

## I. ECONOMIC ENVIRONMENT

### (1) INTRODUCTION

1. Singapore's sound macroeconomic policies and relatively high degree of openness helped it to recover rapidly from the effects of the Asian crisis. GDP growth in 1999 and 2000 averaged 8% compared with -0.9% in 1998. However, Singapore's heavy dependence on export markets, especially for its manufactured products, has resulted in a sharp economic slowdown since then, primarily due to the global economic slowdown; the emergence of Severe Acute Respiratory Syndrome (SARS) and events in the Middle-East in 2003 also prevented a more rapid recovery. There is also a longer term concern about Singapore's relative costs of production compared to neighbouring countries and rising unemployment owing to structural changes. As a result of these factors and possibly a slowdown in total factor productivity (TFP) growth, which appears to have set in during the mid 1990s, the authorities have been re-assessing some aspects of the development strategy that had previously served Singapore well, at least as concerns economic growth.

### (2) RECENT ECONOMIC PERFORMANCE

2. During the period under review (2000-04), Singapore has had to adapt to several additional shocks subsequent to the Asian financial crisis: the global economic slowdown in 2001, which weakened demand for electronics in particular; the war in Iraq; and the SARS outbreak in 2003, which badly affected tourism. The outcome was that, after growing at almost 9.7% in 2000, real GDP fell by 1.9% in 2001 and remained sluggish in 2002 and 2003 (Table I.1). As a consequence, the unemployment rate rose to 5.2% in 2002 and 5.4% in 2003. There was some deflation in 2002 but the situation reversed in 2003 (Table I.1). Real GDP grew by 1.1% in 2003 and according to projections by the Ministry Trade and Industry economic growth in 2004 is expected to be around 3.5-5.5%. While a decline in external demand was the main reason for lower growth in the short run, there are several longer run challenges that Singapore faces. For example, the emergence of strong regional competitors in trade and FDI poses a challenge, particularly for Singapore's manufacturing sector.

**Table I.1**  
Selected macroeconomic indicators, 1999-03

	1999	2000	2001	2002	2003
<b>National accounts</b>					
	(Percentage change)				
Real GDP (1995 market price)	6.9	9.7	-1.9	2.2	1.1
Private consumption	8.6	14.5	3.3	2.4	-0.5
Government consumption	6.5	18.5	4.1	3.0	-0.2
Gross fixed capital formation	-4.9	8.7	-4.5	-9.9	-3.8
Net exports of goods and non-factor services	7.1	-13.2	21.1	17.1	36.5
Unemployment rate (%)	4.6	4.4	3.4	5.2	5.4
<b>Productivity</b>					
	(Percentage change)				
Labour productivity in manufacturing	17.0	11.5	-13.5	10.3	5.3
Total labour productivity	7.3	5.4	-5.2	3.6	2.3
Total factor productivity	3.2	3.7	-6.8	1.0	..
<b>Prices and interest rates</b>					
	(Per cent)				
Inflation (CPI, %age change)	0.0	1.3	1.0	-0.4	0.5
Three-months fixed deposit rate (period average) <sup>a</sup>	1.7	1.7	1.5	0.9	0.5
Prime lending rate (period average) <sup>a</sup>	5.8	5.8	5.7	5.4	5.3
Savings deposit rate (period average) <sup>a</sup>	1.4	1.3	1.1	0.6	0.3

Table I.1 (cont'd)

	1999	2000	2001	2002	2003
<b>Money<sup>b</sup>, credit (end period)</b>	(Percentage change)				
Money supply (M3)	7.3	-1.8	4.0	-0.8	5.9
Credit to private sector (end period) <sup>c</sup>	-2.9	4.7	5.8	-1.0	6.3
<b>Exchange rate</b>					
Nominal exchange rate index (1995=100)	101.2	101.6	103.0	102.1	..
Real effective exchange rate index (1995=100)	95.1	95.2	96.0	93.7	..
<b>Fiscal policy</b>	(Per cent of GDP, unless otherwise indicated)				
Fiscal balance <sup>d</sup>	3.4	2.5	-1.8	0.1	..
Operating revenue <sup>e</sup>	21.5	21.0	19.7	18.6	..
Tax revenue	15.9	16.0	16.0	13.7	..
Operating expenditure	10.4	11.5	12.2	12.3	..
Development expenditure <sup>f</sup>	7.2	5.9	5.8	5.0	..
Fund transfers and transfer payments <sup>g</sup>	0.5	1.1	3.5	1.1	..
Public sector total debt	90.1	84.2	96.7	99.2	..
Domestic debt	90.1	84.2	96.7	99.2	..
<b>Savings and investment</b>					
Gross national savings	50.6	46.3	43.6	42.5	44.2
Gross domestic investment	32.0	32.0	24.9	21.2	13.4
Savings-investment gap	18.6	14.3	18.7	21.4	30.9
<b>External sector</b>					
Current account balance	18.6	14.3	18.7	21.4	30.9
Net merchandise trade	15.1	13.7	18.3	22.5	32.1
Value of exports	151.0	161.3	155.4	155.5	172.8
Value of imports	135.9	147.5	137.2	133.0	140.7
Services balance	2.5	2.1	0.8	0.3	1.2
Capital account	-0.2	-0.2	-0.2	-0.2	-0.2
Financial account	-17.2	-6.2	-16.6	-15.3	-27.5
Direct investment	10.4	12.9	-2.4	2.3	6.4
Balance of payments	5.2	7.4	-1.0	1.4	7.4
Terms of trade, 1995=100	90.2	84.7	75.8	72.1	73.1
Merchandise exports (%age change)	5.7	22.4	-8.3	2.7	12.1
Merchandise re-exports	0.2	30.7	-2.3	4.9	7.4
Merchandise domestic exports	9.8	16.9	-12.9	0.8	16.3
Merchandise imports (%age change)	10.8	23.4	-10.5	0.3	7.0
Service exports (%age change)	13.3	13.5	2.8	2.9	-0.3
Service imports (%age change)	25.0	15.0	7.5	4.7	-3.2
Gross official reserves (S\$ billion)	128.5	139.3	139.9	142.7	163.2
in months of imports	8.2	7.2	8.1	8.2	8.9
Gross official reserves (US\$ billion)	77.2	80.4	75.8	82.3	96.3
Gross external public debt (S\$ billion)	0.0	0.0	0.0	0.0	..

.. Not available.

a Refers to average of end-of-month rates of ten leading banks.

b M3 = M2 + net deposits with non-bank financial institutions; M2 = M1 + fixed, savings and other deposits + Singapore dollar negotiable certificates of deposit held; M1 = currency in circulation + demand deposits.

c Refers to bank loans and advances (including bills) to non-bank customers.

d Based on fiscal year, ending 31 March. Calculations do not include net investment income contribution.

e Includes net investment income contribution from FY 2000.

f Excludes land-related expenditure from FY 2001.

g Including e.g. medical endowment fund, elder care fund.

Source: Ministry of Trade and Industry, *Economic Survey of Singapore*, various issues; Monetary Authority of Singapore, *Annual Report*, various issues; and the authorities of Singapore.

3. The economy is dominated by services, at 63% of GDP, followed by manufacturing, with a share between 23% and 26% during the period under review (Table 1.2). The Government believes that manufacturing and services should remain the "twin engines of growth" and reports indicate that it will make a concerted effort to build on existing competitive strengths to sustain manufacturing at 20% or more of GDP.<sup>1</sup> However, because of the pressures from low cost regional manufacturers, there has been a structural shift in Singapore's manufacturing sector from low-cost to high-value-added production (Chapter IV). The share of employment in the manufacturing sector continues to fall (from 21% to 18% in 1999-02), raising concerns about training and re-employment.

**Table 1.2**  
**Basic economic and social indicators, 1999-03**

	1999	2000	2001	2002	2003
Real GDP (\$\$ billion)	147.8	162.2	159.1	162.5	164.3
Nominal GDP (\$\$ billion)	139.6	159.7	154.1	158.1	159.1
GDP per capita (\$\$)	35,338	39,740	37,296	37,893	38,023
<b>GDP by industry at 1995 prices</b>	<b>(Annual percentage change)</b>				
Agriculture, fishing and quarrying	-1.8	-4.9	-5.9	-5.8	-0.4
Manufacturing	13.0	15.1	-11.6	7.8	2.8
Utilities	3.4	7.2	1.8	3.8	1.8
Construction	-9.0	-0.7	-2.6	-10.8	-10.7
Services	6.3	8.0	2.4	1.4	1.0
Wholesale and retail trade	6.5	14.8	-3.3	2.7	6.7
Hotels and restaurants	5.4	8.5	-0.2	-2.9	-12.2
Transport and communications	7.6	7.7	3.9	4.9	-2.0
Financial services	5.7	3.6	2.3	-6.3	3.7
Business services	5.5	5.7	2.4	1.2	-1.8
Other services <sup>a</sup>	6.3	8.5	8.5	4.6	2.1
Owner-occupied dwellings	7.8	6.3	4.5	2.1	2.6
Less: FISIM <sup>b</sup>	1.4	-2.0	4.2	-0.7	1.6
Add: taxes on products	8.1	9.7	-4.1	0.7	5.8
<b>Share of gross value added</b>	<b>(per cent)</b>				
Agriculture, fishing and quarrying	0.1	0.1	0.1	0.1	0.1
Manufacturing	23.1	26.8	23.7	25.8	26.3
Utilities	1.6	1.5	1.9	1.7	1.7
Construction	7.9	6.3	6.1	5.4	5.0
Services	63.6	61.9	64.5	63.5	63.4
Wholesale and retail trade	12.8	12.7	12.4	12.3	13.1
Hotels and restaurants	2.3	2.3	2.4	2.2	1.9
Transport and communications	11.8	11.6	11.3	11.4	11.1
Financial services	12.4	11.3	12.4	11.9	11.6
Business services	13.9	13.7	14.4	13.6	13.3
Other services <sup>a</sup>	10.3	10.4	11.8	12.1	12.3
Owner-occupied dwellings	3.6	3.4	3.6	3.5	3.6

**Table 1.2 (cont'd)**

<sup>1</sup> See for example, Economic Review Committee (2002).

	1999	2000	2001	2002	2003
<b>Share in employment<sup>c</sup></b>					
Manufacturing	21.0	20.8	18.8	18.2	17.9
Construction	6.9	13.1	6.1	5.9	5.6
Services	71.1	65.5	74.2	75.0	75.6
Wholesale and retail trade	14.8	13.7	14.8	15.1	14.6
Hotels and restaurants	6.4	5.5	6.3	6.2	6.3
Transport and communications	10.8	9.4	11.1	10.8	10.6
Financial services	5.5	4.6	5.3	5.3	5.1
Business and real estate services	10.4	10.8	11.9	11.8	11.9
Public administration and education	11.1	..	11.1	11.8	12.5
Personal, health and social services	12.0	..	13.7	13.9	14.5
Other <sup>d</sup>	1.0	0.6	1.0	0.9	0.9
Education (% of labour force)					
Primary	22.0	25.1	19.9	19.1	18.4
Secondary	43.4	38.3	42.2	42.1	40.6
Higher	34.7	36.6	37.9	38.7	41

.. Not available.

a Includes public administration and defence; education, health and social work; other community, social and personal services; and domestic work.

b Refers to financial intermediation services indirectly measured.

c Data are sourced from the June Labour Force Survey (LFS) conducted by Ministry of Manpower. As the survey is on households, it excludes construction workers living at worksites and workers who commute daily from abroad to work in Singapore. Data for 2000 are from the Census of Population conducted by Singapore Department of Statistics, Ministry of Trade & Industry.

d Includes agriculture, fishing, mining & quarrying, utilities, and activities not adequately defined.

Note: Services data show an inconsistency in definition because different sources have been used for share in GDP and share in employment.

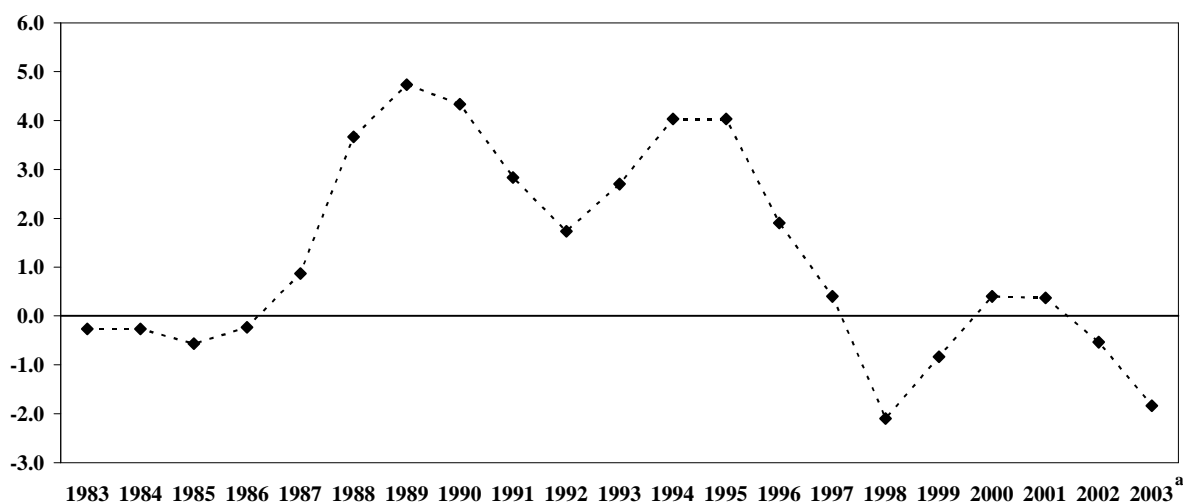
Source: Monetary Authority of Singapore, *Annual Report*, various issues; and the authorities of Singapore.

4. Singapore's long-term economic performance depends to some extent on whether it can reverse the recent decline in its total factor productivity (TFP), which after growing at an average annual rate of 2.1% during 1981-94, fell by an average of 0.3% annually during 1995-03 (Chart I.1, and Table I.3), influenced by an adverse economic environment and the cyclical nature of TFP growth. Nevertheless, Chart I.1, which is based on a three year moving average, suggests a long-term downward trend in TFP since 1994. This development comes on the heels of research indicating that during 1966-91, Singapore grew almost exclusively through factor, particularly capital, accumulation, with only a modest contribution from TFP (Box I.1). This was also true during the period 1995-03 when growth in output (as well as labour productivity) was largely due to capital accumulation. A broadly similar conclusion was reached by the IMF in a recent study, which found that capital accumulation has accounted for more than half of Singapore's growth since 1960; this pattern appears to be similar to that found in other East Asian economies. The study also suggests, however, that TFP has contributed to around one-fifth of Singapore's growth during this period (between 0.9-1.6% on average between 1960 and 2003), in line with TFP growth in other advanced economies.<sup>2</sup>

<sup>2</sup> IMF (2004).

**Chart I.1**  
**Total factor productivity growth, 1983-03**

Per cent, 3-year moving average



<sup>a</sup> Preliminary.

Source: Information provided by the authorities of Singapore.

**Table I.3**  
**Sources of productivity growth, 1981-03**  
(Per cent)

	1981-94	1995-03	1981-03
Output	7.6	4.4	6.4
Capital	4.1	3.5	3.9
Labour	1.4	1.3	1.4
TFP	2.1	-0.3	1.1
Labour productivity growth	4.8	1.8	3.6
Capital/labour	2.6	2.0	2.4
TFP	2.1	-0.3	1.1
Capital productivity growth	-0.5	-2.4	-1.2

Note: Figures may not add up due to rounding.

Source: Based on data provided by the authorities.

5. The developments in TFP growth since the mid 1990s has meant that while Singapore's very high rates of national saving and domestic investment have continued to raise labour productivity, capital productivity appears to have declined since 1994<sup>3</sup>, raising concerns about high savings rates and/or capital allocation.<sup>4</sup>

<sup>3</sup> During the period 1995-98, for example, capital productivity fell by an average of 2.9% annually (see Wong and Sim (undated)).

<sup>4</sup> See for example Fernald and Neiman (2003); Wong, Soon Teck and Sim, Benson (undated); and Ministry of Trade and Industry (2002).

**Box I.1: Sources of growth in output and labour productivity**

Total factor productivity (TFP) reflects the efficiency with which factors of production are used, and is thus a key determinant of an economy's performance. TFP should be distinguished from labour productivity, which is the amount of output per employee. Among the main determinants of improvements in labour productivity are changes in the volume of investment and total factor productivity (TFP). Growing investment contributes to improvements in labour productivity by increasing the amount of capital that employees have to work with. In the absence of accompanying improvement in TFP, however, higher labour productivity can only be achieved at the expense of lower capital productivity. One of the most important sources of TFP growth in the long run is technological progress.

During 1995-03, growth in the capital stock accounted for over three-quarters (3.5 percentage points) of output growth and the entire growth in labour productivity (Table I.3). The slight fall in TFP reduced growth in both output and labour productivity. The lack of improvement in TFP during this period meant that the growth in labour productivity was accompanied by a substantial decline in capital productivity. Of the 3.2 percentage point drop in average annual output growth between the periods 1981-94 and 1995-03, 2.4 percentage points can be attributed to the fall in TFP growth.

Some research on TFP in Singapore (Alwyn Young, 1992, 1995 and 1998, for example) indicates that growth was attributed to factor accumulation rather than TFP. This view has not gone unchallenged; another study (Chang-Tai Hsieh, 2002) found that TFP in Singapore grew reasonably quickly. However, a more recent study (see Fernald and Neiman, 2003) is more consistent with the earlier findings of Young. According to Fernald and Neiman (2003), market distortions (such as market power, favourable access to capital and tax preferences), which in many cases grew over time, favoured parts of the economy, possibly reducing the cost of capital of firms operating in the favoured sector and enabling them to earn large economic profits. As a result, output in the favoured sector grew nearly 10% annually for two decades, with negative TFP growth. By contrast, the relatively unfavoured sector had slower output growth, about 6% per year, but rapid TFP growth of around 2.5% annually. Another possible explanation for Singapore's low TFP is high investment in less productive assets, such as buildings, relative to more productive assets (Wong and Sim, undated). In fact, Singapore implemented a public housing ownership scheme in the early 1960s, which has resulted in most Singaporeans becoming home-owners, with a substantial amount of Singapore's capital stock in the housing sector. Calculations of TFP, which have, *inter alia*, removed residential housing from the total capital stock, suggest that TFP in Singapore has been underestimated (Ministry of Trade and Industry, 2002). A study by the IMF (2004), finds that although capital accumulation accounts for around half of Singapore's economic growth since 1960 (similar to levels found in other east Asian economies), TFP growth was not as insignificant as suggested by Young. The IMF, however, also suggests that in light of diminishing returns from capital and labour, TFP must be improved, possibly through higher investment in human capital and education.

*Source:* Young, Alwyn, (1992), "A Tale of Two Cities: Factor Accumulation and Technical Change in Hong Kong and Singapore", in Olivier J. Blanchard and Stanley Fisher, eds, *NBER Macroeconomics Annual 1992*, Cambridge, MA: MIT Press; Young, Alwyn, (1995), "The Tyranny of Numbers: Confronting the Statistical Realities of the East Asian Growth Experience, *Quarterly Journal of Economics* (August), pp. 641-680; and Young, Alwyn, 1998, "Alternative Estimates of productivity Growth in the NICs: A Comment on the Findings of Chang-Tai Hsieh", NBER Working Paper No. 6657; Chang-Tai Hsieh, 2002, "What Explains the Industrial Revolution in East Asia? Evidence from Factor Markets", *American Economic Review*; Fernald, John and Brent, Neiman (2003), "Measuring Productivity Growth in Asia: Do Market Imperfections Matter?", Federal Reserve Bank of Chicago, October 2003, WP 2003-15; Wong, Soon Teck and Benson, Sim (undated), "Multi- (or Total) Factor Productivity Trends, 1980-1998," *Statistics Singapore Newsletter*; and Ministry of Trade and Industry (2002), "Total Factor Productivity with Singaporean Characteristics: Adjusting for impact of Housing Investment and Foreign Workers," *Economic Survey of Singapore*, Third Quarter 2002.

6. Singapore's high savings rate finds its reflection in its strong external indicators. National saving, although declining, continues to greatly exceed domestic investment. The excess saving (averaging 20.78% of GDP during 1999-03) has been invested abroad. This net outflow of capital has resulted in large financial account deficits, particularly portfolio investment; net inflows of FDI were negative in 2001 but have since become positive. The counterpart of these financial account deficits is persistently large current account surpluses (also averaging 20.78% of GDP during 1999-03). In this regard, the merchandise trade surplus remained healthy, reflecting the importance of merchandise trade for Singapore, particularly external demand. The surplus in the services balance has narrowed slightly since 1999. With the current account surplus exceeding the financial account deficit during much of 1999-03 (the exception was 2001), Singapore has run surpluses in its balance of payments and accumulated official reserves of more than S\$160 billion, equivalent to over eight months of imports.

7. The importance of external demand to Singapore's economy clearly means that the external environment plays a role in TFP developments but the associated seeming decline in capital productivity does raise certain concerns, including Singapore's industrial policy. Singapore's past, highly successful, economic strategy has involved, *inter alia*, a reliance on its openness to international trade and one of the highest saving rates in the world, averaging 45.4% of GDP during the period 1999-03<sup>5</sup> and consequent high levels of investment in the business sector, including government linked companies (GLCs), in an active industrial policy. This opens the issues of: large amounts of savings generated by the mandatory fully-funded state pension scheme, the Central Provident Fund (CPF); the role of GLCs and state-owned enterprises under the statutory boards, which, according to the authorities, account for 13% of GDP; and the widespread use of tax and non-tax incentives to direct investment into certain activities. The past strong supportive state role may have been necessary in the early stages of Singapore's economic development to address market failure, when product and factor markets were far from perfect, but considerable improvements in the functioning of these markets could well suggest a need for less government involvement in the economy. Indeed the authorities have reconsidered and are redefining the State's role in the economy. Thus, for example, the Government is gradually divesting its stake in GLCs and has allowed competition in several services.

### **(3) MACROECONOMIC POLICIES**

#### **(i) Monetary and exchange rate policy**

8. There have been no major changes in the monetary policy framework since the last review. Singapore continues to apply an exchange rate centred monetary policy framework focussed on "promoting price stability as a sound basis for sustainable growth".<sup>6</sup> Monetary policy consists of managing the Singapore dollar, which is pegged to a currency basket that includes the major trading partners and competitors and moves flexibly within a policy band.<sup>7</sup> The Monetary Authority of Singapore (MAS) announces the level and direction in which the Singapore dollar will fluctuate within the band semi-annually. The MAS implements this policy through direct sales or purchases of

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<sup>5</sup> The high rate of national saving can also be attributed to the fact that capital-owners appear to receive slightly more than half of total factor income (51.8% during 1990-98), a very high share by international standards. Given that capital-owners' propensity to save is usually much greater than that of wage-earners, the higher the capital owners' share of total factor income, the higher the overall saving rate. Capital-owners' large share of total factor income may be related to the continuing setting of wages by the National Wage Council. It is also the consequence of pure profits' high share of GDP (one-quarter, according to estimates by Fernald and Nieman, 2003), owing perhaps to the market power of some large companies, including GLCs.

<sup>6</sup> This framework has been in place since 1981.

<sup>7</sup> Monetary Authority of Singapore (2000a).

the Singapore dollar in the foreign exchange market. Money market operations supplement the foreign exchange intervention and are used to offset short-term fluctuations in banking liquidity.<sup>8</sup>

9. In 1999, MAS maintained a neutral policy stance, following an easing of monetary conditions in the second half of 1998, and narrowed the exchange rate band to its pre-crisis level. The nominal exchange rate came down significantly from its peak in 1998 and was relatively stable in 1999. The real effective exchange rate (REER) also declined, reflecting the effect of the Government's cost-cutting measures in 1998. The easy monetary conditions were also reflected in low domestic interest rates (Table I.1).

10. After maintaining a neutral policy stance in 1999, the MAS allowed a gradual appreciation of the Singapore dollar in 2000 and mid 2001 (Table I.1). After shifting to a neutral policy stance in mid July 2001, in October 2001, the MAS widened the band to accommodate higher volatility in international markets. In 2002, the band was narrowed again as market volatility eased, but the neutral monetary policy stance has been maintained with a 0% appreciation path for the Singapore dollar.<sup>9</sup> This policy stance was maintained after reviews in July 2002 and January 2003. However, in light of the uncertain economic outlook given the hesitant recovery of the external economic environment, in July 2003, MAS re-centred the exchange rate policy band, while maintaining a 0% appreciation policy path, with no change to the width of the band. The high degree of liquidity in the banking system has kept domestic interest rates down. Despite low interest rates, demand for credit weakened considerably in 2002 (Table I.1). Consumer prices rose by 1% in 2001, but the significant slack in the region has contributed to mild deflation since end 2001; prices declined by some 0.4% in 2002. Inflation was also contained in 2002 as a result of a package included in the FY 2002-03 Budget, which reduced the cost of key consumer goods.<sup>10</sup> Inflation is expected to remain subdued while economic activity recovers moderately.<sup>11</sup>

11. While there are no formal exchange controls, some restrictions remain on lending to financial entities for speculative purposes against the Singapore dollar. As a result, extending Singapore dollar credit facilities of more than S\$5 million to non-residential financial entities in Singapore dollars is prohibited.<sup>12</sup> In addition, non-resident financial entities must convert Singapore dollar proceeds obtained from Singapore dollar loans, equity listings, or bond issuance into foreign currency before using them to finance activities outside Singapore.<sup>13</sup>

## **(ii) Fiscal policy**

12. Singapore follows a prudent fiscal policy aimed at keeping expenditures below operating revenues and at attaining moderate budget surpluses over the business cycle. According to the authorities, Singapore has traditionally eschewed counter-cyclical policies. However, during the period under review, every fiscal budget appears to provide measures, such as tax incentives for households and businesses or direct support to help them overcome economic difficulties.<sup>14</sup> For instance, tax measures introduced in FY 1998/99 were extended in FY 1999/00 to sustain the

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<sup>8</sup> The money market tools used by MAS include foreign exchange swaps, inter-bank lending/borrowing, and sales and purchases or repurchases agreements in government securities.

<sup>9</sup> Monetary Authority of Singapore (2003a).

<sup>10</sup> In particular, it is estimated that the motor vehicle-related measure introduced by the FY2002 Budget, pushed down private road transport costs by 1.4% thereby containing inflation; road taxes were also reduced by around 20%. (Monetary Authority of Singapore (2003b).

<sup>11</sup> Monetary Authority of Singapore (2003c).

<sup>12</sup> Information provided by the authorities.

<sup>13</sup> IMF (2002a).

<sup>14</sup> Monetary Authority of Singapore (2003b).



economic recovery; incentives were also introduced to enhance Singapore's "competitive edge", and encourage the growth of knowledge-intensive and high-value-added activities. The Budget for FY 2001/02 provided a series of incentives to increase the attractiveness of the Singapore economy, as well as to facilitate its transition to the next phase of economic development (based on knowledge-intensive industries). In addition, the government announced two off-budget packages in 2001 amounting to 8.4% of GDP, to help households and businesses overcome the recession.<sup>15</sup> Economic recovery in 2002 remained weak; as a result, some of the measures contained in the two off-budget packages were extended until June 2003.<sup>16</sup> On the revenue side, taxes were restructured to maintain Singapore's economic competitiveness; there was a shift towards indirect taxation as personal and corporate income tax rates were cut and the Goods and Services Tax (GST) was raised (Chapter III(4)(ii)).<sup>17</sup> In FY 1999 and FY 2000, Singapore was able to maintain a budget surplus; however, the situation was reversed in FY 2001 and FY 2003. According to the authorities, these deficits are not structural and the Government remains committed to a prudent fiscal policy.

13. The Budget for FY 2003/04 introduced further measures to stimulate the economy. Two additional relief packages were announced in 2003: a S\$230 million SARS Relief Package (0.2% of GDP), and package (of 0.7% of GDP), including various rebates and an acceleration of some infrastructure projects. As a result of these measures, the deficit for 2003 is expected to be 1.1% of GDP.<sup>18</sup>

### (iii) National wage policy

14. Wages continue to be regulated according to recommendations to the Government by the National Wage Council (NWC).<sup>19</sup> The NWC's annual recommendations are based on reviews of wage trends in relation to economic performance and projections.<sup>20</sup> In good years, the NWC has recommended wage increases and additional bonuses and in times of adversity, it has recommended wage cuts to help companies remain viable and preserve jobs. In 2003, in response to the SARS outbreak, the NWC recommended, *inter alia*, a wage freeze for most companies, a reduction in wages for companies directly affected, and the granting of bonuses in companies doing well.<sup>21</sup>

## (4) STRUCTURAL MEASURES

15. With Singapore's manufactured exports facing intensified competition in the longer term from other countries in the region with lower input, particularly labour, costs, the Government intends to carry out major structural reforms as recommended by the Economic Review Committee (ERC) in 2003. These reforms are aimed at addressing the immediate problem of competitiveness as well as the longer run challenge of moving into high-value-added industries.

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<sup>15</sup> These off-budget packages feature a series of tax reductions and fee rebates for individuals and businesses, as well as transfers to the public via the New Singapore Shares, the Skills Development Fund the ElderCare Fund, and the Community Assistance Fund (Monetary Authority of Singapore, 2003b).

<sup>16</sup> These measures include property rebate, rental rebates, reduction of the diesel tax on taxis, and reduction of petrol excise duties.

<sup>17</sup> The Government is committed to bringing down both corporate and personal income tax rates to 20% within three years (Ministry of Trade and Industry, 2003).

<sup>18</sup> Data provided by the authorities based on FY 2003 budget estimates.

<sup>19</sup> The NWC is a tripartite advisory body, created in 1972, which includes representatives from the Government, employers, and the trade unions.

<sup>20</sup> It is not clear to the Secretariat whether these recommendations are generally followed.

<sup>21</sup> Ministry of Manpower, Procedures/Guidelines [Online]. Available at: [http://www.mom.gov.sg/MOM/CDA/0,1858,1276-----4469\\_1760---3945---,00.html](http://www.mom.gov.sg/MOM/CDA/0,1858,1276-----4469_1760---3945---,00.html) [6 February 2004].

16. To address the ERC's recommendations on lowering costs, the Government has lowered the corporate tax rate from 26% in 2000 to 22% in 2003/04 (thereby reducing the value of certain tax incentives).<sup>22</sup> It has also cut CPF contribution rates from 40% to 33% (20% for employees and 13% for employers) in 2003. Despite this reduction, rates remain high by international standards. Moreover, the CPF apparently fails to provide individuals with sufficient income security during retirement. This has been attributed to the low returns from CPF investments and the heavy pre-retirement withdrawals allowed for the purchase of housing. In order to address the situation and the rising dependency ratio caused by an aging population, the Government announced key changes to the CPF scheme to ensure that Singaporeans have enough savings when they retire.<sup>23</sup> The ERC also suggested that factor costs, such as wages and land charges, should be kept down to lower overall costs of production. The Government considers that, in order to facilitate the ongoing structural adjustment of the economy, the labour market needs to be more flexible, allowing workers to easily change jobs, and companies to hire or fire workers as required. It believes that companies should be allowed to adopt flexible working and compensation arrangements, and that wages need to be linked to performance and firm's profitability, and less on seniority.<sup>24</sup> To keep land costs manageable, it was recommended that the Government ensure an adequate supply of industrial land at internationally competitive prices to enable Singapore to attract investment in manufacturing. In accordance with this recommendation, the Government has reserved enough industrial land to meet the needs of the manufacturing sector<sup>25</sup>, and has published a list of industrial sites available for sale.<sup>26</sup>

17. The longer-run challenge of moving Singapore into higher-value-added manufacturing and services is being addressed principally through investment in infrastructure and incentives to attract investment in the targeted areas, and through further regulatory reform.<sup>27</sup> The ERC also expressed concern about the apparent lack of an "enterprise culture" in Singapore. Steps are being taken to attract multinational companies, especially in targeted sectors, and to provide assistance to local companies to become "entrepreneurial". In this context, a new Minister of State for entrepreneurship and for services has been established. For services, in particular, it was felt that Singapore has "not been as aggressive and proactive" as in manufacturing, and therefore steps had to be taken to rectify this imbalance.<sup>28</sup>

18. The Government has also undertaken regulatory reform in services (telecommunications, electricity, and gas) and raised or removed foreign investment limits (for example in telecommunications, financial services, electricity). Some steps have been taken to curtail the role of GLCs, which operate in many sectors; some enterprises have been privatized during the period under

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<sup>22</sup> In the Budget Speech introducing the FY 2004 Budget to Parliament, the Finance Minister indicated that the corporate tax rate would be reduced further to 20% by FY 2005.

<sup>23</sup> For a detailed list of these changes, refer to Central Provident Fund Board (2003 and 2004).

<sup>24</sup> Ministry of Finance (2003).

<sup>25</sup> Minister of Finance (2003).

<sup>26</sup> This list of industrial sites available for sale is known as the Reserve List; interested parties can make an application for the site, indicating their minimum bid price. If the application meets the Government's reserve price for the site, it will be launched for open tender. The minimum bid must be at least 85% of the Chief Valuer's estimated market value (EMV) for the site for the bid to be accepted. The EMV is determined on the day the tender closes. All bids matching this minimum amount are sent to the land sales agency for evaluation. The Reserve List is published online at: <http://www.ura.gov.sg>.

<sup>27</sup> Singapore has developed infrastructure to support its biotechnology industry and the industrial parks cater to special needs of targeted industries. Many of Singapore's incentives relate to R&D related industries or services.

<sup>28</sup> Economic Review Committee (2003a), p. 154. The ERC report states that many of Singapore's service industries are not yet world class, citing as a main reason the belief that Singapore has not been sufficiently proactive and aggressive in developing the service sector.

review, although it is not clear what market share they represent (Chapter III(4)(i)(c)).<sup>29</sup> Moreover, after long eschewing an over-arching competition law, the Government has announced its intention to enact such a law.

## **(5) DEVELOPMENTS IN TRADE**

19. The economy's openness to trade and investment has played an important role in Singapore's development. Since 1999, trade in goods and services has accounted on average for some 360% of GDP. Nevertheless, growth in merchandise exports and imports has been erratic during the period under review.<sup>30</sup> Growth in services trade has slowed (Table I.1). Singapore is a major supplier of services (e.g. seaport and airport services, and trading services), but it is now facing competition from other service suppliers in the region. The quality, efficiency and cost of infrastructure services could be further improved; for instance, port charges need to decline.<sup>31</sup>

### **(i) Composition of merchandise trade**

20. Singapore continues to export mainly manufactured products; office machines and telecommunication equipment remain the main exports despite a 14 percentage point decline since 1999, attributable to the downturn in the global demand for electronics (Chart I.2). Exports of fuel have increased since 1999.<sup>32</sup> Manufactured goods accounted for roughly 80% of imports in 2003 (down from 83.2% in 1999). As in the case of exports, manufactured imports consisted mainly of office machines and telecommunication equipment; imports of fuel are also important. Entrepôt trade remains a major income-generating activity, accounting for 44.7% of Singapore's total exports in 2003, up from 40.1% in 1999. In 2003, re-exports also consisted of manufactured goods, again mainly office machines and telecommunication equipment.

### **(ii) Direction of merchandise trade**

21. In 2003, Singapore's main market for domestic exports was the European Union (16.0%), followed closely by the United States (15.5%). However, both regions have declined in importance since 1999 (Chart I.3). The authorities attribute this partly to an increase in domestic exports to China and other Asian countries. The East-Asian countries as a group remained Singapore's main market. ASEAN absorbed 25% of Singapore's domestic exports in 2003, up from 19.6% in 1999. China's share has increased since 1999 for total exports and as a source of imports. Major import sources in 2003 included Malaysia (16.8%), the United States (13.9%), the European Union (12.5%), and Japan (12%). Since 1999, Malaysia has displaced the United States as Singapore's main source of total exports and imports. The share of the East-Asian countries in total imports has remained almost unchanged, while the share of imports from ASEAN countries has increased. This, together with ASEAN's increasing share of Singapore's domestic exports, suggests perhaps some trade diversion due to the AFTA.<sup>33</sup> Malaysia is also an important source of re-exports.

<sup>29</sup> There is very little information available on the GLCs, the sectors in which they are active (their contribution is estimated by the authorities at around 13% of GDP although other studies puts the share higher), or future plans by Temasek to reduce its shareholdings in these companies (Chapter III(4)(i)).

<sup>30</sup> The sharp rebound following the Asian crisis in 1999-00 was followed by a decline in 2001 and moderate growth in 2002. Rapid growth resumed in 2003 (Table I.1).

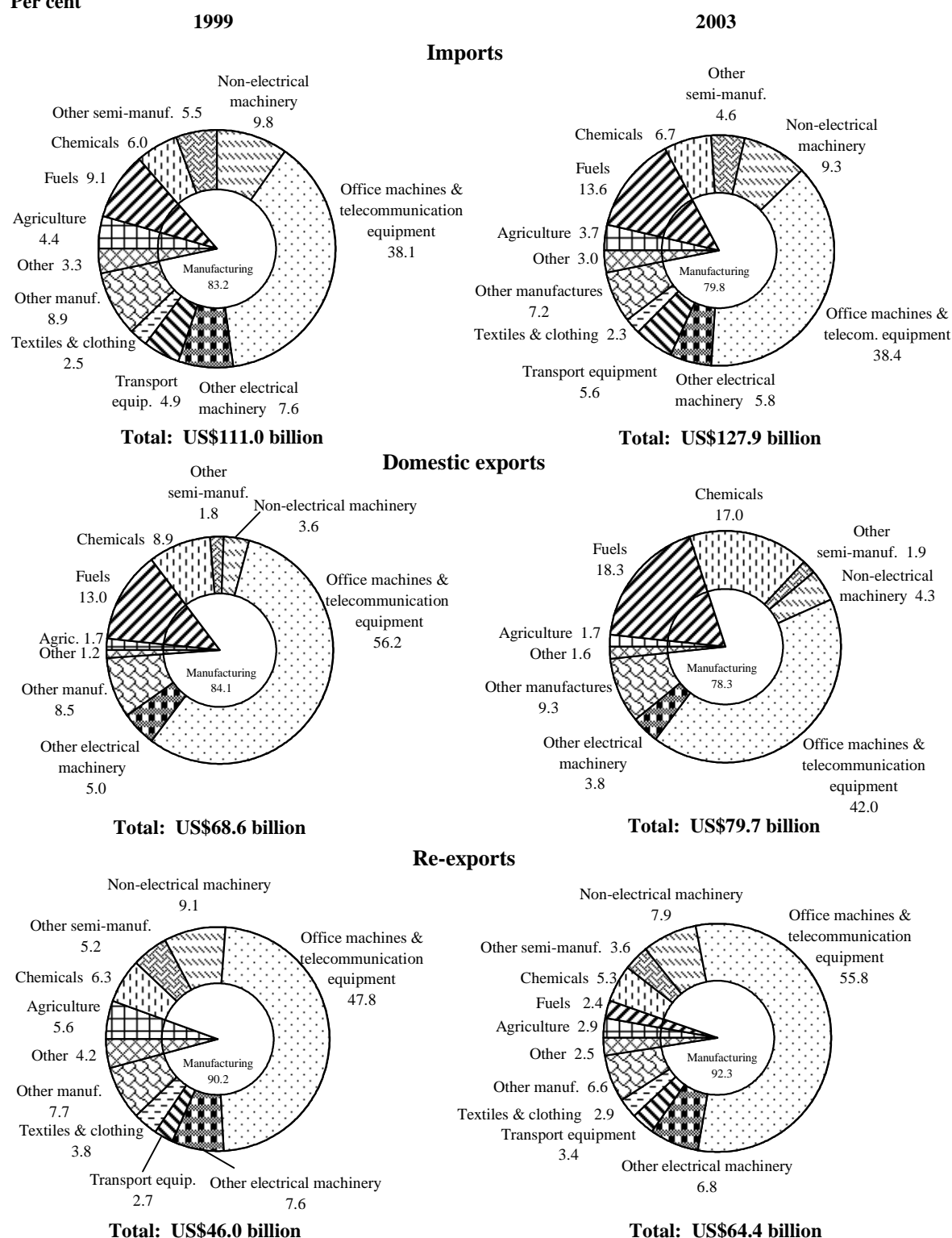
<sup>31</sup> Ministry of Finance (2003).

<sup>32</sup> This was due to a 49% increase in oil prices from 1999 to 2002.

<sup>33</sup> The share of the ASEAN countries in total imports increased from 23.7% in 1999 to 24.4% in 2003.

**Chart I.2**  
**Product composition of merchandise trade, 1999 and 2003**

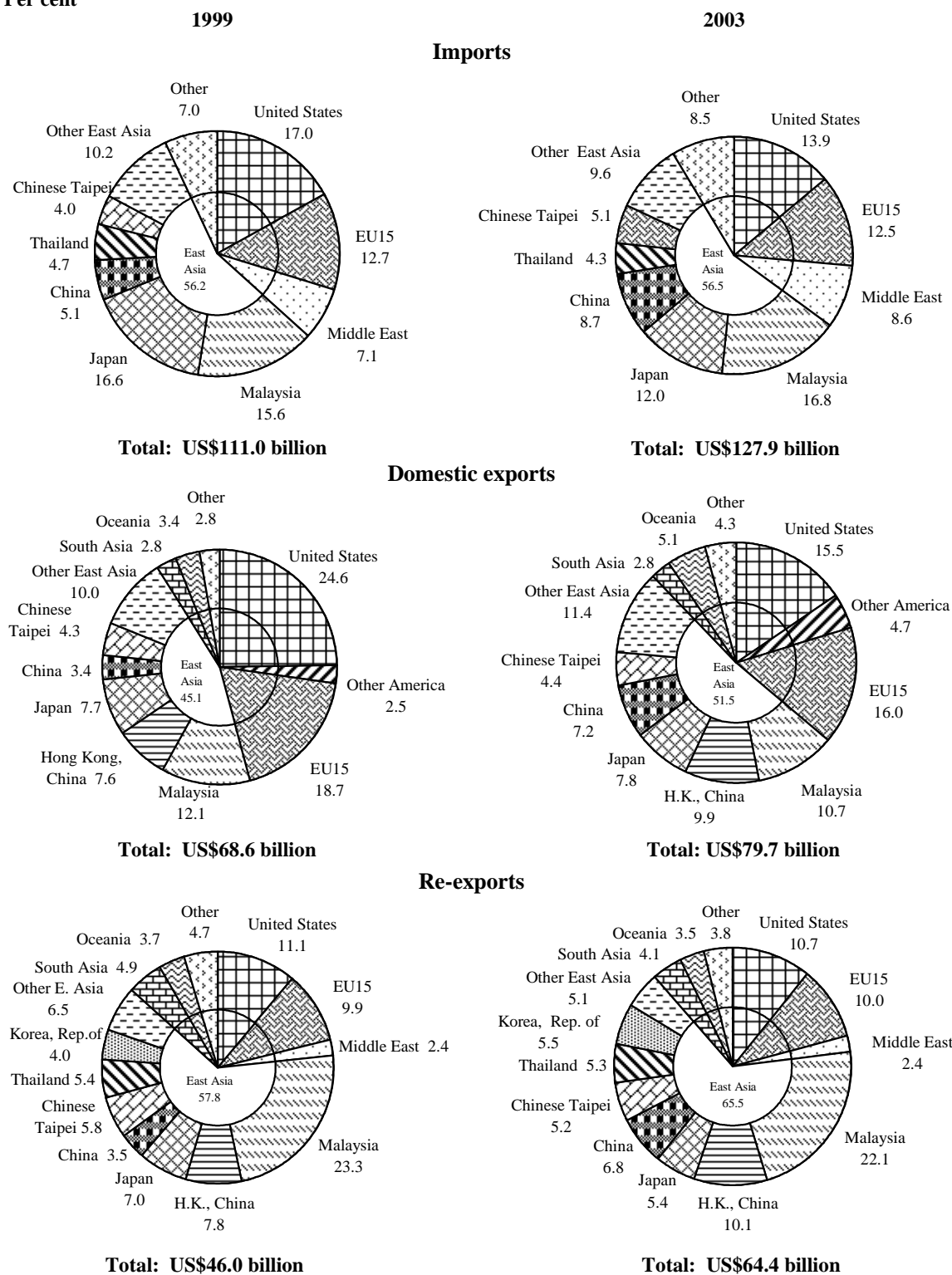
Per cent



Source : Data provide by the authorities of Singapore.

**Chart I.3**  
**Direction of merchandise trade, 1999 and 2003**

Per cent



Source : Data provide by the authorities of Singapore.

**(iii) Composition of trade in services**

22. Singapore remains a net exporter of services; services exports (in terms of GDP) have been growing since 1999, from 32.4% to 33.6% in 2003. Consistent with Singapore's role as an entrepôt, transportation, despite a slight decline since 1999, remains the most important service export. The share of exports of "other business services" in total services exports has increased since 1999.<sup>34</sup> In 2002, services imports were also dominated by transportation and "other business services" (Table I.4).

**(iv) Direction of trade in services<sup>35</sup>**

23. The European Union, Japan, and the United States continue to be Singapore's major service export markets and the largest suppliers of services imports. The combined share of exports of these three trading partners has not varied much since 1999; the United States' share decreased from 18.8% in 1999 to 16.5% in 2001, the EU's share showed a slight increase since 1999 (from 14.5% to 15.1%), while Japan's share fell from 9.9% in 1999 to 9.1% in 2001. In 2001, the major services suppliers to Singapore were the United States (32.4%), the European Union (16.6%), and Japan (5.6%).

**Table I.4**  
**Trade in services, 1999-03**  
(S\$ million and per cent)

	1999	2000	2001	2002	2003
Services balance	3,550.1	3,382.9	1,293.0	443.7	1,980.5
Export of services	44,683.3	50,699.7	52,139.9	53,676.1	53,494.9
of which in %:					
Transportation	40.5	40.4	39.4	40.0	38.4
Travel	19.3	17.8	15.9	14.9	13.0
Insurance	1.4	1.7	2.3	2.5	2.8
Government services	0.3	0.3	0.3	0.3	0.3
Construction	0.6	0.5	0.7	0.7	0.6
Financial	4.5	4.7	4.1	4.3	5.9
Computer & information	0.9	0.8	1.1	1.1	1.0
Royalties	0.3	0.3	0.6	0.6	0.6
Social	0.0	0.1	0.1	0.1	0.1
Other business services	32.2	33.4	35.7	35.6	37.2
Import of services	41,133.2	47,316.8	50,846.9	53,232.4	51,514.4
of which in %:					
Transportation	45.7	46.7	43.6	43.0	45.4
Travel	15.9	16.5	19.3	21.2	16.7
Insurance	4.7	5.4	5.1	5.6	6.2
Government services	0.5	0.4	0.5	0.5	0.5
Construction	0.8	0.5	0.6	0.5	0.5
Financial	1.3	1.5	1.3	1.3	1.2
Computer & information	0.7	0.8	1.0	0.7	0.7
Royalties	15.9	13.2	12.0	10.6	11.3
Social	0.1	0.1	0.1	0.1	0.1
Other business services	14.4	15.0	16.5	16.4	17.4

Source: Data provided by the authorities of Singapore.

<sup>34</sup> Other business services include accounting, advertising, architectural, business management, engineering and technical, legal, research and development, and trade-related services.

<sup>35</sup> Based on information provided by the authorities, which is not complete; it includes only the eight major trading partners and excludes services such as travel and government services.

**(6) DEVELOPMENTS IN FOREIGN DIRECT INVESTMENT (FDI)**

24. Singapore has traditionally been a major recipient of FDI, third in the region after China and Hong Kong, China.<sup>36</sup> However, inward FDI decreased from S\$27.2 billion in 1999 to S\$19.9 billion in 2002. Net FDI as a share of GDP also decreased substantially, from 10.4% in 1999 to -2.4% in 2001; but recuperated in 2002 and to 2003 (Table I.1).

25. In 2001, inward FDI was mainly in services (56.7%), but there has been a substantial decline in foreign investment in this sector since 1999, when it absorbed 73.2% of total FDI.<sup>37</sup> The major decline in investment occurred in commerce and financial services. In contrast, FDI flows in manufacturing have increased substantially since 2001. The United States is the major single investor, followed by Japan. U.S. investment in Singapore has almost doubled since 1999; Japan's investment has also increased. The European Union also continues to be a major investor in Singapore, but its investments have declined since 1999 as have investments originating in Asian countries as a group.

26. Singapore's total outward FDI stock was S\$131.19 billion in 2001 (Table AI.1). Investment abroad was mainly in financial services (56.5%) followed by manufacturing (20.7%). Since 1999, the proportion of investment in manufacturing has decreased while that in services has increased.<sup>38</sup> Singapore invests mainly in the region, with Asian countries absorbing some 48% of Singapore's investments abroad. The major recipient in 2001 was China (12.6%). A substantial share (36%) of Singapore's investment abroad goes to "other countries." (e.g. Latin American countries) (Table AI.2).

**(7) PROSPECTS**

27. As a small open economy, Singapore's future growth depends heavily upon the recovery of its main trading partners, particularly their demand for electronics, which would not only boost manufacturing but also trade-related services. Sustained recovery in services after the post-SARS rebound of the sector also depends on a more favourable external environment. The Singapore economy rebounded in the second half of 2003 in tandem with improvements in the external environment and, according to the authorities, the immediate outlook is healthy as growth in the major economies is expected to be sustained into 2004.

28. The prospects for growth in the longer run, however, depend upon Singapore's ability to reverse the slowdown in TFP growth since the mid 1990s and meet the challenges from low cost regional competitors. Such a reversal requires, *inter alia*, a re-evaluation of certain aspects of Singapore's development strategy, including its active industrial policy, which arguably served Singapore well in the past, at least as concerned economic growth, but may not be up to the challenges now facing the economy, particularly the emergence of other countries in the region. Singapore is tackling these issues, including through: reforms of the state pension scheme (the CPF scheme); cuts in the corporate tax rate (which reduces the value of certain tax incentives, although these are still widely used); and the announcement by the Government of its intention to enact an over-arching competition law, after long eschewing such a policy; steps have been taken slowly to reduce government holdings in the GLCs, which operate in many sectors. These, together with other ongoing structural reforms, notably those aimed at opening up services (financial and telecommunications) to more competition and making labour markets more flexible, should increase the resilience of the economy in meeting present and future challenges.

<sup>36</sup> UNCTAD (2003).

<sup>37</sup> Services include "other".

<sup>38</sup> Services include "other".