Given the suddenness of the downturn, the disruption to Singapore's economy would have been worse had the Government not acted decisively.

Given its goal of saving jobs by easing cash-flow constraints posed by the downturn, the Jobs Credit scheme had to be implemented in a manner that posed minimal administrative burden to recipients. MOF, in close collaboration with the Central Provident Fund Board (CPF Board) and the Inland Revenue Authority of Singapore (IRAS), used existing administrative data from CPF contribution and tax filings to compute and distribute Jobs Credit payouts. This avoided the need for burdensome declarations from companies.

We also had to sacrifice comprehensiveness for efficiency in some instances. For example, MOF decided not to use rental costs (in addition to wages) to calculate payment quantum to businesses, as we would then have to ask businesses to submit rental information.

Similarly, the SRI schemes had to be put in place quickly due to the prospect of an acute arrest in credit flow. MOF and the Ministry of Trade & Industry (MTI) harnessed the network of financial institutions and the existing government framework of smaller-scale credit schemes, allowing government agencies to launch the new credit programmes as early as six working days after the Budget speech.

**Act in partnership:
*Move cohesively with all stakeholders,
public and private***

A timely response need not also be reactionary. Due to the volatility of the situation, it was essential not to launch schemes on the scale of the Jobs Credit scheme and the SRI without careful assessment.

The complexity of the modern economy means any successful countercyclical strategy requires both whole-of-government collaboration and private sector buy-in. MOF's processes for involving relevant government agencies and the private sector in formulating the Budget are well institutionalised. These range from a defined work stream of developing, reviewing and fine-tuning the budgets of individual Ministries, to pre-Budget consultations with businessmen, subject experts, unionists and other key stakeholders in Singapore. The formulation of the Budget 2009

measures illustrates MOF's longstanding commitment to inclusiveness.

For instance, the need to ease business costs in an environment of declining revenues was a recurrent theme in pre-Budget dialogues. Similarly, the SRI is the product of intense engagement with the banking community and corporate representatives of the worst-affected sectors.

On the Government front, in formulating the policies, MOF worked very closely with the Ministry of Manpower (MOM) on the structural elements of the Jobs Credit scheme, and with MTI, SPRING and IE Singapore for the SRI.

The same cohesiveness has been reflected in the execution of the measures. Multiple government Ministries monitor the impact of the Budget 2009 measures, evaluate private sector feedback, and share policy-relevant information across agency boundaries.

The Minister for Finance has consistently reiterated that the success of both the Jobs Credit scheme and the SRI requires the private sector to collaborate with the Government to achieve the objectives that are in the best interest of all parties. The Government can take in feedback, set clearly defined policy objectives and commit substantial resources in support of the business sector. However, it does not have

control over hiring and retrenchment decisions of employers, nor does it have the expertise to evaluate commercial viability and credit worthiness of businesses across the whole of Singapore's diverse economy. For the Jobs Credit scheme and SRI to succeed, we need companies and financial institutions to respond positively.

CONCLUSION

These basic principles are not specific to anti-recessionary measures, nor are they unique to MOF or new to the Singapore Public Service. Indeed, they are defining characteristics of the public policy landscape in Singapore.

The two key Budget 2009 measures, although differing in many ways, are illustrative of how these principles are expressed and embodied in Singapore's major public policies.

However, to paraphrase Keynes, the injunction that "when the facts change, we change our minds" remains the most fundamental principle of all. Given the volatility of the economic environment, the Government must place a premium on flexibility and remain nimble in its responses. Should the needs of the Singaporean economy change, the Government will not hesitate to fine-tune—or, if necessary, overhaul—our strategies and policies, in order to advance the interests of Singaporeans and Singapore businesses.



Jonathan Pflug is an Associate for Economic Strategy in the Ministry of Finance. He is a member of both inter-agency teams responsible for formulating, implementing and monitoring the Jobs Credit scheme and the SRI.

NOTES

1. Budget 2009 speech. For more details, see <http://www.singaporebudget.gov.sg/>
2. Prior to 2009, the largest deficit on record was 3% of GDP in 2003, in response to the recession that followed the outbreak of the Severe Acute Respiratory Syndrome.
3. Based on internal MOF data
4. With the employer's CPF contribution standing at 14.5% of employee wages, a 9-percentage point CPF cut would lower employer contribution rates to 5.5%. This is a 62% reduction. The scale of this reduction is in line with those undertaken in response to the 1985 recession, when the employer's CPF contribution was lowered from 25% to 10% in the following year.
5. In a February 2009 post-Budget survey, the Singapore Chinese Chamber of Commerce and Industry (SCCCI) asked its 131 member associations which measures they considered to be most helpful. 78% of respondents cited the Jobs Credit scheme. See Teh Shi Ning, "Jobs Credit scheme most helpful: survey", *Business Times*, 19 March 2009.
6. Under Budget 2009, the new Bridging Loan Programme supplants an initiative of the same name, originally launched in November 2008, which provided a 50% risk-share on unsecured working capital loans of up to \$500,000. The Budget 2009 version of the programme surpasses the November initiative on every scale.
7. In terms of retaining jobs, multi-national corporations, like German chipmaker Infineon Technologies Asia-Pacific, have applauded the Jobs Credit scheme for easing the pressure off their labour costs. Meanwhile, Deloitte and Touche has cited the scheme as affirmation for its decision to hire 150 new graduates. Some other companies have also said that they would use the funds in different ways, such as investing in training and new equipment. See Alvin Foo and Robin Chan, "Cash grant helps wage bill", *The Straits Times*, 24 January 2009.
8. At a March 2009 tripartite dialogue with unionists, Mr Tan Peng Heng, President of the Singapore Industrial and Services Employees' Union, raised the example of an aerospace company that intends to use the wage bill savings to subsidise training. See Jeremy Au Yong, "How the Budget helped one company", *The Straits Times*, 25 February 2009.



Conversation with Bradford DeLong

Thinking Beyond the Crisis

In conversation with Ethos, noted economics historian and commentator Professor Bradford DeLong, traces the roots of the current crisis, and expresses confidence in the long-term resilience of the global economy.

In what way is the current global crisis similar to ones in the past, such as the Asian financial crisis of the nineties?

As in the Asian case, this financial crisis was triggered by what you might call “overinvestment” or “irrational exuberance”, the effects of which then become orders of magnitude greater than original problem.

The quantity of bad investments made in Thailand in 1993 to 1996 was quite small relative to the collapse in Asian financial values in 1997 and 1998. Similarly, the amount of bad subprime mortgage loans made in the US is at the most US\$1 trillion, and yet we have a US\$20- to US\$30-trillion collapse in global financial asset values as a result.

In 1997 to 1998, you had a slight collapse of the financial market’s risk tolerance and a flight to the safety of the US dollar. This meant that domestic central banks could do little to calm the markets or diminish the amount of risk held by the private sector. It took the International Monetary Fund (IMF) six months before it

recognised that it was faced with a crisis which didn’t originate in bad government policies, but instead, was due to the collapse of the private sector’s risk tolerance. But once that was acknowledged, and the US Treasury and Wall Street banks made their move, things turned around remarkably quickly.

In fact, this was the sort of nightmare crisis Nouriel Roubini predicted years ago—that the US housing sector would go bust and cause a panic flight from dollar-denominated assets, leading to a collapse in the financial system. If the People’s Bank of China saw its dollar-denominated portfolio shrinking and decided to dump its assets, the US Federal Reserve would be powerless to respond. We’ve heard about organisations being too big to fail, but the US in a full financial crisis would be too big to rescue.

Fortunately, however, what we seem to have at the moment is a much smaller crisis: there is still a rush toward dollar-denominated assets which are still seen as safe in the global economy, and that

is much easier to handle. The People's Bank of China knows that it would be very difficult to get out of dollar-denominated assets fully; its best course is to postpone its paper losses into the future where they will no longer matter as much.

Was there anything policymakers and regulators could have done to prevent the crisis?

After the fact, it always seems clear that you should regulate more. But then, you might also have halted financial innovations which were nevertheless useful.

Economists believe that the world's safe real interest ought to be around 2% per year in real terms—reflecting stable growth rates. And the global equity premium—the expected return you get by investing in riskier stock and corporate equities—is about 2.2%, if you do the sums.

Yet when you look at the real world, the safe interest rate is close to 0% per year and the risky rate is around 8%. We seem to be doing a really poor job of mobilising the collective risk-bearing capacity of the global economy.

In other words, we should be able to do a much better job of diversifying everyone's financial portfolio, so that people would then be much more willing to hold risky assets and much more willing to invest. We ought to

have more sophisticated financial systems and portfolio diversification, more confidence in safety and much higher investment.

We seem to be doing a really poor job of mobilising the collective risk-bearing capacity of the global economy.

While financial innovation that leads to profoundly foolish portfolios like those seen in the current crisis should be curbed, the market would not be able to do its job of spreading more of the collective risk-bearing capacity of the world—and a lot of it isn't mobilised—if financial innovations were restrained.

Look at the Industrial Revolution: it introduced factories, canals, railroads and so on, all of which required the mobilisation of the savings of huge numbers of individuals to fuel different enterprises. There was also diversification, which assured individual savers that if any enterprise they didn't control or didn't understand went bankrupt, it wouldn't carry all of their wealth down with it.

Can the US continue to increase spending in order to stimulate the economy?

Fiscal-driven recovery in Japan failed in the 1990s and early 2000s: it led to disastrous long-term government debt-

to-GDP ratio. But it has to do with limits to Japan's debt-bearing capacity—it is the ultimate ageing society; immigration is not going to be high. The debt-bearing capacity of the Japanese economy isn't growing, so they were rightly concerned about unsustainable debt accumulation patterns.

In contrast, the US is much more optimistic about its long-run productivity growth rate. We believe we invent a lot of new technologies and spread them all around the population, as opposed to Japan where new technologies appear to be confined to the export-oriented manufacturing sector and to consumption in the Ginza. So we think our economy's going to grow faster than the Japanese think their economy will grow for the long run.

Plus, the US government is relatively small for an advanced industrial country. Our debt is relatively low. The projections (once you assume something will be done about government healthcare spending) are quite good that we will have an economy whose productivity is growing at 2% per year, with a population that is growing from immigration by 0.5% to 1.5% per year.

How might the crisis change the global balance of power?

Had a steep fall in the dollar accompanied a crisis of this magnitude, as it could have, import substitution

from manufacturing within the US would have left Singapore and the rest of Asia stranded. But the dollar has not declined much against Asian currencies. This is in spite of global imbalances, long-term merchandise trade deficits, and the fact that international accounts have to balance in the long run. The US is the importer of last resort, which means that Asia is going to be one of the boats lifted fastest by the rising tide. China and Asia are going to be coupled to the North Atlantic core for a long time to come, unless they can magically find some way other than export-oriented development to grow.

The US is the importer of last resort, which means that Asia is going to be one of the boats lifted fastest by the rising tide.

The US is going to emerge from the crisis as the world's only hyper-power still. The smart thing that a hyper-power does is, it uses its time at the peak to create a world that is peaceful and congenial, for it to exist in after it is no longer the global hyper-power.

This is one way to view the history of the second half of the nineteenth century, where around 1840, the British government realised that there was a

rising superpower across the ocean, and that its best policy in the long run was to ally with and shape the development of the US in such a way, that when not Britain but the US became the global superpower, it would still be a comfortable world for Britain to be in. Thus, British policy towards the US was very different from say its aggressive behaviour in Guangzhou and China. So when the 20th century rolled around, the US sent armies to Britain's aid in Europe twice.

Once you understand that that is the most important fact about the global diplomatic history of the late nineteenth and early twentieth centuries, the implications for the US today are, I think, obvious. The odds are overwhelming that India or China will become the most important power to come; the capital where everyone sends their senior Ambassadors to in 2100s isn't going to be Washington. It's going to be either Beijing or New Delhi. So the question is how the US should be acting now to shape this world 100 years from now.



In Singapore at the invitation of the Centre for Public Economics, Civil Service College to deliver a lecture on "The Financial Crisis of 2007–2009: Understanding its Causes, Consequences—and its Possible Cures", Professor Bradford DeLong was interviewed by ETHOS Editor, Alvin Pang. He is a professor in the Department of Economics at the University of California, Berkeley; chair of the Berkeley International and Area Studies Political Economy major; a research associate at the National Bureau of Economic Research; and a visiting scholar at the Federal Reserve Bank of San Francisco. From 1993 to 1995, he worked for the US Treasury as a deputy assistant secretary for economic policy. While in the Clinton administration, Professor DeLong worked on the Uruguay Round of the General Agreement on Tariffs and Trade, the North American Free Trade Agreement, and on many other issues. He has written on, among other topics, the evolution and functioning of the US and other nations' stock markets, the course and determinants of long-run economic growth, the making of economic policy, the changing nature of the American business cycle, and the history of economic thought.



The Ethos Roundtable

Crisis-proof Governance

Participants: **MR SA BALI ABAS**, Permanent Secretary, Prime Minister's Office, Brunei
MR SABIR SAID AL-HARBI, Director General, Economics Statistics,
Ministry of National Economy, Oman
MR SOLOMON MOLEBATSİ SEKWAKWA, Permanent Secretary, Ministry of Finance &
Development Planning, Botswana

How is the current global economic crisis affecting your country, and how is your government responding?

SA BALI: Brunei is an oil-producing country. Crude oil and gas provide approximately about 70% of GDP; almost 90% of our exports come from oil and gas. Obviously, the dramatic drop in oil prices from around \$140 to around \$40 has greatly reduced the revenue we have been privileged to enjoy thus far. At the same time, Brunei imports most of our goods. So with the price of imported goods ballooning, local inflation is also going up. In order to counter this, we have looked into tightening our fiscal policies and being more prudent.

SABIR: Even in the oil-producing Arab world, the impact of the crisis will differ from country to country. Oman is similar to Brunei: 40% of our GDP and 60% of government revenue come from oil. So declining prices may affect public finance. But even with current oil prices at around \$45 per barrel, oil-producing

countries such as Oman should do fine; the past few years of high oil prices were simply a bonus.

Our own industries have not been as exposed to the crisis, and so the impact on Oman has so far been limited. Certainly, the stock market has declined by about 30%, but the Government's efforts in developing and growing the economy remain unchanged. The Central Bank of Oman is able to provide banks with credit and liquidity if necessary, but so far it has not been necessary.

Some sectors across the region have been more directly affected, such as construction and real estate. You see this especially in Dubai, where economic growth has been led by construction and property development. But Dubai is still able to provide a \$20-billion stimulus package.

SEKWAKWA: Botswana is about the size of France but with a small population, so the cost of providing services is high. We are among the largest producers of diamonds in the world. When the crisis

hit, the demand for diamonds fell; since the mineral sector contributes to 40% of our GDP and 50% of our government revenue, we were badly affected. A second major source of revenue is tourism, which has also been badly affected by the crisis.

Nevertheless, revenue accumulated in the past is helping to cushion the effects of the downturn, and if the turnaround comes in two to three years' time, we should be fine.

But what we are concerned about now is the global economic picture once the turnaround arrives. Will things be the same? Will people be buying diamonds as they were before? We think it may not be so, and adjustments will have to be made. As public servants, we are now occupied with thinking through how best to reform the economy and find new ways to drive it forward after the crisis.

So the good years of the recent past have allowed you to build up resources that can now be used to deal with the current crisis. What are your priorities in deploying these resources?

SEKWAKWA: We want to develop an economy that isn't just focused on dealing with the crisis; we need to emerge stronger than before after the downturn is over. So we are investing in infrastructure and in people, building capacity so that when the turnaround comes, we are better placed. In doing

so, we also address the immediate concern of keeping people employed. In Botswana's case, we are able to directly generate and maintain employment levels, since most sectors are dependent on the government.

SABIR: The challenge all around the world is indeed to be ready for the upswing and to come back stronger after a decline.

In Oman, we embarked, quite some time back, on a policy of economic diversification, in order to move away from dependence on oil towards income generation in other sectors such as tourism, fisheries, gas and petrochemicals. In recent years, oil has been declining as a proportion of our GDP.

A special ministry was established a few years ago to develop the tourism sector. The government is also trying to attract foreign investment, particularly for tourism and other industries. These new industries will stimulate the economy, open up markets and bring in new technology and expertise,

The challenge all around the world is indeed to be ready for the upswing and to come back stronger after a decline.

which will in turn stimulate our business sector.

SA BALI: Brunei is focusing on developing the business sector. We are also opening up areas for industrial development, since as Sungai Liang Industrial Park,¹ where we support potential investors and facilitate business startups.

The public service is also looking into streamlining its processes and procedures to make it easier for people to start businesses in Brunei. While it is well known that the private sector is the main engine of economic growth, the major employer in Brunei is the government: there are 44,000 public servants and the government sector is quite saturated. Unless we speed up the development of the private sector, we will not be able to generate much more employment.

The crisis has renewed attention in the role of governments—as regulators and as rescuers. Have you seen a change in public expectations of governments since the onset of the crisis?

SABIR: One of the things I discovered in the crisis is that the regulatory framework in Oman, especially in the financial sector, is very strong. Banks are still in a very strong position and have not been badly hit at all. In fact, we are hoping that the flow of foreign investments will grow; we foresee that

investments may be diverted away from Europe and the US—where trust has been declining—to countries where regulations have been more robust. The consensus is that the government will have to respond quickly according to changing global circumstances and how they affected the private sector.

SEKWAKWA: I think this crisis is an opportunity to clean up the economy. Our banks are more tightly regulated compared to some European countries; we don't really have a *financial* crisis. What happened in the US should really not have happened and, going forward, we will see a move towards tighter regulation and supervision of their financial sector.

The impact in Botswana is more because of the decline in export sales. Before this global financial crisis, we had a food crisis: the prices of commodities were going up, and the government had to step in with assistance. This time, we could not do as much. People appreciate that given the current situation, we have to tighten our spending and be more prudent.

SA BALI: To me, the issue is not so much a lack of governance as there is a lack of adherence to governance. You can have all the laws, procedures and processes, but if the players are not really observing

these rules, then things start to happen. Look at these toxic assets in the US: the people don't want to buy them, and the US government is not ready to let them go at a greatly reduced price because the banks will incur more losses. It should really be the responsibility of the main corporate players.

In Brunei, the focus is on a prudent operating budget for government. We will also make the public service more efficient, to make every dollar that we spend, count. Of course, we do not stop investing in human **capacity building** and in developmental projects where resources have already been allocated.

Is there anything that you observed in Singapore during your time at the Leaders in Governance Programme that you have found useful to consider?

SABIR: I think the Singapore Government's budgetary response to the crisis is exemplary, because it will not only help businesses but also employment, and at the same time reinvest in human resources.

The other remarkable thing is that the Government plans 30 to 40 years ahead, and not only plans but documents everything, so you can look at past results and learn from them.

The strength of Singapore's institutions is that they have a clear sense of vision, mission and tasks.

Everyone knows what is happening; there is good interaction between politicians, policymakers, operational staff, and the public. It is as if they are all working in a small office: everybody speaks the same language.

It was rewarding to learn not only about the successes of Singapore but also areas which needed adjustment.

SA BALI: Indeed, there seems to be good communication between public sector leaders and the political leadership. This mutual respect is important; they might not always agree with each other but they are able to work together for the better of the country.

It was rewarding to learn not only about the successes of Singapore but also areas which needed adjustment, such as population policies: how you have moved from a two-child policy in the past to now having to bring in people from elsewhere, because of your low fertility rate.

Also, I found it laudable that you spend a hefty proportion of your GDP in research and development—perhaps the only country in Asia other than Japan to do so.

SEKWAKWA: I see some red lights: for instance, bringing in immigrants may

slow down population decline, but if not managed properly, it will have negative effects. The other challenge that I think Singapore needs to be mindful of, is that when you are at the top, you have no one ahead to pace yourself with, so you have to run faster and outdo yourself or risk becoming complacent. Other countries are catching up. ~~And~~ even as you develop, people's expectations will change. So you cannot depend on your past success to determine future growth.

The other challenge that I think Singapore needs to be mindful of, is that when you are at the top, you have no one ahead to pace yourself with, so you have to run faster and outdo yourself or risk becoming complacent.

When looking at policy issues, you need to have a broad enough mind to see from design through to implementation. It is one thing to come up with a good policy ~~and~~ but quite another to execute it. In that respect, I have been impressed with the level of professionalism of your political leadership. 

The ETHOS Roundtable was conducted by ETHOS Editor Alvin Pang in March 2009. Mr Sa Bali, Mr Sabir and Mr Sekwakwa were participants in the 2nd Leaders in Governance Programme (LGP), organised by the Singapore Civil Service College from 16 to 24 March 2009. Drawing from Singapore's development experience, the LGP offered practical insights into the fundamentals of good governance effective policy implementation for sustainable development and social cohesion. Over the seven-day programme, participants interacted with senior government officials and thought leaders, and visited key government agencies to understand their operating philosophies and systems.

NOTE

1. Developed by the Brunei Economic Development Board, the 271-hectare site is positioned to be a world class petrochemical hub, drawing an estimated US\$1.3 billion in investment and creating up to 1,065 permanent jobs. For more details, see http://www.bedb.com.bn/bisop_spark.htm

 Opinion

Linda Lim

Singapore's Economic Growth Model: Too Much or Too Little?

Singapore's economic growth model of the past forty-odd years, like those of its fellow "Asian tigers", has been based on the export of initially labour-intensive manufactures to world markets, followed by a move up the technology and value-added ladders as comparative advantage shifts. Like Korea, Taiwan and Japan, economic development in Singapore has been substantially state-directed and features a managed-float currency regime; like Hong Kong, it is based on free trade and capital flows.

Should Singapore rethink its growth strategy for a post-crisis world?

Over the past two decades however, Korea and Taiwan have reduced the state's role in their economies, while Hong Kong is still the world's freest economy. Singapore's economy, on the other hand, continues to be firmly state-directed while diversifying into high-

value services, with heavy reliance on an imported workforce. Most notably absent, outside of banking and property, is the strong domestic private sector participation that is such a distinctive feature in Japan, Korea, Taiwan and Hong Kong.

Can Singapore's state-heavy growth model be sustained in the long term, especially after the systemic shock and global rebalancing of the current financial crisis?

ECONOMIC THEORY AND LIMITS TO STATE-DIRECTED GROWTH

Asia's economic growth follows the theory of comparative advantage, which says that countries can increase the value of their production and consumption from a fixed resource base by participating in international trade, i.e., by each country specialising in making and exporting only what it is relatively more efficient in producing, compared with other countries. Comparative advantage in one or more sectors means comparative

disadvantage in others—a country cannot be internationally competitive in every sector. Despite its abundance, in absolute terms, of labour, skills, and now capital, China will not end up producing everything in the world; if it tries to do so, demand for its fixed resources will cause inflation, undermining its initial cost advantage.

Resource-based comparative advantage is not the only determinant of international competitiveness and trade flows. According to strategic trade theory (most closely associated with Nobel Laureate Paul Krugman), a country can become competitive in an industry by exploiting economies of scale or learning through exports. Agglomeration advantages (observed by Alfred Marshall and later popularised by Michael Porter as “clusters”) may lead to the development of industrial concentrations in particular locations, where the proximity of suppliers, customers and competitors allows an area as a whole to be internationally competitive in a specific sector or industry: think Silicon Valley for high tech, or Wall Street for finance.

Such location-specific competitive advantage can complement or overcome resource-based comparative advantage or disadvantage—but it too is limited. Not every country can have scaled-up economies in the same industry; often, when countries try to develop these artificially, excess capacity results

and everybody loses. There are also disadvantages to agglomeration, or clusters—most notably congestion costs (such as land and labour shortages when too many firms chase the same scarce resources in a given location, pushing up each other's costs) and negative externalities (such as environmental pollution and dissipation of intellectual property).

Comparative and competitive advantage both allow for government policy to influence a location's competitiveness in particular sectors—through selective investments that shape resource endowments, and tax incentives and subsidies to target resource allocation toward particular sectors.

As an economy moves up the technology ladder, the capital and opportunity cost of further state directed shifts in comparative or competitive advantage escalates.

However, these policies can be imitated with relative ease, leading to “beggar-my-neighbour” outcomes¹ (where neighbouring countries compete to attract foreign investors with ever more attractive and costly tax breaks) and excess capacity.

As a national economy moves up the technology ladder, the capital and opportunity cost of further state-directed shifts in comparative or competitive advantage escalates, given diminishing returns. Furthermore, competition based on advantages created by government policy rather than market forces introduces a large element of political risk into private business decisions, encourages inefficiency in the allocation of resources, and reduces world welfare.

There is also the risk of falling into the “fallacy of composition”: the error of inferring that something is true of the whole because it is true of some part, or even every part, of the whole.² In government industrial policy, a tax cut for sector A can stimulate its growth and development by attracting resources—capital, labour and entrepreneurship—to that sector. But if every other sector—B, C, D, etc.—also gets a tax cut, then no sector is better off. The Government budget may simply end up running massive deficits, saddling the economy as a whole with higher inflation.

IMPLICATIONS FOR SINGAPORE'S GROWTH MODEL

These time-tested economic maxims boil down to one prognosis for Singapore's economic model—you can't have everything, even without size and

resource constraints. Trying to achieve comparative advantage in too many sectors at once will only push up resource costs, aggravate negative externalities such as inflation and environmental degradation, and result in reduced competitiveness overall.³ Competitive advantage based on economies of scale, first-comer and agglomeration or cluster advantages derived from government policy, rather than geographical resources, are probably unsustainable.

GLOBALISATION AND GROWTH

But doesn't globalisation enable us to increase our resource base by importing labour, skills and capital; and to expand our market to the world and thus benefit from economies of scale, even though we are small? Don't globalisation and technological innovation enable us both to tap more resources, and to utilise them more efficiently?

It is true that Singapore has benefited enormously from globalisation, in both factor and product markets. But there are also constraints, diminishing returns, and additional risks.

One risk was identified by Lee Tsao Yuan,⁴ then Alwyn Young^{5,6} and Paul Krugman in the 1990s.⁷ They showed that Singapore's economic growth in the 1970s and 1980s had occurred mainly through factor accumulation (the addition of inputs of labour and

capital) rather than increased factor productivity (producing more with the same labour and capital).

Since 1990, however, Singapore's growth has demonstrated increased productivity (to which global competition and foreign inputs of capital, skills and technology have contributed). But the ready availability of foreign inputs potentially or actually deters better utilisation of domestic resources—because of the temptation to just add more input to get more output. Imports of unskilled foreign labour may artificially preserve the competitiveness of labour-intensive activities (such as construction), retarding the reallocation of complementary resources to more productive uses. Imports of skilled foreign talent and foreign capital may have the unintended consequence of “crowding out” or even “chasing away” local talent, capital and entrepreneurship, as would an over-present role of the state in the economy.⁸

Given Singapore's land scarcity, foreign labour and capital contribute to domestic inflationary pressures that could undermine the cost-competitiveness of various sectors. Imports of capital also add to persistent current account surpluses and large foreign exchange reserves in putting upward pressure on the exchange rate, again undermining cost-competitiveness.

CHALLENGES IN THE POST-CRISIS WORLD

Singapore's small and open economy is extremely vulnerable to global contagion effects. As major markets in the US, Europe and Japan have fallen into recession, Singapore's exports have declined, particularly in the highly capital-intensive, risky and volatile electronics and pharmaceutical sectors targeted by the state. Recessions also usually produce global consolidations of industry, with smaller, more peripheral locations the most likely to be abandoned first. Discretionary spending falls, especially for luxury consumption, and the global tourism sector—including the casino industry—has been hit hard.

Since the 1997-98 Asian financial crisis, the benefits of free capital flows have been increasingly challenged by academic research. Their costs have been heightened by the 2008 crisis, which saw even well-managed emerging market economies severely hit by capital flight. Capital deleveraging and increased risk-aversion and regulation worldwide post-crisis will shrink financial sectors and cross-border capital flows, with some possible retreat from globalisation toward “localisation of finance”. Increased political risk and uncertainty will also discourage investment in sectors where government policy influences returns,

such as pharmaceuticals and medical tourism by American consumers, with health-care reform under the Obama administration.

The international community will continue to push for reduction in the international macroeconomic imbalances which have contributed to the current crisis. Undervalued managed-float currencies, large current account surpluses and massive foreign exchange reserves which are built up by Asian countries like Japan, China and Singapore and then recycled into financial and real assets in the West, will be less tolerated.

On the other hand, a retreat from quasi-mercantilist policies may well provide new sources of growth in expanded domestic consumption in Asia. Many Chinese economists, like Zhiwu Chen⁹ and Yasheng Huang,¹⁰ already recommend this change for China, which shares with Singapore the world's lowest shares of consumption in GDP—about 40%.¹¹

AN ALTERNATIVE STRATEGIC VISION

Lee Soo Ann and I have argued elsewhere that Singapore's economic growth model today is predicated on "more of the same" policies that may be out of place in a changed local, regional and global environment:

"This includes bureaucratic targeting of favoured sectors for receipt of (now much more costly) state subsidies and tax-breaks directed to attracting capital investment and technology from foreign companies and institutions serving international markets.....the newly favoured sectors (such as "life sciences", gambling casinos and high value-added services like finance, medicine and education) create disproportionately more jobs for foreigners than for locals, at all skill levels, and can only be sustained by massive immigration. They are also much more capital-intensive and risky, and subject to stronger global and regional competition... Because of these simultaneous "big bets" in a small place, the reliance on external factors of production, and the costs of failure, are much higher..."¹²

From an economist's perspective, it seems relatively clear that Singapore's recent economic growth model has tried to do too much and for too little benefit, in contradiction to what economic theory tells us. From a business strategist's perspective, what *should* be done?

First, there should be a national conversation on the purpose and nature of economic growth for an affluent and educated nation at our stage of development, and in our geographical location. While Singapore's economic growth record to date has

been admirable, it has emphasised quantitative targets over qualitative results and the distribution among beneficiaries. Focusing on “how much” growth does not necessarily tell us “how good” it is, or “for whom”. “People for growth” (growth as an end in itself) is not the same as “growth for people” (growth as a means toward greater welfare for people, presumably citizen workers and consumers). The assumption that the former will inevitably lead to the latter should itself be re-examined.

While Singapore's economic growth record to date has been admirable, it has emphasised quantitative targets over qualitative results and the distribution among beneficiaries.

Second, the growth we choose should be sustainable—both financially (i.e., without ongoing subsidies in an intensely competitive world economy, and without generating inflation through the import of excess labour and capital) and environmentally (i.e., without creating congestion costs and negative externalities that undermine competitiveness and growth, in a world already running up against severe natural resource constraints).

Third, what is the best process for growth? Do we stake our carefully husbanded national savings, accumulated over generations of restrained consumption, on a few major, capital-intensive, risky and expensive projects dependent on foreign capital, foreign labour, foreign skills, foreign entrepreneurs and foreign markets in which we have much competition and no intrinsic comparative advantage? Or do we privatise the economy, releasing capital and talent to local entrepreneurs who can allocate resources according to market forces, and innovate, creating value in smaller but nimbler, more diverse and more locally-rooted enterprises (which, if they fail, will take only small parts, rather than big chunks, of the economy down with them)?

Fourth, we need to identify our distinguishing advantage. What is distinctive about us, as a nation and as a place, that will enable us to build a unique niche in the regional and world economy that cannot be fulfilled by others, however much they try to emulate our strategies?

A time of global crisis and transformation, and of impending major economic, social and demographic shifts in our region, is an excellent time to re-examine not just Singapore's economic growth model, but also our identity and

values as a nation, since growth and identity are ultimately linked. 

Linda Lim is Professor of Strategy at the Ross School of Business, University of Michigan. This article was adapted from a talk given at the annual Singapore Economic Policy Conference on 24 October 2008, organised by the Singapore Centre for Applied and Policy Economics (SCAPE), National University of Singapore.

NOTES

1. In the current global financial crisis, the importance of coordinated interest-rate and bank-rescue policies is an instructive example of the need to avoid beggar-my-neighbour consequences which would hamper recovery for everyone.
2. This concept is most associated with John Maynard Keynes' "paradox of thrift", but there are other examples.
3. Thus, Singapore is unlikely to be, simultaneously, internationally competitive in semiconductors, life sciences, health care, education, financial services, digital media, creative industries and casino tourism.
4. Lee, Tsao Yuan, "Growth without productivity: Singapore manufacturing in the 1970s", *Journal of Development Economics* 19 (1985), 25-38.
5. Young, Alwyn, "A Tale of Two Cities: Factor Accumulation and Technical Change in Hong Kong and Singapore", in NBER *Macroeconomics Annual* 1992, ed. O. J. Blanchard and S. Fischer (Cambridge and London: MIT Press, 1992), 13-54.
6. Young, Alwyn, "The Tyranny of Numbers: Confronting the Statistical Realities of the East Asian Growth Experience", *Quarterly Journal of Economics* 110 (1995), 641-80.
7. Krugman, Paul, "The Myth of Asia's Miracle", *Foreign Affairs* 73.
8. Over the last 40 years, Hong Kong's GDP growth rate and per capita income have surpassed Singapore's, and this was achieved with a smaller state sector, lower savings and higher consumption, suggesting a more efficient use of capital.
9. Zhiwu Chen, "Privatisation would enrich China", *The Financial Times*, 7 August 2008.
10. Huang, Yasheng, *Capitalism with Chinese Characteristics: Entrepreneurship and the State* (New York, NY: Cambridge University Press, 2008).
11. Singapore economists like Tilak Abeysinghe, Choy Keen Meng, Lee Soo Ann and myself have similarly noted

the extremely low share of both labour incomes and consumption in Singapore's GDP, and its correlation, as in China, with increasing income inequality, between average and rich and also between local and foreign, private and state actors. In both economies, the state owns or controls much of the remainder, including investment by foreign multinationals which are largely controlled and incentivised by the state. See Abeysinghe, Tilak and Choy, Keen Meng, "The aggregate consumption puzzle in Singapore", *Journal of Asian Economics* 15 (2004), 563-78.

12. Lim, Linda and Lee, Soo Ann, "Globalising State, Disappearing Nation: The Impact of Foreign Participation in Singapore's Hub Economy", in *Management of Success Revisited*, ed. Terence Chong (Singapore: Institute of Southeast Asian Studies, 2009) (forthcoming).



Opinion

Bernard Nee and Julia Yap

Staying Ahead of the Game: Singapore's Economic Development

Singapore's growth and transformation from a developing nation in the early 1960s to a successful and thriving modern economy has been the source of much fascination for many observers.

Ours is a story that appears to defy conventional economic theory; it has, for instance, attracted its share of criticism for being too “firmly state-directed”.

Yet a closer examination of Singapore's economic development strategy demonstrates that the role played by the Government in anticipating new and emerging opportunities is not incongruent with healthy market forces: indeed, both elements have been and will continue to be key to Singapore's continued economic growth in the long term.

“We (the EDB) talk to companies, listen carefully to them, what they are thinking, and what they think are possible markets and new businesses?”

Lim Siong Guan, ex-EDB Chairman (2006–July 2009)

SINGAPORE'S APPROACH TO INDUSTRY DEVELOPMENT

Most governments identify industry sectors to focus on. Where they differ is how these areas are chosen and what actions are taken to support their growth. In practice, the Singapore Government's approach can be described as a three-step process: **Listen, Think, Act.**

LISTEN (to the Market)

The Singapore Economic Development Board (EDB) gathers constant feedback from existing and potential investors in Singapore as part of their investment promotion activities. It keeps abreast of industry, technology and demographic trends through ongoing conversations with industry leaders, international advisors, futurists and other experts.

Market players (i.e., private sector companies) ultimately determine the success or failure of a business idea. Recognising this reality, Singapore

Government agencies keep close contact with the private sector, and listen closely to their perspectives and requirements in order to shape a market environment conducive to business growth.

The career aspirations of Singaporeans—including tertiary level students, potential entrants to the job market, and those already in the workforce—are also important indicators of new growth opportunities. For instance, the interest of young Singaporeans was an important motivation for Singapore's push into “green” industries and clean technology.

With globalisation and increasing mobility, notwithstanding the financial crisis, Singapore would lose our top talent if it did not ensure that there are good jobs in growth sectors that excite Singaporeans. Similarly, companies establishing operations in Singapore do so expecting to fill most of their positions with people already living here. Hence, as a knowledge-based economy, there is a need to match the aspirations of Singapore-based talent with business needs. It would not make economic sense for companies to set up in Singapore if the bulk of their workforce had to be sourced from abroad.

Broader processes such as the Economic Review Committee (from 2001 to 2003) and the Economic Strategies Committee bring together a wide range

of stakeholders as well as the general public in a national conversation about the growth directions that Singapore should adopt. These interactions help to ensure that Singapore's growth strategies and policies do not lose sight of two fundamental objectives: *sustained long term growth, and good jobs for our people.*

TEST (Ideas)

Businesses are profit-driven and make investment decisions that make sense for them in the long run. Even if a government decides to promote in a new growth area, it can only succeed if it passes the rigor of the marketplace. Firms must decide that Singapore's value proposition makes commercial sense for them before they locate here.

“Companies are very rational. The critical thing is whether their Singapore plant is the most productive in the world or not. If it is, they keep the plant. If not, they close it down.”

Lim Siong Guan, ex-EDB Chairman (2006–July 2009)

Manufacturing, for example, continues to make up a significant share of Singapore's GDP, despite intense international competition that has evolved from one concentrated around

production factors to one that encompasses entire supply chains. Apart from factors such as the intellectual property regime and the availability of skilled manpower, companies, like Schlumberger, are in Singapore because they can leverage our strong logistics connectivity to efficiently bring components in, and finished products out. Clearly, firms continue to find it worth their while to remain in Singapore.

Furthermore, investment incentives are structured to encourage reinvestment and long-term expansion in Singapore, and to build local capabilities. They are not used to subsidise the continued operation of otherwise non-viable ventures in Singapore. This discipline extends to all aspects of Singapore's economic strategy.

ACT (to seize Opportunities)

Singapore's economy is small and dependent on external markets and international capital. It is imperative that we differentiate ourselves in the global marketplace, build relevant capacities, and be in a position to *act decisively* when opportunities arise.

Singapore is able to offer businesses a decisive value proposition today because of our track record in several decisive areas, including our trustworthiness, quality and the rule of law, our

skilled workforce and technological competency, our physical and trade connectivity and our attractive quality of life.

“We have to be at the forefront of this game. If we are not, someone else will.”

Lim Siong Guan, ex-EDB Chairman (2006–July 2009)

Singapore is one of the few places in the world where design, research and development, manufacturing, brand development and corporate headquarter activities can co-locate and thrive. It is well placed to host, support and complement global companies seeking to expand into regional markets, as the Asian growth story develops after the current world economic crisis abates.

AN ECONOMIC ECOSYSTEM

The Singapore government's philosophy of listening to—and testing ideas with—the market means that our economic environment has evolved with the changing needs of companies as well as citizens. The economic landscape we have today is a result of market forces—and not one shaped by an economic ideology that picks favourites, based for instance on national affiliation. Indeed, given the realities of globalisation, the debate over whether a company is foreign or local has become moot; it is equally

unrealistic to imagine that a small economy could be artificially shielded from market forces by government intervention for long.

Nevertheless, there is a perception that local companies have been disadvantaged by the strong presence of foreign multinational corporations (MNCs) in Singapore. The reality is that local companies have benefited tremendously from this growth. For instance, the supplier base for MNC operations in Singapore has become increasingly local. Many home-grown companies such as MMI, Sunningdale and Venture, have successfully partnered MNCs, both locally and in their regional expansion.

The aerospace sector is another case where strong links between local firms and overseas MNCs have led to the growth of a highly competitive industry. The world's top three engine makers—Rolls-Royce, General Electric and the Pratt and Whitney group—have a substantial presence in Singapore. As a result of significant and long-term partnerships with these global players, local companies including SIA Engineering and ST Aerospace have become world leaders in airframe maintenance and modification.

In recent years, an increasing number of local entrepreneurs have also spawned promising business start-ups,

many of which have become industry leaders and internationally recognised brands. An example is Hyflux, with its expanding footprint in Singapore, China, Middle East, North Africa and India. Agencies such as SPRING and International Enterprise Singapore spearhead ongoing efforts to nurture more of such home-grown businesses going forward.

PREPARING FOR THE FUTURE

Many emerging industries bear fruit only after sustained and judicious investment over time, and therefore require concerted and deliberate development efforts in order to reach their full potential in time for Singapore to benefit economically.

“The world is changing,
opportunities are changing;
you need to be clear in your
mind how you are approaching
change, to identify for yourself
what the opportunities are and
what the challenges are going
into the future”

Lim Siong Guan, ex-EDB Chairman (2006–July 2009)

For example, the development of the biotech industry had its roots in studies in 1980s which resulted in the set-up of the Institute of Molecular and

Cell Biology in 1987. By the late 1990s, Singapore had become a key node in the global manufacturing network of leading pharmaceutical companies like GSK, Schering-Plough, Merck, Wyeth and Pfizer. Only after having established capabilities in the industry, and given the completion of the Human Genome Project, did Singapore mount a substantial push for the Biomedical Sciences sector in 2000.

In the context of a small, highly connected open economy in a fast-evolving economic landscape, Singapore's government-led strategy of *Listening* to market participants and futurists, *Testing* ideas in the market and *Acting* decisively on opportunities is a pragmatic yet dynamic approach to the art of anticipating, preparing for and fully capitalising on emerging economic opportunities. 

Bernard Nee is the Chief Information Officer of Singapore's Economic Development Board and Executive Director of its Strategic Planning and The Knowledge Centre. Julia Yap is Assistant Head in Strategic Planning and The Knowledge Centre.



Adeline Aw, Wee Shu Lin and Lee Chor Pharn

The End of the World (Economy) as We Know It

“...After this crisis, the world is not going to be the same again.
This is not just another cyclical downturn and recovery.
The world’s economy is undergoing a structural shift.”

-Singapore’s Prime Minister Lee Hsien Loong
in Parliament, 27 May 2009

Many economists have described the current economic and financial crisis as the most severe economic recession since World War Two. The crisis has indeed had far-ranging consequences: once-mighty banks and financial institutions have evaporated; major industries are experiencing significant consolidation; thousands of factories all over the world

have shut down, and millions of workers have lost their jobs. Some economists have even speculated that the world was poised for a second Great Depression.

It is still too early to determine if the global economy has indeed seen the worst of the downturn as there are simply too many uncertainties that could destabilise any sort of recovery. However, it has become increasingly

clear that the global economy will not revert to its pre-crisis status quo.

The years leading up to the financial crisis were marked by very benign economic conditions leading to structural imbalances in the global economy. At the global level, the developed economies saw strong growth in credit growth and private consumption, while the level of savings plummeted.¹ Emerging economies redirected their excess savings to finance consumption in developed economies. This cycle reinforced trade interdependence between the G3 nations (US, Japan and the European Union) and emerging Asian economies and meant that the Asian economic growth became more, rather than less, dependent on G3 growth.

It has become increasingly clear that the global economy will not revert to its pre-crisis status quo.

The current financial and economic crisis has unravelled this intertwined relationship, which the historian Niall Ferguson has described as “Chimerica”.² Consumption in the US has fallen, perhaps for the foreseeable future.³ Exports from Asia to the developed countries have collapsed. Singapore

has been affected severely, with its economy expected to experience its largest contraction since 1965. To date, Singapore’s economic success has largely been attributed to the openness of its economy and its concentration on activities which largely serve G3 demand. But with the unravelling of “Chimerica” bringing long-term change to the global demand landscape, Singapore, along with much of Asia, is likely to face significant challenges in the post-crisis future.

LEGACY EFFECTS FROM THE CRISIS: TIPPING POINTS FOR THE WORLD

The crisis of 2008–2009 will have at least **four legacy effects** that could permanently alter the global demand landscape.

- **Rising public debt** in the US, Japan and Europe has escalated with the high cost of recovery fiscal spending. If these countries do not offer viable and sustainable solutions to reduce debt levels in the longer term, investors’ confidence in assets denominated in these currencies could diminish. In any case, investors would also be wary that high levels of public debt now could lead to high levels of taxation later. Reduced foreign appetite for G3 assets (in particular US assets) will impair

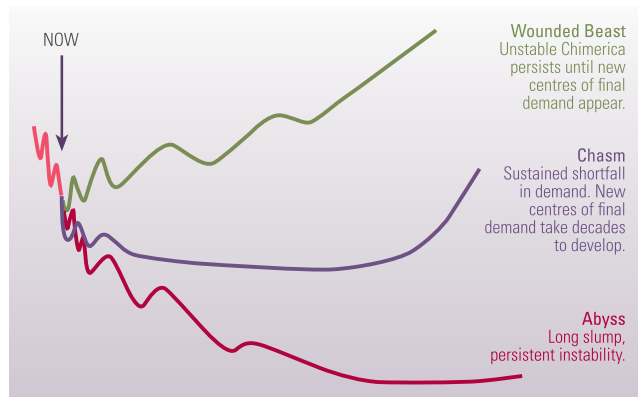
these governments' abilities to invest in areas such as education, infrastructure and social safety nets, reducing their long-term economic potential.

- **Increased government intervention** in the financial sector may stifle the innovation necessary for wealth creation and the financing of the real economy. Over the long run, private consumption and growth levels may be muted if access to credit is restricted.
- **Creeping protectionism** could reduce the overall level of global trade and affect the main mechanism that has supported Chimerica's prosperity. Blatant forms of protectionism, such as tariff wars, seem less likely. But more subtle forms of protectionism, embedded as clauses in many fiscal stimulus plans, may hinder the free flow of trade too.
- **Fundamental changes in G3 consumption behaviour** could affect the growth path of the world economy. US consumption spending, in particular, accounts for one-third of global growth in private consumption. Hence, any decline in G3 consumption, arising from higher levels of unemployment and the need to save more, would significantly affect global GDP growth.

THE CHANGING LANDSCAPE OF GLOBAL DEMAND: POSSIBLE SCENARIOS

The interplay and depth of these legacy effects will determine the likelihood and extent of revival in the growth engines of Chimerica. While the current crisis has certainly increased the range of possibilities facing the world economy over the next ten to twenty years, we can extrapolate these legacy effects to derive three possible scenarios for the future of the global economy.

FIGURE 1: HOW THE WORLD COULD EVOLVE: THREE SCENARIOS



Source: Courtesy of Economics and Strategy Division, Ministry of Trade and Industry

Scenario 1 : Wounded Beast

In this scenario, the world emerges relatively unscathed from the economic crisis of 2008–2009 as coordinated government efforts succeed in stabilising the global financial system. Financial innovation, in turn, manages to outpace the tightening in regulation, allowing households and firms to attain easy

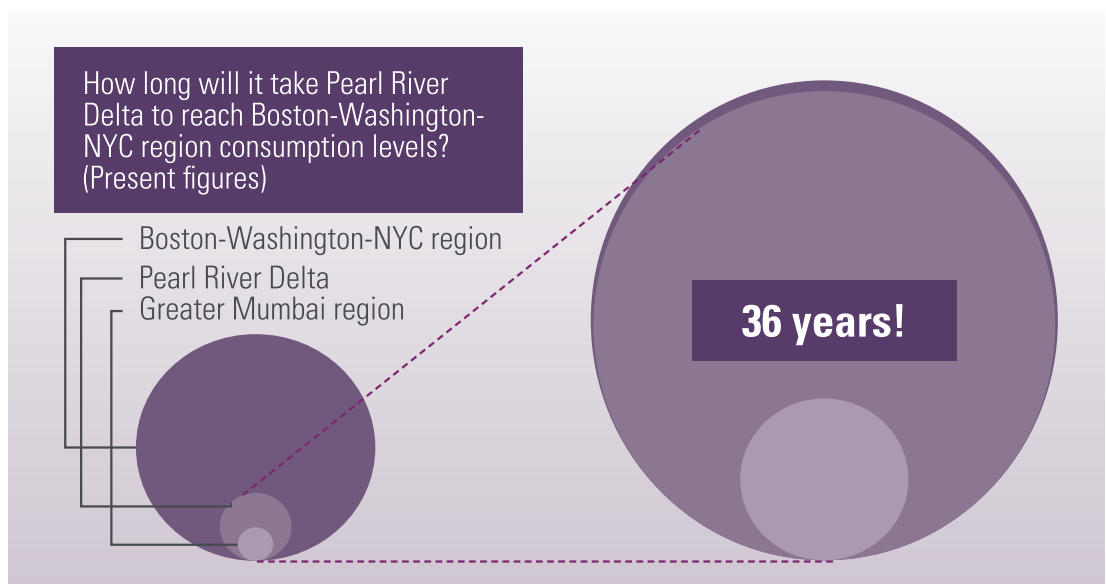
access to credit. Consumer and business confidence are restored in the major developed economies, and the exported “Chimerica” engine revives.

The pick-up in export earnings accelerates the urbanisation process in many emerging Asian economies, resulting in larger numbers joining the urban middle class in Asia. While wealth and buying power increase in these urban centres, the pressures associated with urbanisation, such as infrastructure shortages, also intensify. The demand for raw materials and other resources to support infrastructure grows strongly, but reduced investments in supply during the 2008–2009 downturn create severe upward pressures on resource prices. In addition,

speculative activity, occasional supply disruptions and seasonal shortage add to the volatility in resource prices.

This scenario is not a return to a stable status quo. A quick revival of Chimerica means that there will be less will to deal with the structural imbalances that led to the crisis in the first place. The persistence of these imbalances and the intensification of demand on limited resources and commodities increase the likelihood of asset bubbles and crashes, and volatile, unstable growth over the long run. Business cycles, which have already become shorter over the last ten years, will shrink even more. In this world, Singapore, as a small and vulnerable open economy, will have to deal with the impact of a volatile, unstable global macroeconomic environment.

FIGURE 2: CHINA CANNOT REPLACE US DEMAND AT CURRENT LEVELS



Source: Courtesy of Economics and Strategy Division, Ministry of Trade and Industry

Scenario 2: Chasm

A lack of international coordination and political will delay the process of economic recovery. Conservative lending practices become entrenched in the commercial banking sector, and credit growth to the private sector and households slows down. A global demand shortfall results as savings rates in the G3 permanently rise with the protracted downturn. Consequently, trade flows are significantly reduced with the fall in G3 demand. Creeping levels of protectionism further inhibit Asia's ability to tap into G3 demand. The emergence of new and more insidious forms of protectionism occurs as governments are pressured to take actions with mass appeal in stimulating the economy.

In response to both diminished G3 consumption demand and more restricted market access, Asian governments step up public spending and focus on building up domestic demand. Domestic consumption in Asia, however, will need several decades of growth before it can fully replace G3 as a final source of demand. Global growth therefore slows down considerably, below its long-term potential.

Scenario 3: Abyss

In the "Abyss", international recovery efforts fail to contain the adverse effects of the financial and economic

crisis. The global economy stagnates for a prolonged period of time, akin to a "Great Depression II". The protracted nature of the downturn causes deficit governments in the developed economies to exhaust their arsenal of fiscal and monetary tools. Public debt burdens rise to unstable levels and prevent G3 governments from enacting key longer-term structural reforms.

With both public and private sector spending diminished, unemployment rates soar to historic highs. Political instability in many countries mounts. Fears of more job losses to foreigners feed social and political unrest amongst the public; governments are pressured into implementing a massive slew of protectionist measures that eventually lead to a complete breakdown in existing trade architectures. With world trade stalled, the export-led model of growth in Asia collapses. Economic activity stalls in these nations and government expenditure becomes the primary driver of growth in the region. Economic growth will eventually resume, but it will take several years of persistent effort from Asia, as well as extraordinary coordination across governments, to restart the engines of growth again.

IMPLICATIONS FOR SINGAPORE

All three scenarios present significant challenges for Singapore. Against this

backdrop, Singapore would need to address three main themes of **Resilience**, **Survival** and **Relevance** to secure its continued economic progress. In the “Wounded Beast”, Singapore would need to develop deeper resilience to resource shocks and shorter business cycles to cope with heightened economic volatility. Muted G3 consumption growth as in the “Chasm” and the “Abyss” suggests that Singapore would need to develop new capabilities to survive a shortfall in G3 demand. Finally, the reduced relative importance of G3 final demand will require Singapore to stay economically relevant to Asia as economies in the region seek to jump-start their domestic demand. 

Adeline Aw, Wee Shu Lin and Lee Chor Pharn are from the Economics and Strategy Division of the Ministry of Trade and Industry. The division studies and identifies key sectors and clusters in Singapore, assesses the impact of policy initiatives by other government agencies and produces research and analyses of the Singapore economy and global trends.

NOTES

1. In 2006, the American personal savings rate was -0.6%, an indication that the average US consumer was spending more than they were earning.
2. Ferguson, N. and Schularick, M., “‘Chimerica’ and the Global Asset Market Boom”, *International Finance* 10 (2007): 215-239.
3. The Great Depression altered the spending habits for at least one generation of Americans.



Interview with Vernon L. Smith and associates

Auctions, Market Experiments and Public Policy

A discussion with **PROFESSORS VERNON L. SMITH,**
STEPHEN RASSENTI and **BART WILSON**

How has experimental economics deepened our understanding of economic theory and its implications for public policy?

VERNON L. SMITH: You can now ask policy-type questions in laboratory experiments which replicate markets in the real world. You can observe very important features of the market in action, and confirm or reconsider your ideas about how it will play out.

As an example of how we model economic behaviour, we like to conduct this double auction market experiment at our lectures where we ask 16 people from the audience to be eight buyers and eight sellers in a hypothetical market. Buyers are given values and sellers are given opportunity costs for each unit of the good. If the buyer is willing to pay \$12 for a unit of the good and buys it for \$9, he would make a profit of \$3. Sellers make profits when they sell above their opportunity costs. We would reward the buyers and sellers with cash to

motivate him. Buyers and sellers have no knowledge of each other's values and opportunity costs. The equilibrium exchange quantity of the experiment is sixteen and each seller should have been able to trade two of the four units that he can produce.

With some deviations within one or two units of the equilibrium quantity, it is common for prices to converge by the end of the first period. This happens even though the participants have never done economics before and do not understand economics and the concept of competitive equilibrium. It makes no difference in the ability of people to trade and make exchanges.

This competitive equilibrium can be achieved even in the absence of complete information. What really matters is private information and knowledge. Giving more public information on individual circumstances may make it worse, for example, in the case of posted pricing.

In what ways have your market experiments been used to illuminate real-world problems?

SMITH: Bart has also conducted experiments of petrol markets (sponsored by the Federal Trade Commission). Various policy makers in the ~~U.S.~~^A are pushing a ban on the refiner practice of setting different prices for petrol to petrol stations in different zones—a practice also known as zone pricing. The policymaker's intuition suggested that forcing refiners to charge the same price to all stations would distribute competition between the stations.

The objective of the experiments was to compare the possible outcomes between two types of market institutions: a market where refiners set different prices of petrol for petrol stations in different zones, and another market which had refiners charge the same price for all zones.

BART WILSON: The participants of these experiments were refiners and petrol station owners, and the computer robots were the buyers. Some stations were located near the corners of a grid and faced little competition. Others were clustered around the centre and competed with each other. So the buyers had different locations on the grid and they went out and bought from the different stations. It turned out that you

made the consumers worse off when you banned zone pricing. The petrol station retailers were the ones who were going to earn more. We found that they earned three times as much profit with the ban. Banning zone pricing raised prices where consumers were getting lower prices, because refiners raised prices to the retailers who had higher margins, foregoing profits on the competitive stations with low margins. The prices charged by retailers at the corners didn't fall because there was no competition at their stations.

SMITH: The experiment demonstrated beautifully that the standard intuition was completely wrong. It showed policymakers what they couldn't see from their own perspectives. The implication of the experiments was not to ban zone pricing, but instead to let the refiners do what they were currently doing because it didn't hurt consumers.

Singapore's Certificate of Entitlement system (for car ownership) and government land sales also go through auctions. Are there other public policy areas where auctions can be used to maximise consumer benefit?

STEPHEN RASSENTI: Bus routes or bus lines can be auctioned to bus companies that are willing to serve the routes. In today's world, you have a perfectly

expressive language in auctions where bidders can come and tell you what they're willing to pay. You don't have to worry that some routes won't get served and try to pre-package them. This need not happen.

In the same way that companies pay to serve a route, they can be paid to serve one. Instead of setting the price at a positive number, you can set it at a negative number and subsidise companies to serve a route. In these auctions, you can let companies express their willingness to buy a whole package of routes that they would be interested in serving and pay you a particular price, because they would clearly be interested in servicing adjacent territories.

SMITH: You can run the auction without much information, because the relevant knowledge resides with the companies. For the design of the auction, you have to make sure that the rights, the alternatives and the modes of choice enable companies to express their diverse preferences.

RASSENTI: The same is true with respect to spectrum licenses, which have been auctioned all over the world in pre-packaged format. In such auctions, the spectrum bandwidths and regions are always stated, but it is possible to conduct these auctions without pre-stating these.

You can let the buyers express how much bandwidth and which regions they need. Many of the buyers don't need what is pre-packaged. Sometimes they need a little bit less; and those that need a little bit more may have to end up buying two licenses, and be stuck with something that is not worth much to him. Why should regulators make those decisions? Why not just let buyers bid for what they need? The environment becomes very complicated, but sometimes a more complicated message space will create more efficient allocation, making it easier for the participants to express their preferences clearly. Otherwise, the regulator may have to be quite strategic or manipulative during the auction process.

Another area of opportunity for auctions is airport landing rights. In the US, airports are required by law to charge landing fees that reflect the costs of building and running the airports. But the Department of Transportation has figured that, under existing law, they can allow the airports more flexibility when pricing, as long as they don't charge more than the overall costs. There are different kinds of auctions that can be used for landing and takeoff rights. It can be a real-time auction where the pilots do the bidding while the airplanes are circling. They can be assisted in their decisions by the

information management systems that they have access to.

Right now, landing rights are still being pre-allocated. There is a prohibition on trading of airport landing rights for cash in the US. The only thing you can do is to exchange something in return for something else. Also, rights are not the only bottleneck. US airports fund airport improvements by selling the gate rights to those airlines that provided the funding for the airport improvements. And so now, for example, even if an airplane can land at an airport, it may not be able to find a gate to dock at, while there are empty gates that only airline partners have access to. So there are opportunities to use auctions to enhance the efficiency of the system.

How have governments responded to the use of experimental economics in understanding policy problems? Has it influenced their policy design, for example, in the way they structure their markets with their privatisation exercises?

SMITH: You get the most receptive environment when people are facing a genuine problem with their current way of doing things and they are looking for a different way. One good example is the evolution of the market for sulphur and nitrogen dioxide in the Los Angeles Basin. A colleague, David Porter, who is with Chapman University, was involved

with its design. They devised a system and allocated rights to pollute. The idea was to tighten the standards and let people trade the permits. But they didn't have any trading mechanism.

You get the most receptive environment when people are facing a genuine problem with their current way of doing things and they are looking for a different way.

Intermediaries formed and they knew more about both sides of the market than the buyers and sellers. This led to a situation where the market was competitive and disorganised. The intermediaries made huge arbitrage profits buying and reselling the permits. The companies were outraged and they thought that there ought to be a better way to do it.

John Ledyard, Dave Porter, and Mark Olson from Caltech went to the laboratory to create a trading system for these permits. This was a complex market because there were two kinds of pollutants. Some people only traded in one, some in the other and others in both. There is also a distinction between coastal and inland permits because of prevailing winds onshore. If you're located on the coast, you also need to

have permits inland but if you're inland, you don't need coastal permits. So there are constraints. You need to buy enough permits to support your emissions until you get your act together to install cleaner equipment. So basically people buy and sell these permits in blocks. How do you get them to fit together? That's where the combinatorial auctions came in.

In that market, they did a range of laboratory experiments before they actually implemented policies and they had the cooperation of the industry players and the government.

RASSENTI: Having a real necessity is an important point. Reforms in the power industry in the United States are slow to come by because people are still well off doing things the inefficient way. In Australia, where Vernon and I went to do consultancies in the 1990s, Australians were complaining that they were paying twice as much for energy as people in the United States. They wanted to renovate their energy industry and the way it was organised to become more competitive. Many in the industry took part in the experiments simulating the new structure before they did something in Australia.

SMITH: At that time, each Australian state owned its own generator which

generated electricity for its own needs. The National Grid Management Council wanted to create a national electricity market. It was fine if the states wanted to retain ownership of the generators but they had to compete to supply electricity in the national market. So a lot of those assets are still publicly owned but they are disciplined by the market.

Conducting laboratory experiments is like having a wind tunnel before implementing policies.

The experiments involved a lot of participants from both sides of the market—buyers, sellers and the national grid. People were asking questions and debating. Back then, it was really a pretty radical idea to trade energy on a network, on high voltage grid in real time. People buying and selling, and disciplined by the constraints on the grid.

The experiments provided a marvellous practical means for overcoming some of the market resistance to this radical new system. It was like having a wind tunnel before implementing policies. 

This discussion was excerpted from an interview conducted by Donald Low, Head

of the Centre for Public Economics and Associate Fellow at the Centre for Governance and Leadership, Civil Service College, when Professor Smith and his associates were in Singapore in March 2008, during which they delivered a lecture and conducted a two-day workshop on experimental economics.

VERNON L. SMITH is a Professor of Economics and Law and a research scholar in the Economic Science Institute at Chapman University, California. He has authored and co-authored over 300 articles and books on capital theory, finance, natural resource economics and experimental economics. Cambridge University Press published his *Papers in Experimental Economics* in 1991, and a second collection, *Bargaining and Market Behaviour* in 2000. In 2008, they published *Rationality in Economics: Constructivist and Ecological Forms*. Professor Smith received the Nobel Prize in Economics in 2002 for his work in experimental economics and continues work in the study of market performance, the design of market-based management systems, and in researching the property right foundations of specialisation and exchange.

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of auction systems for efficient distribution of public resources such as electric power and communications spectra. Professor Rassenti is currently working on a project that examines a competitive alternative to government controlled drug testing.

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Stephen Choo

Rethinking Incentives for the Downturn

Management approaches that engage and enable employees are needed more than ever in a downturn, argues Hay Group's Stephen Choo.

Good times can obscure many mistakes. In a boom market, companies may be more lenient towards poor performance and be less inclined to enforce strict performance management systems. In crunch times, many companies do the opposite, and impose stricter or more punitive measures on all employees regardless of performance. Mediocre performers are unlikely to

see the need to change while high performers—seeing no return on their discretionary effort—may leave. Hence, employee engagement suffers at a time when the company needs it most.

Employers may be less concerned about employees leaving them during a downturn. However, when good times return, disengaged employees are more likely to jump ship at the first opportunity, just when recovery for

the firm becomes possible. Conversely, when employers adopt a long-term view of engaging their employees during a downturn, they will be rewarded with increased loyalty and motivation when the next wave of growth arrives.

The extended period of market growth in Singapore, and indeed in Asia, meant that many employees were accustomed to receiving some sort of bonus and annual salary increases, and may have come to regard these bonuses as a right rather than as a reward for organisational success. With the economic crisis limiting salary budgets, how can managers avoid the money trap and ensure that their staff continues to be motivated and engaged?

In a spot survey of 516 public, private and government organisations in Asia conducted in November 2008, Hay Group found that Asian companies were using their salary budgets more strategically to

reward performance—paying an average of 66.7% more in base salary increases to their high-performing employees compared to all other employees. At the high end, Malaysian, Hong Kong and Singaporean companies surveyed had doled out an average of 60% more in base salary increases to their star performers in 2008 (Table 1).

Certainly, a robust performance management and reward system is critical to success in a downturn. As always, it is important for organisations to clearly define, communicate and recognise what good performance looks like, and to appropriately portion rewards based on differentiated performance (as well as ensure that poor performance is identified and addressed).

Yet appropriate reward and recognition does not have to equate with spending. Employees work for more than money: they work to get training and career development, to make a valuable

contribution, and because they enjoy contributing to a common vision and culture. Managers should understand what it is that their employees truly value and focus on improving these, even if (and especially when) financial rewards are being squeezed.

TABLE 1: PERCENTAGE POINTS DIFFERENCE IN BASE SALARY INCREASE BETWEEN HIGH PERFORMERS AND ALL EMPLOYEES (ACTUAL 2008 VS FORECAST 2009)

Country	2008 Actual	2009 Forecast
China	4.0	2.0
Hong Kong	3.2	2.0
India	5.4	4.0
Indonesia	3.0	5.0
Japan	0.6	0.5
Korea	2.0	0.0
Malaysia	4.0	3.0
Singapore	3.0	2.0
Thailand	2.9	1.8
Vietnam	3.5	0.0
Asia	4.0	3.0

Source: Hay Group Global Study Finds Singaporean Companies Will Pay for Performance, Hay Group press release, 15 December 2008

We believe that in order to retain key staff, organisations must resist the temptation to use ever higher salaries as their primary employee retention tool. Ironically, employees who are attracted to jobs only because of high salaries during the boom years (as was common in the banking and financial sectors) will also tend to leave for the same reasons during a downturn. Instead, employers should focus on increasing employee engagement and developing better support systems that enable their employees to succeed.

NOT JUST PAY, BUT ENGAGE AND ENABLE!

Research from Hay Group Insight suggests that an increasing number of organisations enjoy high levels of employee engagement, yet nonetheless struggle with performance issues.

Motivation is only potential energy until it is well harnessed. While employees may feel committed to organisational success, they may nevertheless lack the conditions to channel their efforts productively and effectively.

Getting the most from motivated employees requires that organisations support them in being successful. Employees must not only be **engaged**, by shared goals, but also be **enabled** for optimal performance.

Hay Group Insight has found enabling of employees embraces two key components. The first is an *optimised role* which requires that employees be effectively matched to their jobs, such that their skills and abilities are effectively utilised.

The second is a *supportive environment*, which involves providing people with the resources they need (for example, time, information, tools and equipment) and removing barriers to getting the job done (such as red tape, or tasks that don't add value).

By considering both employee engagement and employee enablement, research by Hay Group Insight suggests that there are four distinct groups of employees within a typical organisation (Figure 1).

FIGURE 1: CLUSTERING OF EMPLOYEES BY ENGAGEMENT AND ENABLEMENT

		Employee Engagement	
		Low	High
Employee Enablement	High	Detached	Effective
	Low	Ineffective	Frustrated

- *Effective employees* are both highly engaged and well supported for success. In these ideal circumstances, employees are most likely to be high achievers.
- *Ineffective employees* lack both engagement and support and are

understandably likely to struggle in their job roles. Their poor performance and morale can quickly become a drain on the organisation and others around them. The “vocal few” many often fall within this group.

- *Frustrated employees* (which may account, on average, for 20% of all employees) represent lost opportunities for their organisations. These employees are aligned with the organisation’s direction and are enthusiastic about making a difference but are nonetheless held back by jobs that do not suit them or work environments that get in their way. Managers are often surprised when such people leave as they appear to be highly engaged employees.
- *Detached employees* are in roles that suit them reasonably well, and find themselves in a broadly supportive work environment. But for various reasons, their levels of engagement with organisational objectives and task requirements are insufficient to make them optimally effective. This group is often populated with individuals willing to do what is needed to meet their objectives, but no more.

What these employee types make clear is that both engagement and

enablement are necessary to provide an optimal climate for effective employees. Take away either strong support structures or high levels of staff engagement and you end up with either frustrated or detached employees. What is worse is when both support and engagement are lacking: employees become ineffective and often a drain on overall morale.

If key talented employees are leaving after all the effort put into engaging them, the secret may lie in balancing out the effort with employee enablement.

Consider these numbers: frustrated employees represent as much as one third of the Asian workforce with only 16% of them believing that they are effective in their jobs. Despite being well engaged by their employers, the frustration of these employees largely stems from a lack of empowerment and professional development. This is in contrast to a similar Hay Group Insight study conducted in the UK, which found that only 21% of the UK employees were feeling frustrated and two out of every five employees considered themselves effective workers (Table 2).

**TABLE 2: HOW ASIAN EMPLOYEES FEEL
COMPARED TO THEIR UK COUNTERPARTS**

	Asia	UK
Effective	16%	39%
Ineffective	20%	12%
Frustrated	29%	21%
Detached	35%	28%

Source: The Frustration Factor, Hay Group press release, 25 August 2008

The highest percentage (35%) of Asian employees was found to be detached. They are the ones who will only perform the minimum of what is needed to meet their objectives, and no more. What is worrying with these detached employees, despite the high level of training they have received, is that 60% of them intend to leave their organisations the minute someone makes them a marginally better offer.

So if key talented employees are leaving after all the effort put into engaging them, it may well be that they have not been able to convert their enthusiasm into effective action on the job.

Singaporean organisations that focus only on engaging and motivating employees may ironically be missing out on getting the best possible performance, even from committed employees. In a downturn, both effective engagement and enablement are critical to retaining the talent that organisations will need when the upswing inevitably returns. 

As Regional Director of Hay Group Insight, Dr Stephen Choo works closely with senior executives of leading organisations throughout the region, developing highly effective management strategies with the use of strategic diagnostic tools in employee opinion research. He works closely with senior executives and middle-level managers in converting survey results into workable action plans. Dr Choo received his PhD in International Management from the University of Western Australia and has written a book entitled *Entrepreneurial Management* (Victoria, Australia: Tilde University Press, 2006) and more than 20 papers on leadership, entrepreneurship, innovation and strategic human resource management in several academic and professional publications.



Bryan Caplan

Singapore's Political Economy: Two Paradoxes

Economist Bryan Caplan, noted for his insights on public choice, visited Singapore in November 2008. His observations address how “economically efficient, but politically unpopular” policies might successfully be carried through a democratic system, and sheds light on the environment in which public policy is made and implemented in Singapore.

SINGAPORE VERSUS THE MEDIAN VOTER MODEL

Singapore, when compared to almost any other democratic country, has two deeply puzzling features.

Puzzle #1: It frequently adopts policies that economists would call “economically efficient, but politically unpopular”.¹ For example, Singapore has near-unilateral

free trade, admits large numbers of immigrants, supplies most medical care on a fee-for-service basis, means-tests most government assistance, imposes peak load pricing on roads, and fights recessions by cutting *employers'* taxes. These are policies that could easily have cost politicians their jobs in many other democracies, yet they have stood the test of time in Singapore.

Puzzle #2: Even though Singapore follows the forms of British parliamentary democracy, it is effectively a one-party state. The People's Action Party (PAP) has held uninterrupted power since the country gained Home Rule in 1959, has never received less than 60% of the popular vote,² and has always enjoyed an overwhelming majority in Singapore's Parliament—it currently holds 82 out of 84 seats.

To put these paradoxes in perspective, we need to review the Median Voter Model, the workhorse of studies in modern political economy. In the Median Voter Model, two political parties compete for votes by advocating a “platform”—a bundle of policies. Citizens in turn vote for the party with the platform closest to their ideal policy bundle.

Setting aside various complications,³ the Median Voter Model implies that competing political parties tend to offer policy platforms that centrist voters regard as ideal. This also implies that a rival party should be able to match a dominant party's electoral success simply by mimicking its centrist platform. As a result, parties rarely achieve lasting political dominance.

Despite its abstractions, the Median Voter Model usually fits the facts of actual political behaviour in democracies

around the world. However, it also highlights why Singapore's political economy is so puzzling. Singapore persistently adopts policies that would have been overturned by the democratic process almost anywhere else on earth, but the same party keeps winning election after election by a landslide. Why doesn't a rival party promise to abolish unpopular policies and soar to power? How, in short, is Singapore's political-economic equilibrium possible?

EXPLANATION NO. 1: SINGAPORE IS NOT REALLY A DEMOCRACY

One common conclusion is that Singapore must be—despite its Westminsterian pedigree—a thinly-veiled dictatorship, which informally suppresses political rivals and rigs its elections, which in turn ~~allow the government~~ to unilaterally adopt unpopular (yet efficient) policies. This “Singapore as a thinly-veiled dictatorship” theory coheres neatly with Western stereotypes about the city-state, and elegantly resolves the two paradoxes. Unfortunately, this dictatorship thesis ignores three basic facts.

First, Singapore has several legal opposition parties;⁴ they may face minor indignities but hardly live in mortal fear of the PAP.⁵ Pressure from the dominant party is a feeble explanation for the opposition's near-total failure to

gain political office, given that many countries (such as Pakistan) demonstrate vigorous electoral competition despite far graver dangers.

Second, while there are unusual restrictions on political expression, these shield people from criticism, not policies. Opposition candidates who avoid personal attacks against PAP politicians can and do freely attack specific policies as ineffective or unfair. An opposition candidate could safely campaign on a platform to abolish Electronic Road Pricing or slash immigration. Indeed, an opposition candidate could safely campaign on a platform to rein in politically-motivated defamation suits. In the Median Voter Model, embracing these positions would quickly usher opposition politicians into power—assuming, of course, that the median voter genuinely wants the changes in question.

Third, there is no evidence that Singapore's elections are corrupt. Indeed, international observers have consistently rated its government as one of the least corrupt in the world,⁶ with elections that are “free from irregularities and vote rigging”.⁷ The Global Barometer country report for Singapore finds that 86% of Singaporeans believe that their elections are either “completely free and fair”, or “free and fair, but with minor problems”.⁸ So

while decades of one-party electoral dominance is frequently a strong symptom of electoral corruption, this is not the case in Singapore.

International observers have consistently rated Singapore's government as one of the least corrupt in the world.

This is not to deny the many peculiarities of Singaporean politics.⁹ My point is that these peculiarities are largely irrelevant as far as the Median Voter Model is concerned. In Singapore, voters are free to vote for opposition candidates, and opposition candidates can safely advocate the elimination of unpopular policies. In the Median Voter Model, this is all you need for the will of the people to prevail.

EXPLANATION NO. 2: SINGAPORE'S VOTERS ARE UNUSUALLY ECONOMICALLY LITERATE

Many of Singapore's successful policies would be considered unpopular around the world, but they persistently survive the democratic test in Singapore. Once we reject the dictatorship hypothesis, the next obvious explanation for Singapore's effective policies is that its electorate is unusually economically literate. In my book *The Myth of the Rational Voter*:

Why Democracies Choose Bad Policies,¹⁰ I find that even in the relatively market-oriented US, the market mechanism is unpopular, especially in international and labour markets. Could Singapore be the exception that proves the rule—a country where the man-in-the-street embraces market mechanisms?

It is worth pointing out that this “unusual economic literacy” hypothesis largely fails for the country where it is most plausible: Hong Kong, which has been ranked the freest economy in the world since 1970.¹¹ Under laissez-faire policies, Hong Kong enjoyed decades of remarkable economic growth. One would expect this excellent performance, combined with status quo bias, would lead to popular support for laissez-faire policies. It does not: Lau Siu-kai and Kuan Hsin-chi¹² find that a majority of Hong Kong residents want to change many of its most distinctive policies.

Given Singapore's many economic, political and cultural similarities to Hong Kong, it seems unlikely that Singaporean public opinion would be significantly better. Unfortunately, nothing comparable to the survey by Lau and Kuan exists for Singapore. But the 2002 World Values Survey¹³ data suggests little reason to believe that the Singaporean electorate is unusually economically literate. Singaporeans and Americans have virtually the

same beliefs about the social benefits of competition,¹⁴ and Singaporeans are more likely to accept income inequality as a trade-off for better incentives.¹⁵ Yet Singaporeans are actually less sympathetic to private enterprise than Americans,¹⁶ and seem to favour a much more restrictive approach to immigration than do Americans.¹⁷

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There is admittedly some indication that Singaporeans are unusually concerned about economic performance. The survey showed that 58.8% of Singaporeans say that “a high level of economic growth” should be their nation's top priority; 48.6% of Americans say the same.¹⁸ Similarly, only 37.9% of Singaporeans—versus 65.2% of Americans—think it would be a “good thing” if people put “less emphasis on money and material possessions”.¹⁹ Once Singaporeans recognise the economic benefits of a policy, they seem more willing to support it. Still, at this point, the case for the “unusual economic literacy” hypothesis looks rather weak.

EXPLANATION NO. 3: SINGAPORE'S VOTERS ARE UNUSUALLY LOYAL, DEFERENTIAL, AND/OR RESIGNED

Even if Singaporean public opinion were unusually economically literate, it would still be hard to explain the PAP's dominance. In the Median Voter Model, opposition parties' best response would be to mimic the policies of the ruling party, leaving voters indifferent. Singaporean politics plainly doesn't work this way; it seems to be in a political class of its own as long as we think of it primarily as a country.

The picture changes radically if we instead think of Singapore as a city. In the United States, big city politics is often about as lopsided as Singaporean politics. Democratic mayors have won without interruption since 1931 in Chicago²⁰ and 1964 in San Francisco.²¹ While the Democrats have failed to monopolise the mayor's office in New York City, they have near-PAP dominance of the New York City Council: Democrats hold 45 out of 48 occupied seats.²² Note that in the Median Voter Model, this cannot be explained purely by the liberalism of urban voters. After all, why can't the Republican parties in Democratic cities simply move sharply to the left?²³

In purely formal terms, the Median Voter Model can account for one-party democracy if you assume that voters

have not only policy preferences, but party preferences as well.²⁴ This means that even if two parties were to offer identical policies, some voters would still decidedly prefer one party to the other. This then allows the favoured party some "wiggle room" to deviate from the public's policy preferences without courting defeat in the next election.²⁵ Well-informed and well-meaning politicians could use this to persistently deliver economically efficient but politically unpopular policies.

Why precisely would voters have these "party preferences"? They might reflect group identification or loyalty. Voters might see one party as being "their party", just as they see the local sports team as "their team". Preferences may reflect deference—a belief in one party's superior competence and/or intentions. This could stem from a successful track record; but voters could also be deferring to politicians' current traits, such as intelligence and charisma. A final, more pessimistic interpretation is that they reflect resignation. A voter might favour one party over another not because he wants it to rule, but because he feels that resistance is futile. In the US, for instance, people who sympathise with a third party rarely vote for it because "it has no chance of winning".

Which of these mindsets seem to fit the realities of Singapore?

While empirical evidence is scarce, several different sources confirm the importance of deference in Singaporean politics. Singaporeans are markedly more satisfied with their national leaders and convinced of their good intentions than Americans.²⁶

Critics seem to endorse the deference hypothesis, suggesting that the “success of the government in the economy” has lent it a significant “performance legitimacy”.²⁷ Compared to Americans, Singaporeans show little interest in “giving people more say”; just 19.7% make this a top priority, compared to 32.6% of Americans.²⁸

The secret to Singapore's success seems to lie in its electorate's “party preference” for a ruling party that takes economic reasoning seriously.

While the deference story does fit well, there is also considerable evidence that resignation is also at play. Singaporeans' unusually low professed interest in politics is telling.²⁹ The stereotype of the apolitical Singaporean appears to have much basis in fact.

Overall, it appears that the answer to the paradoxes of Singaporean political economy can be attributed to a range of “party preference” factors. More

systematic research is necessary to figure out which variants best ~~fits~~ the facts, as well as the relative importance that deference, resignation and party loyalty play in Singapore's politics and policies.

CONCLUSION

In the West, Singapore is widely perceived as a benevolent dictatorship. From this starting point, social scientists have little to learn from Singaporean political economy. The explanation for Singapore's success is simply that it had the good fortune to be ruled by the smartest, nicest dictators on earth.

Once misconceptions about Singapore's democratic credentials are corrected, however, the city-state looks “curiouser and curiouser”; it seems to contradict everything that experts think they know about democracy: How can any party honestly win election after election—much less a party committed to many economically efficient but unpopular policies?

There is little evidence to suggest that Singaporean voters are markedly more economically literate than voters in other countries. The secret to Singapore's success seems to lie in its electorate's “party preference” for a ruling party that takes economic reasoning seriously; this preference gives the party enough slack to implement policies that might not survive a direct popular referendum.

Understanding the paradoxes of Singapore sheds new light on political economy in general. While most democracies have frequent partisan turnover at the national level, sub-national democratic politics are often as one-sided as in Singapore. In the broader world though, such forms of one-party democracy do not seem to depend on the delivery of remarkable economic performance. Is this because the relative importance of loyalty, deference, and resignation varies? Or did Singaporeans simply have the good fortune to put its trust in men who happened to deserve it?

Once political economists have a better understanding of one-party democracy, they will be ready to take a second look at national politics. Why exactly is it so difficult for one party in a democracy to stay on top at the national level? One interesting hypothesis is simply that people are more interested in—and therefore less resigned about—national politics. But this raises further questions: What determines whether a given democratic contest will catch voters' interest? And under what circumstances does greater interest lead to worse policies?

The case of Singapore is a fascinating challenge to time-tested models of how democracy works. But more importantly, the mechanisms underlying Singaporean

political economy are probably at work in every democracy. These mechanisms are not unique to Singapore, just uniquely visible. 

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NOTES

1. See especially Ghesquiere, H., *Singapore's Success: Engineering Economic Growth* (Singapore: Thomson Learning, 2007).
2. Mutalib, H., *Parties and Politics: A Study of Opposition Parties and the PAP in Singapore* (Singapore: Marshall Cavendish Academic, 2004): 5.
3. See e.g. Cooter, R., *The Strategic Constitution* (Princeton, Princeton University Press, 2000): 17-49. One seemingly strong assumption—that preferences are one-dimensional—has received a surprising degree of empirical confirmation. See e.g. Poole, Keith, and Howard Rosenthal, *Congress: A Political-Economic History of Roll Call Voting* (New York: Oxford University Press, 1997).
4. These include the Workers' Party of Singapore, the Singapore Democratic Alliance, and the Singapore Malays National Organisation. The only illegal party is the Communist Party of Malaya. See generally Mutalib (2004), and Mauzy, D., “Electoral Innovation and One-Party Dominance in Singapore”, in Hsieh, J., and D. Newman, eds., *How Asia Votes* (New York: Chatham House Publishers, 2002): 246.

5. See generally Mauzy (2002): 241-245; Mutalib (2004): 239-267. As Mauzy and Milne observed: "The Singapore government has not committed any serious violations of civil rights. There have been no extrajudicial killings or political disappearances, and there are currently no political detainees." In: Mauzy, D., and R. Milne, *Singapore Politics Under the People's Action Party* (New York: Routledge, 2002): 128.
6. The World Bank's *Governance Matters* data set, for example, gives Singapore stellar scores in "Rule of Law" and "Control of Corruption". See: <http://info.worldbank.org/governance/wgi/index.asp>
7. See: <http://www.freedomhouse.org/template.cfm?page=22&year=2008&country=7486>
8. Tan, E. and Wang, Z., "The State of Democracy in Singapore: Rethinking Some Paradoxes". Paper presented at conference entitled, "The Asian Barometer Conference on The State of Democratic Governance in Asia" organised by Asian Barometer, Taipei (Taiwan), 20-21 June 2008.
9. In most democracies, the members of the ruling party respond to their opponents' verbal abuse with more verbal abuse—not lawsuits.
10. Caplan, B., *The Myth of the Rational Voter: Why Democracies Choose Bad Policies* (Princeton: Princeton University Press, 2007).
11. See: <http://www.freetheworld.com>
12. A majority of Hong Kong residents want to change many of its most distinctive policies: 57.6% favour a minimum wage, 68.4% favour price controls for necessities, 74.7% want more progressive taxation, and 75.5% want to "protect local industry against foreign competition". In: Lau, Siu-kai and Kuan Hsin-chi, "Public Attitude toward Laissez Faire in Hong Kong", *Asian Survey* 30 (1990): 770.
13. See: <http://www.worldvaluessurvey.org>
14. World Values Survey variable identifier E039.
15. When asked whether "incomes should be made more equal" or whether "we need larger income differences as incentives" (higher scores on a 1-10 scale indicate greater support for incentives), Singaporeans' average answer was 6.88, versus 5.72 for Americans (World Values Survey variable identifier E035).
16. When asked whether private ownership or government ownership should be increased (higher scores on 1-10 scale indicate greater support for government ownership), the average answer in Singapore was 4.75, versus 3.62 for the US (World Values Survey variable identifier E036).
17. Only 4% of Singaporeans favour open borders, and just 24% are willing to admit immigrants "as long as jobs [are] available"; the comparable numbers in the United States are 12.4% and 44.8% according to World Values Survey variable identifier E143. Mauzy and Milne confirm this pattern: see Mauzy and Milne (2002: 152 and 2002:191).
18. World Values Survey variable identifier E001.
19. World Values Survey variable identifier E014.
20. http://en.wikipedia.org/wiki/William_Hale_Thompson
21. http://en.wikipedia.org/wiki/List_of_Mayors_of_San_Francisco
22. http://en.wikipedia.org/wiki/New_York_City_Council
23. See generally Schleicher, D., "Why is There No Partisan Competition in City Council Elections?: The Role of Election Law", *Journal of Law and Politics* 23 (2007): 419-473.
24. Lindbeck, A., and Weibull, J. W., "Balanced-Budget Redistribution as the Outcome of Political Competition", *Public Choice* 54 (1987): 273-297; Caplan, B., "When Is Two Better Than One? How Federalism Amplifies and Mitigates Imperfect Political Competition", *Journal of Public Economics* 80 (2001): 99-119.
25. Why then is one-party democracy so much more common in cities than countries? The most plausible explanation is that small, dense populations tend to be less heterogeneous—not only in their policy preferences, but in their party preferences as well. As Mutalib (2004: 272) suggests, "A larger land area and population base would allow greater avenues and wider opportunities for political dissension and other sectional or geographical interests to be articulated."
26. World Values Survey variable identifiers E125 and E128.
27. See Mutalib (2004): 239.
28. World Values Survey variable identifier E003.
29. Only 3.2% of Singaporeans say they are "very interested" in politics, and another 32.8% say that are "somewhat interested"; in the US, the corresponding numbers are 18.3% and 47.2% (World Values Survey variable identifier E023). The World Values Survey consistently finds that compared to Americans, Singaporeans are extremely reluctant to engage in even low-level political participation, such as signing a petition or attending a rally (World Values Survey variable identifiers E025 and E027).



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