Singapore Economic Policy

The Twenty-Fifth Singapore Economic Roundtable

May 2016

Jointly organised by
Institute of Policy Studies
& The Business Times

Edited by
Manu Bhaskaran
Faizal bin Yahya
Wilfred Lau

Lee Kuan Yew School of Public Policy
National University of Singapore

IPS Institute of Policy Studies

The Singapore Economic Roundtable

The Singapore Economic Roundtable (SER) is a forum of leading economists, policy makers and business leaders who gather twice a year to discuss important issues that affect Singapore's position in the global economy. It deliberates on the role that government agencies and the private sector in Singapore should play in meeting new challenges facing the Singapore economy.

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The Institute of Policy Studies (IPS) was established in 1988 as an independent think-tank to study and generate public policy ideas in Singapore. IPS became an autonomous research centre of the Lee Kuan Yew School of Public Policy at the National University of Singapore in 2008. Today, IPS continues to analyse public policy, build bridges between thought leaders, and communicate its findings to a wide audience. The Institute examines issues of critical national interest across a variety of fields, and studies the attitudes and aspirations of Singaporeans through surveys of public perception. It adopts a multi-disciplinary approach in its analysis and takes the long-term view in its strategic deliberation and research.

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Foreword

The Twenty-Fifth Singapore Economic Roundtable (SER) was held in May 2016. The SER was convened by the Institute of Policy Studies with two aims. First, to assess the prospects for cyclical monetary and fiscal policies given the state of the macro-economy. Second, each SER also analyses a structural challenge facing Singapore with a view to understanding what policy changes might be needed to resolve such a challenge. The Twenty-Fifth SER was held at a time when global economic conditions were improving, with the G3 economies recovering and Singapore's ASEAN hinterland also set to regain momentum. However, participants were concerned about the domestic headwinds that might constrain economic growth. In particular, higher labour costs arising from the policy-induced tightening of foreign labour inflows would hurt profitability and growth prospects, and weak productivity growth combined with rising wages meant that unit labour costs were rising.

While higher unit labour costs were a risk to inflation in the near term, participants were concerned by the medium to long-term risk of disinflationary pressures. The correction in the real estate sector was one risk factor. Another risk was that the ASEAN Economic Community's trade opening would bring about a cheap labour shock akin to that caused by China when it acceded to the World Trade Organization. As in previous Roundtables, the appropriateness of the exchange rate-based approach to managing monetary policy came under scrutiny. However, the view of most participants was that such an approach, in combination with macro-prudential policies, remained the most optimal among the policy options that Singapore had.

With regard to structural challenges, Singapore had done well in recent years as a result of government policies to accelerate innovation in Singapore, with notable improvements in the development of a start-up scene in Singapore. Generous grants and the introduction of more funding mechanisms had encouraged talented individuals to start companies. Thus, the government has successfully encouraged the formation of more companies. However, Singapore faces some fundamental disadvantages stemming from its high-cost living environment, lack of scale and inadequate development in the financing of innovations.

It was therefore timely for the government to review some of its approaches to innovation so that Singapore could progress further in innovation-led growth. New funding mechanisms could be considered such as crowd-funding. Local corporations and wealthy family businesses have considerable resources and market connectivity to add value to start-ups, and policies could be devised to incentivise them to contribute more toward funding or developing innovation in Singapore.

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1.
Recent Economic Developments[1]

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1.1 External Developments and Outlook

The global economy slowed in Q4 2015 as growth mostly decelerated. Notably, economic activity in the US and Japan was partly dampened by weather-related factors, while China's ongoing restructuring had led to a weaker growth trajectory in the short term. Meanwhile, Asia-ex Japan was weighed down by financial, credit and commodity cyclical headwinds.

The global economy was expected to record another year of lacklustre growth in 2016. Alongside low GDP growth in many advanced economies and weak demand from China, growth in the West is expected to stay tepid. Domestic demand growth in the region will be impeded by rising debt service burdens with the tightening of global financial conditions. Overall, global growth is projected at 3.7% in 2016 slightly below the 3.9% recorded last year before edging up marginally to 3.9% in 2017.

[1] The views and analyses contained in this presentation are the author's and should not be attributed to MAS.

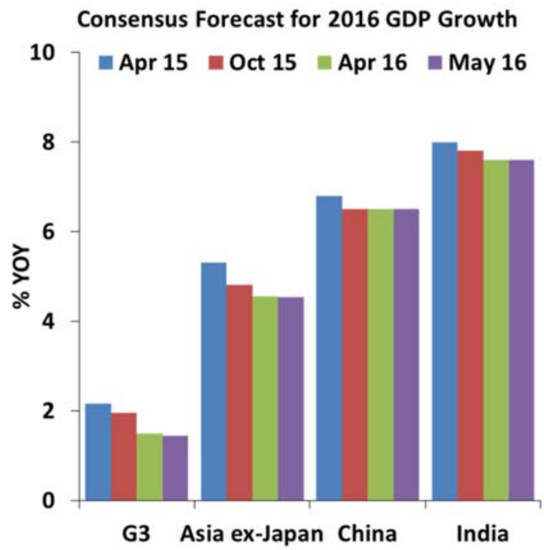


Figure 1.1

The consensus forecast for 2016 GDP growth in the G3 and Asia-ex Japan economies has been downgraded over the past year. After the Global Financial Crisis (GFC), there has been a notable decline in nominal GDP growth rates in the key advanced economies. Debt overhangs, sluggish investment and increases in long-term unemployment have contributed to a reduction in trend GDP growth. This deceleration in nominal growth reflecting low growth and low inflation was concerning, given the elevated stock of public and private sector debt in these economies.

Moving forward, a concerted package of measures that include monetary accommodation, fiscal stimulus and structural reforms aimed at enhancing economic efficiency and removing impediments to growth such as labour and product market rigidities will have a much better chance of lifting investment and economic growth.

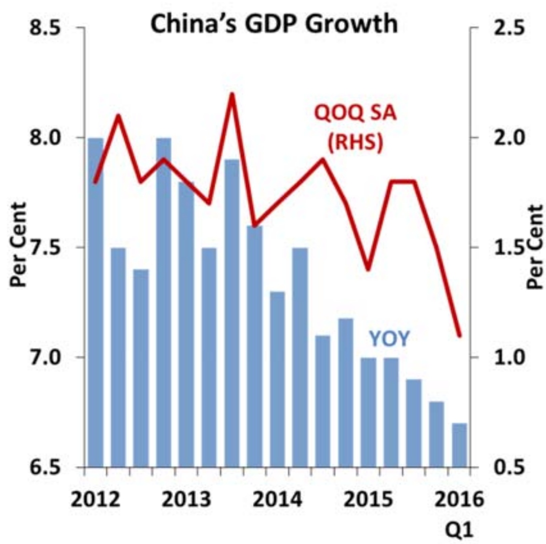


Figure 1.2

The Chinese economy experienced a gradual slowdown over the course of 2015 as the divergence between its goods and services industries widened. In Q1 2016, China's GDP decelerated to 6.7% on a year-on-year (YoY) basis and to 1.2% on a quarter-on-quarter (QoQ), with a seasonally adjusted basis in Q4 from 6.8% and 1.5%, respectively.

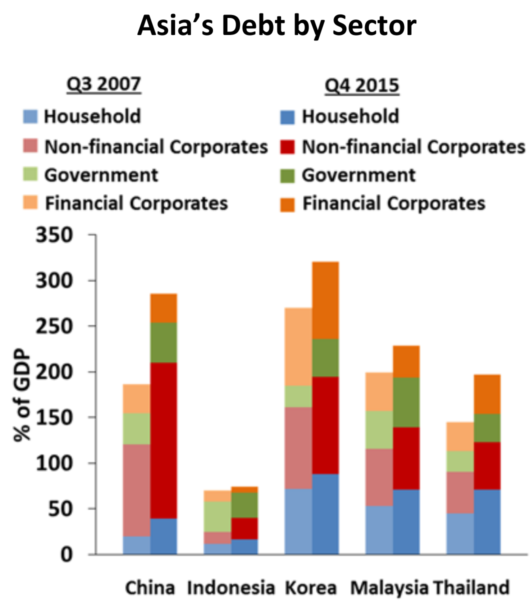


Figure 1.3

Meanwhile, growth in Asia ex-Japan would be hampered by the sharp run up in debt post-GFC. With tightening financial conditions, the resultant deleveraging process combined with slowing growth could lead to a period of weak investment and consumption growth.

1.2 Domestic Developments and Outlook

Singapore's GDP Growth

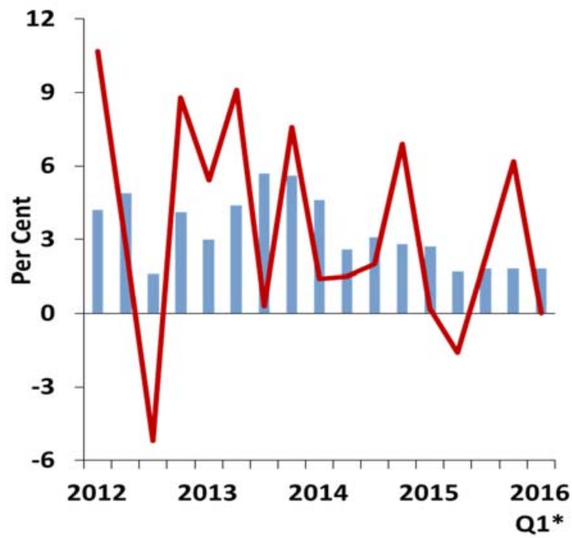


Figure 1.4

The performance of the domestic economy had been modest and uneven over the past six months after a stronger than expected Q4 2015. GDP growth came in flat in Q1 2016 on a QoQ Seasonally Adjusted Annual Rate (SAAR) basis.

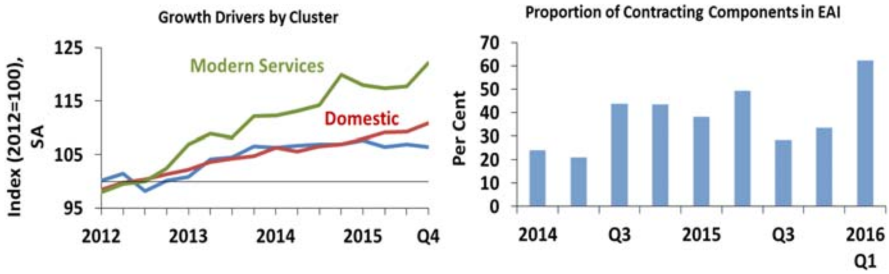


Figure 1.5

Growth was uneven across three broad clusters, with modern services expansion outpacing the rest of the economy. Growth in domestic-oriented activities continued on a relatively slow but steady upward trend. In comparison, the trade-related industries have stagnated since early last year amid persistent weakness in external environments. In early 2016, the proportion of sectoral indicators with negative sequential growth in EPG's economic activity index rose to 62% in Q1 from 33% in the preceding quarter. For the year, the domestic economy expanded at a more moderate pace of 2% in 2015, weighed down by structural and cyclical headwinds.

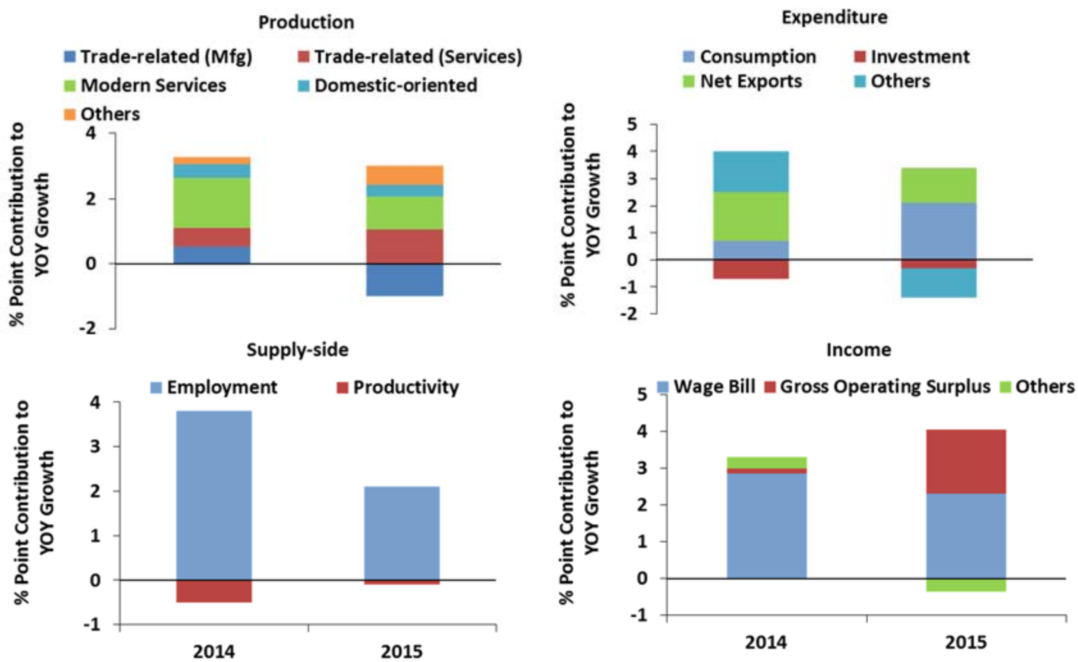


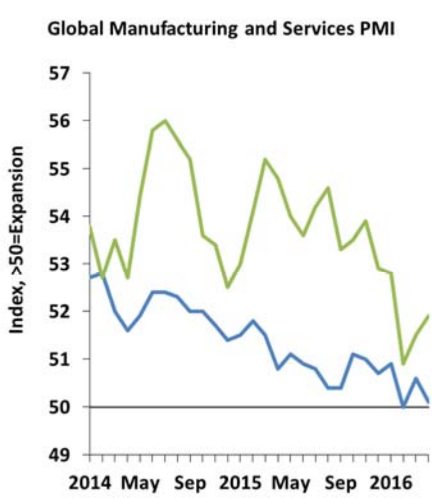
Figure 1.6

Looking at 2015's GDP growth, manufacturing contracted in the face of a more challenging global environment and ongoing consolidation. However, there were strong gains in trade-related and modern services. Notably, trade-related services were boosted by a surge in oil trading while modern services were supported by buoyant fund management activities.

Second, with net exports recording a smaller contribution, GDP growth in 2015 was instead driven by household consumption alongside strong growth in real wages, as well as increase in government consumption. Meanwhile, the drag from investment was reduced.

Third, labour productivity growth was flat in 2015. However, this was an improvement from the decline of 0.5% in 2014. A further decomposition suggested that Total Factor Productivity (TFP) declines offset the gains in capita per worker and labour quality; meanwhile, employment growth slowed.

Fourth, nominal GDP growth increased by 3.3% in 2014 to 3.7% in 2015. This was due to the increase in Gross Operating Surplus (GOS), as firms benefited from lower oil prices. There was also evidence of a shift towards higher value-added activities, particularly in IT and pharmaceutical sectors. Despite the rebound in GOS, the labour share of GDP increased for the fifth consecutive year to 43% in 2015.



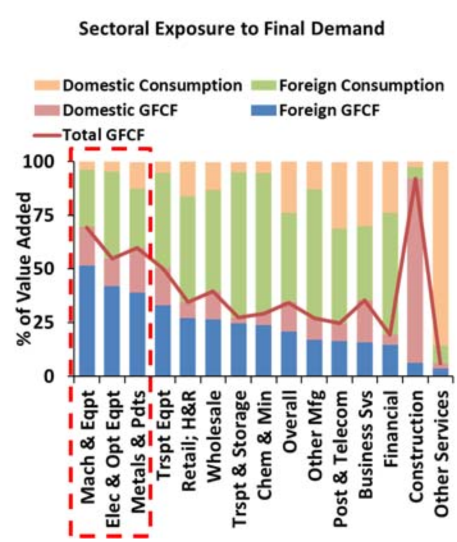


Figure 1.7

The growth outlook of Singapore's key trading partners has weakened discernably. Global manufacturing and services activity is much lower than it was a year ago. Mirroring this downshift in the external environment, the Singapore economy would likely see modest growth in the months ahead. In addition, the domestic economy is expected to be weighed down by the prolonged slump in global investment growth. Estimates from the OECD value in trade databases suggest that Singapore's electronics and precision engineering industries are the most vulnerable to a pullback in foreign investment.

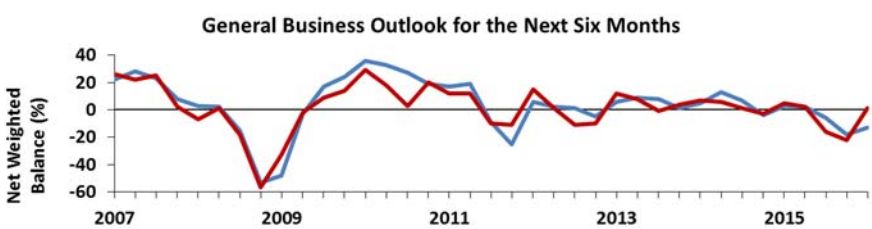


Figure 1.8

Alongside sluggish external conditions and domestic supply-side constraints, signs of strain have emerged in the corporate landscape in the latter half of last year. Some firms have responded by consolidating their domestic operations. In the earlier part of 2015, firms slowed hiring and moderated their expansion plans. As the headwinds intensified towards the middle of last year, firms began to retrench workers. Even as the general business outlook for manufacturing picked up in Q1 following a seven-year low, that of services continued to languish. Overall, the domestic economy should record modest gains this year with GDP growth likely to be in the range of 1–3%.

1.3 Labour Market and Inflation

Overall employment gains were subdued in H2 2015 as cyclical and structural factors continued to weigh on hiring.

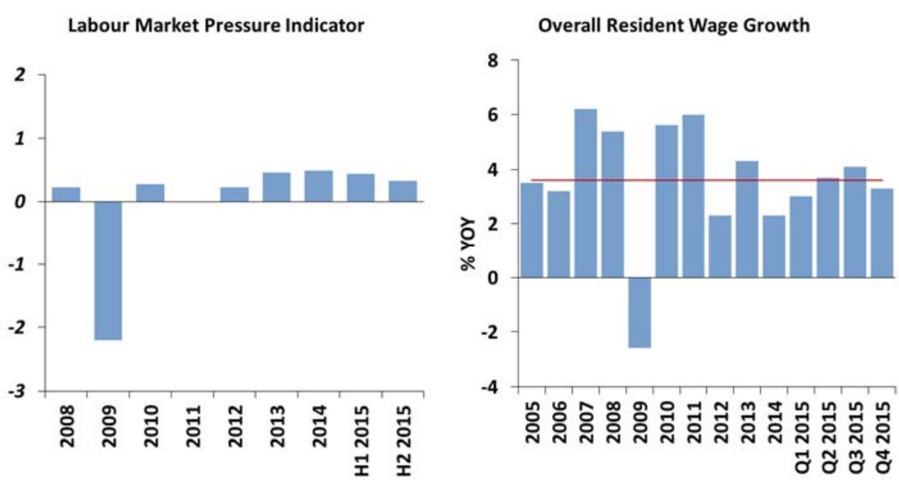


Figure 1.9

In line with weak employment demand, The Economic Policy Group (EPG)'s labour market pressure indicator suggested that labour market tightness at the economy-wide level had eased further. Accordingly, overall resident wage growth moderated to 3.3% year-on-year (YoY) in Q4 2015 from 4.1% and 3.7% in Q3 and Q2, respectively. This brought full-year wage growth to 3.5% in 2015, slightly below the 10-year historical average of 3.6%.

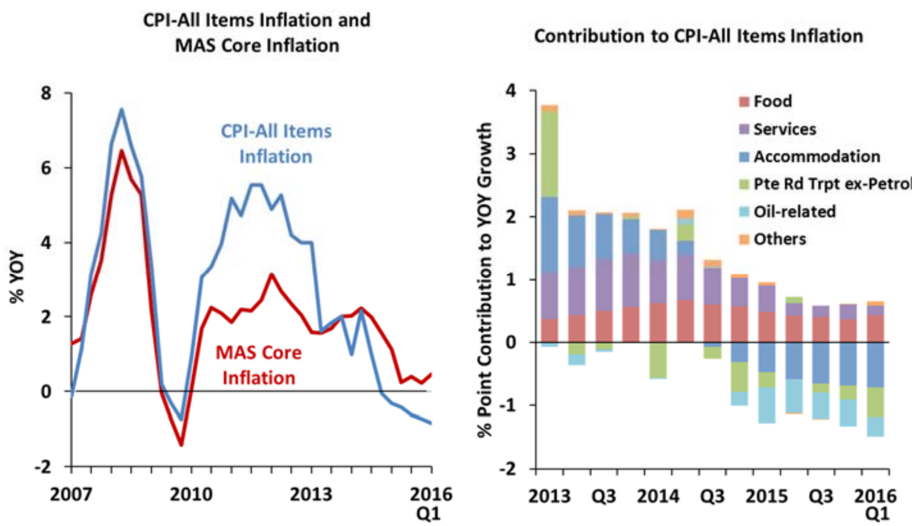


Figure 1.10

MAS Core Inflation, which excludes the cost of accommodation and private road transport, rose to 0.5% year-on-year (YoY) in Q1 2016 from 0.2% in Q4 2015. This reflected a smaller decline in the prices of oil-related items and the dissipation of disinflationary influences from budgetary and other one-off measures. In comparison, CPI-All Items inflation remains on a downtrend, falling to -0.8% in Q1 from -0.7% in the previous quarter as a result of larger declines in housing rentals and car prices.

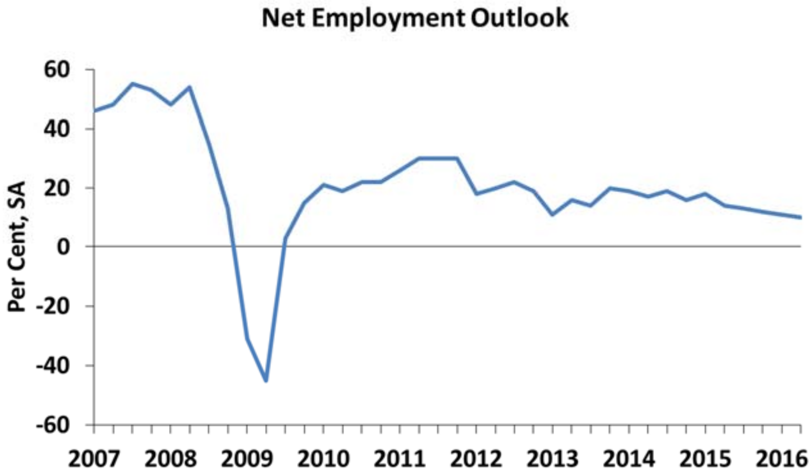


Figure 1.11

In the near term, labour demand is expected to remain subdued given weak cyclical conditions. Meanwhile, labour supply will continue to moderate amid demographic changes in the resident workforce and reduced foreign worker inflows. With lower labour demand and supply, total job creation this year is expected to stay modest. Accordingly, wage pressures are likely to ease in 2016, and overall resident wage growth is expected to moderate to about 2.5–3% from 3.5% in 2015.

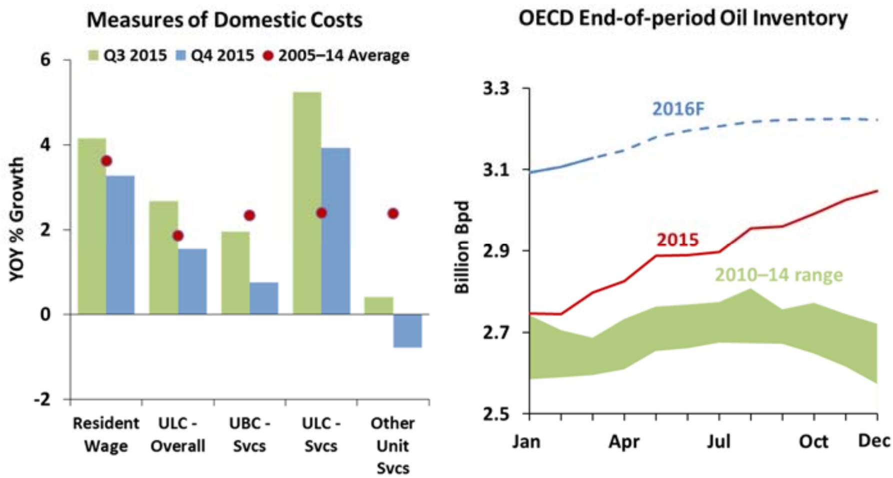


Figure 1.12

With easing labour cost pressures in the economy alongside lower rentals and utility fees, the pace of increase in firms' overall operating costs have slowed as shown by the blue bars (Figure 1.12, left). Subdued domestic demand will also temper the extent to which firms pass on higher domestic costs to consumers. Meanwhile, external sources of inflation are likely to remain muted, and upside to the global oil prices will likely be capped, as the underlying supply overhang remains significant. However, the prices of some global food commodities could rise in the short term due to unfavourable weather.

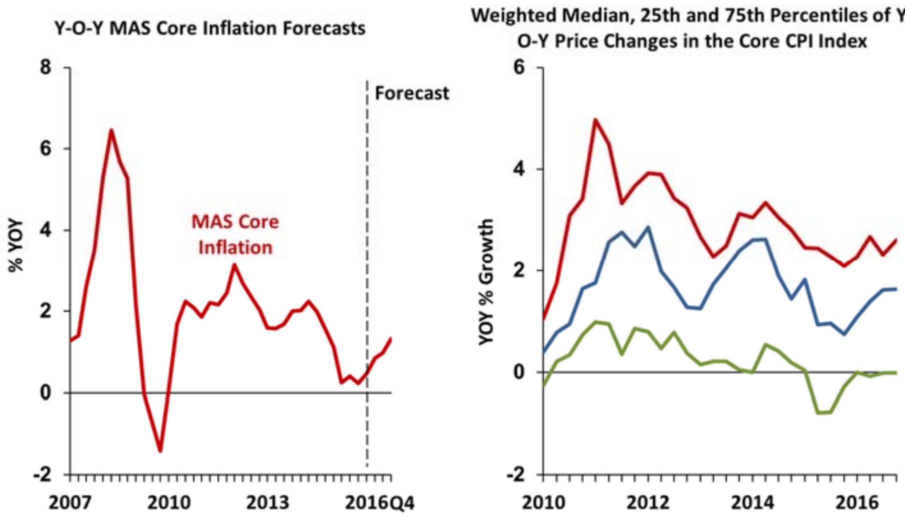


Figure 1.13

MAS Core Inflation is expected to trend slightly upwards over 2016 as the disinflationary effects of oil and other one-off measures ease. Notably, the pickup in core inflation largely reflects smaller price declines in certain components of the CPI basket rather than acceleration in price increases from strengthening aggregate demand. Compared to expectations in October 2015, the projected increase in core inflation this year is now milder given the weaker external price outlook, subdued growth prospects and a reduction in labour market tightness. Taking these factors into account, MAS Core Inflation is likely to be in the lower half of the 0.5–1.5% forecast range barring a sharp rise in global oil prices.

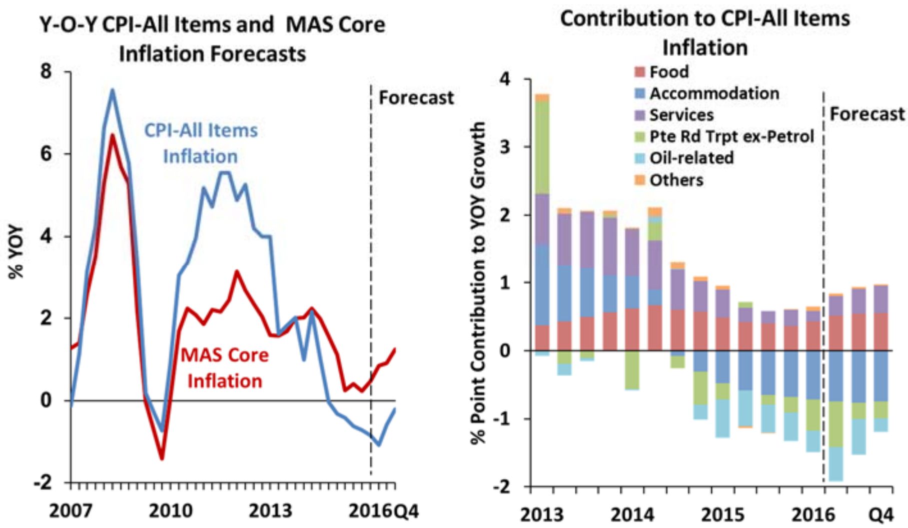


Figure 1.14

CPI All-Items inflation will continue to be dampened by further declines in COE premiums and housing rentals and continue to remain negative throughout 2016. For the year as a whole it is projected to come in between -1% to 0%.

1.4 Monetary Policy

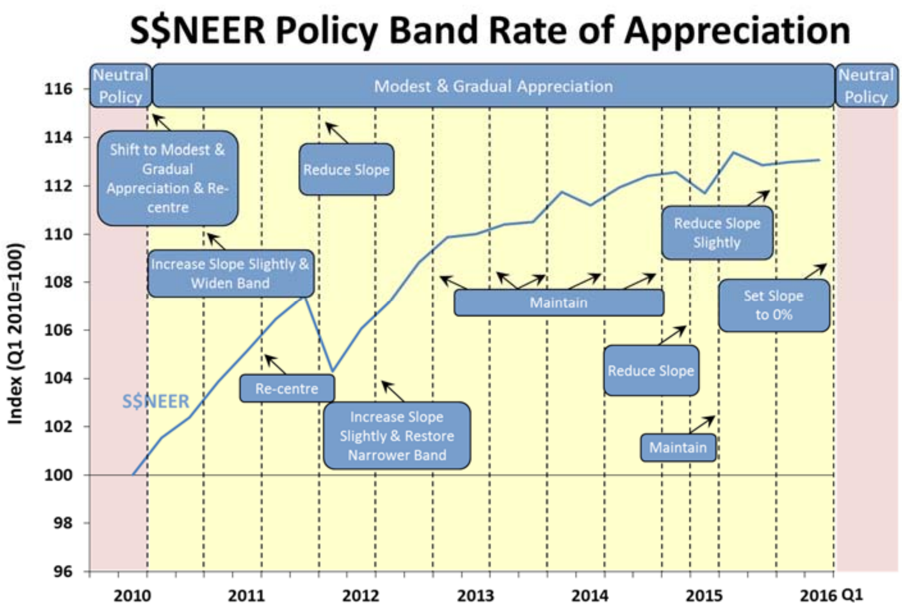


Figure 1.15

In April 2016, the MAS set the S$NEER policy band to a 0% rate of appreciation. This measured adjustment was deemed appropriate as MAS Core Inflation for 2016 was expected to pick up more gradually than previously anticipated and could fall below 2% on average in the medium term. Singapore's GDP growth outlook had also moderated against a less favourable external environment. These policy moves would help ensure price stability over the medium term.

2.
Macro-Economic Outlook for Singapore and Implications for Policy

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Deutsche Bank AG

2.1 Preamble

In the assessment of Singapore's economy, a cross-country perspective was taken to provide a broader context for the risks faced by Singapore's economy. It also explains the macroeconomic vulnerabilities of Singapore and the growth challenges it faced.

2.2 Economic Outlook for Singapore

A z-score type approach was taken in understanding how the key growth indicators are doing. The following is a 10-year based z-score on historical mean and standard deviation, and the states of retail sales, credit, industry production and Purchasing Manager Index (PMI). This was then weighed against their importance to GDP.

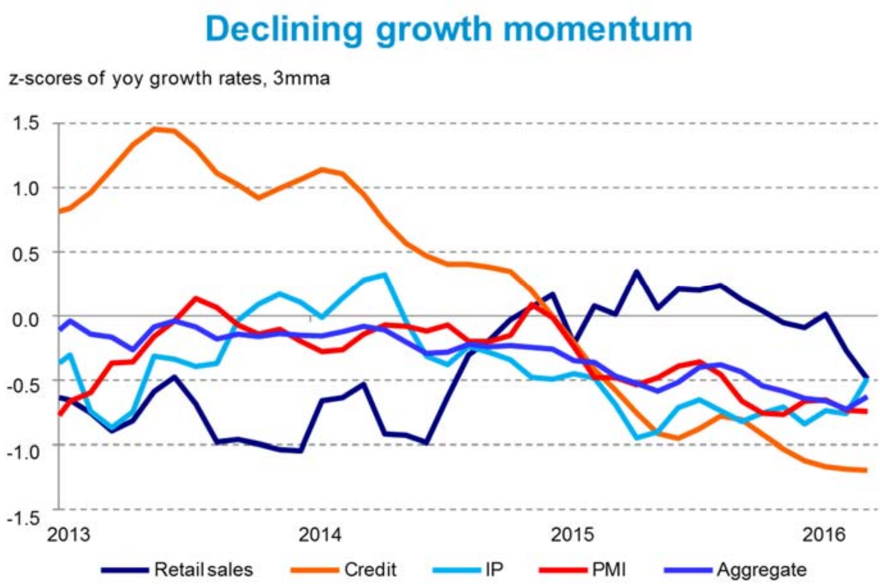


Figure 2.1

All the indicators were half to one standard deviation below the long-term trend (Figure 2.1). Even if there was marginal positive change being seen in one or two indicators on a QoQ basis, these were historically weak numbers despite the exception of slight turnaround in industry production. But this weak growth momentum is not Singapore-specific, as the z-score on an aggregate basis for all of Emerging Markets Asia (EM-Asia) shows.

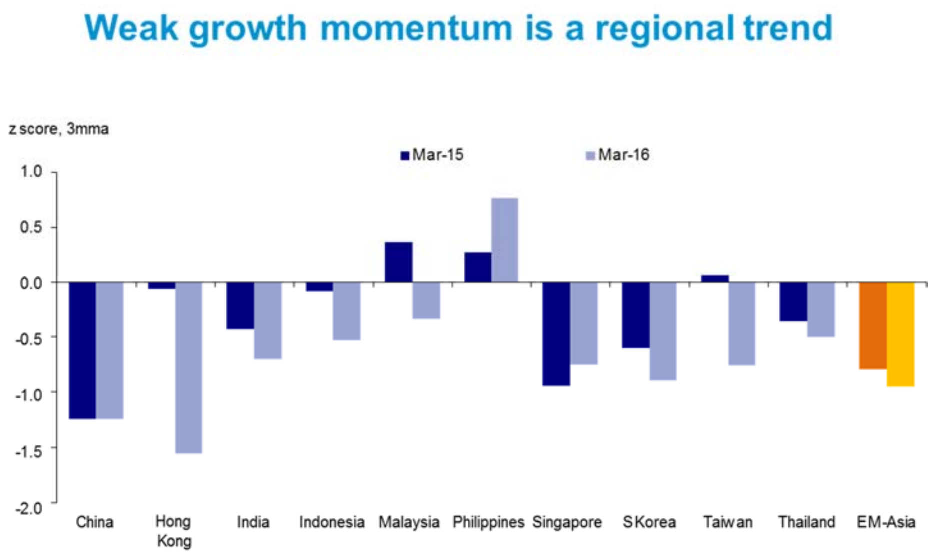


Figure 2.2

In March 2015, Asia was doing poorly. China and Singapore were more than one standard deviation below trend, with things not turning around in March 2016. The chart (Figure 2.2) illustrates the regional GDP weighted growth momentum estimation, and due to slippage in many countries and continuous drag from China, the region as a whole was decelerating. While the Singapore economy may seem depressed, it is reflecting a regional, perhaps even global trend. For an open economy like Singapore, exports are very important, so taking NODX as total exports formed a clearer picture.

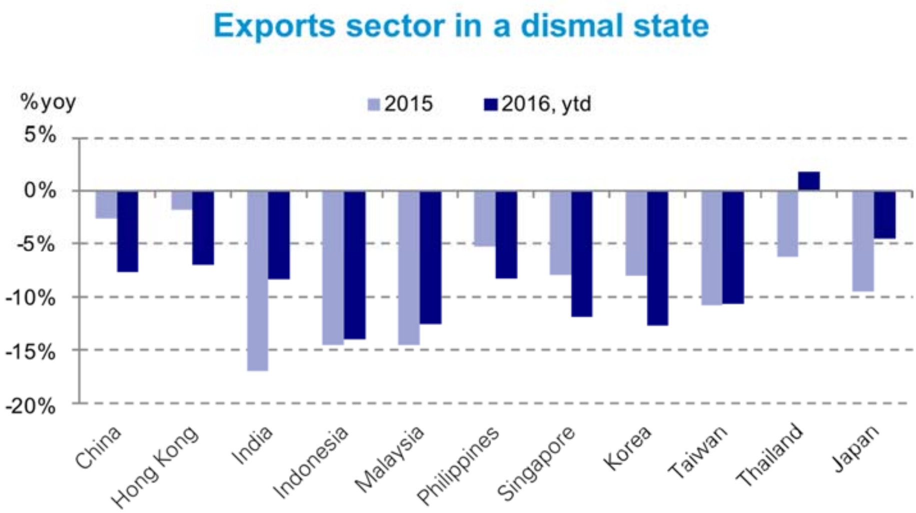


Figure 2.3

2015 was a historically poor year, with 2016 not faring much better to date for Singapore, South Korea, China and the region as a whole (Figure 2.3). This was well publicised and understood, but the speed at which monthly exports were decelerating was striking nonetheless. Even if weak demand from the US and EU was controlled for, the way the supply chain or the way the region used to work seemed to be breaking down — the components were not flowing as fluidly from Singapore, Taiwan and Korea into China as before. One theory was that China's rapid vertical integration meant they were no longer importing as much as they used to from the region. This was particularly true for high-end components, with Korea, Taiwan and Singapore being particularly vulnerable.

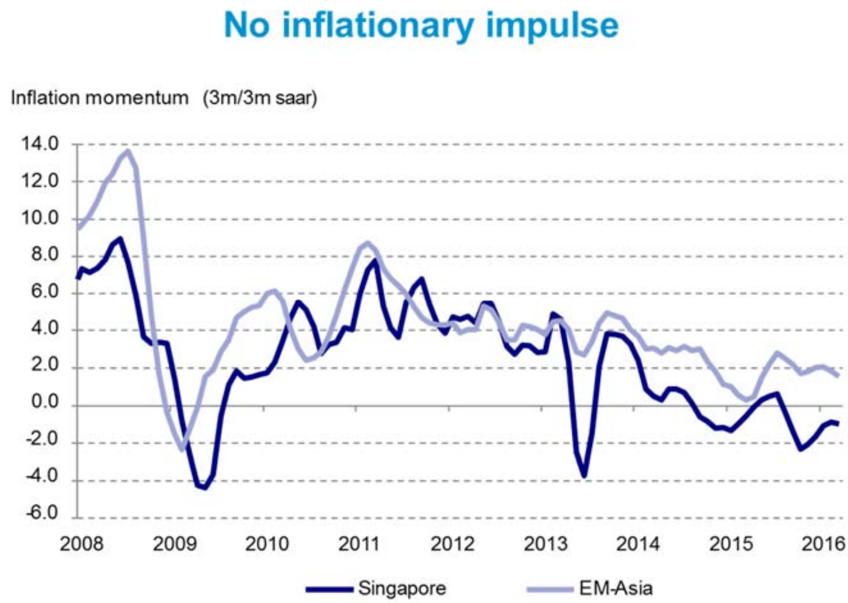


Figure 2.4

Right now, Singapore's inflation momentum is on a quarter-on-quarter seasonally adjusted annualised basis, firmly in negative territory despite some base-related reversion, and it is likely that will not be more than 0% or 1% average CPI inflation this year. Even though there was some gradual base-effect and oil price-driven pickup in inflation in the second half of this year, for the year on a whole, average inflation would be still non-existent. This had major implications for Singapore and its monetary policy.

2.3 Singapore's Macroeconomic Vulnerability

The following figure presents Deutsche Bank's research findings. All countries in EM-Asia are on the vertical axis and on the horizontal axis there are nine key growth and vulnerability dependent indicators.

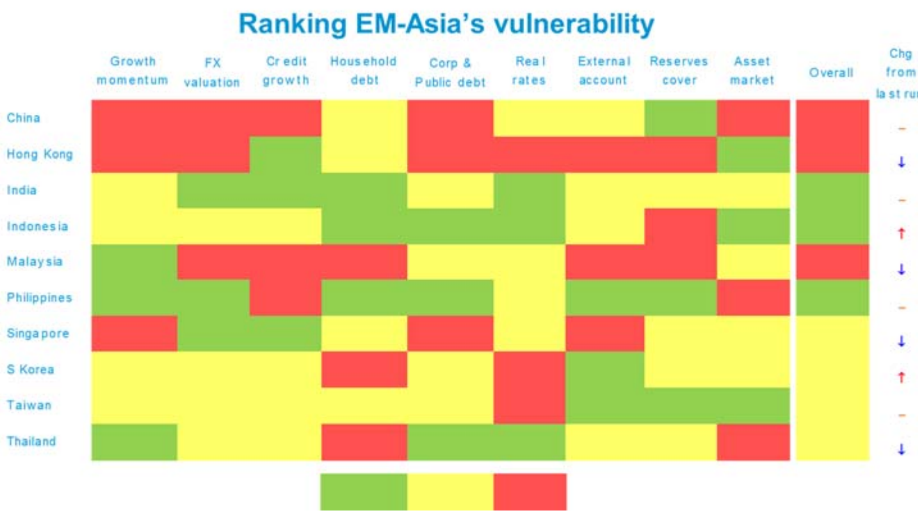


Figure 2.5

Countries are measured by particular indicators, such as growth momentum and its weakness relative to the other countries in its peer group. Economies like China, Hong Kong and Malaysia are bright red (Figure 2.5). Singapore was not in the high vulnerability category but it was yellow with Korea, Taiwan and Thailand in the same cohort. While India and Indonesia used to be weak, they have mostly graduated to the low vulnerability category. Why does Singapore get the yellow marker?

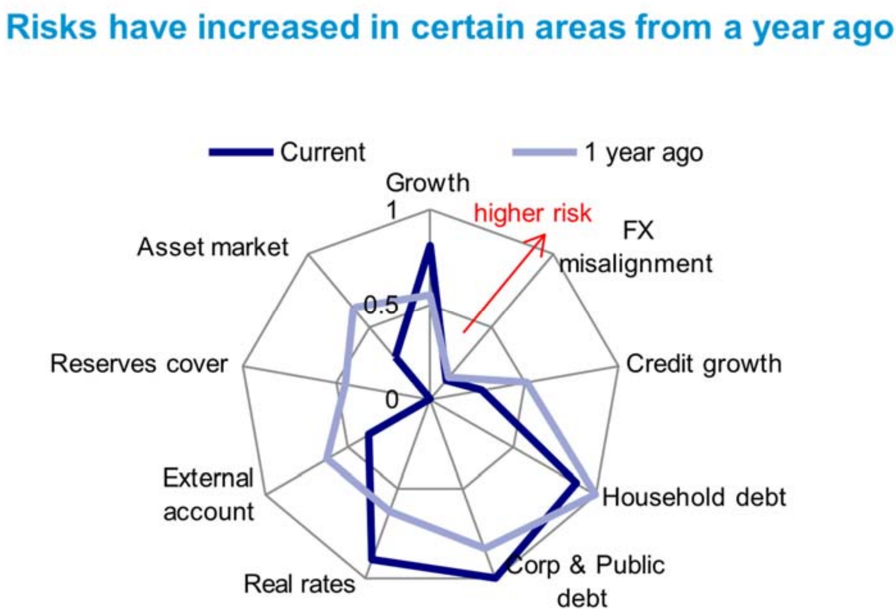


Figure 2.6

Singapore's present vulnerability markers were pegged to the previous year (Figure 2.6). Some vulnerability levels had decreased. The asset market in Singapore a year ago looked frothy, and property and equity prices were high though they had since fallen back because of the correction in the market. However, along the growth axis, slowdown in growth and relatively weak performance against trend have raised growth vulnerability. Similarly, the sustained period of deflation or disinflation had led to real interest rates increasing and Singapore was vulnerable there. Corporate debt and public debt in Singapore have always been high on that list, and the fact that there are very high positive real rates, and low to negative rates of inflation make the debt sustainability issue more onerous with monetary policy implications as well.

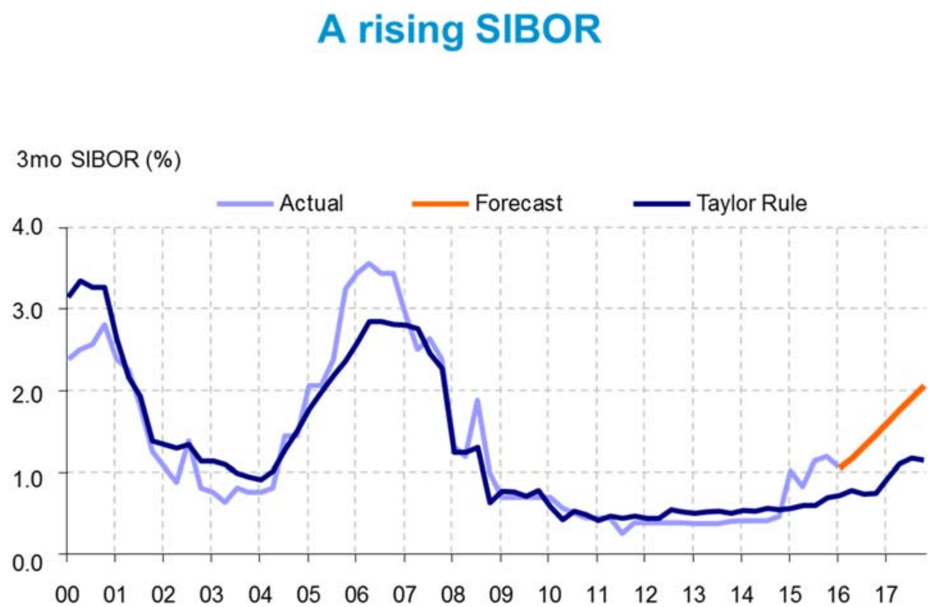


Figure 2.7

Debt risk was driven by corporate and public debt as well as household debt; Singapore had very high household debt by both regional and historical standards. This made Singapore highly susceptible to disorderly rises in interest rates, so the Taylor-rule model projected a gradual increase in interest rates in 2016 or 2017 (Figure 2.7). Even without the Taylor rule, embedded in the market forecasts were expectations that rates would continue to go up the way they have been since the beginning of 2015.

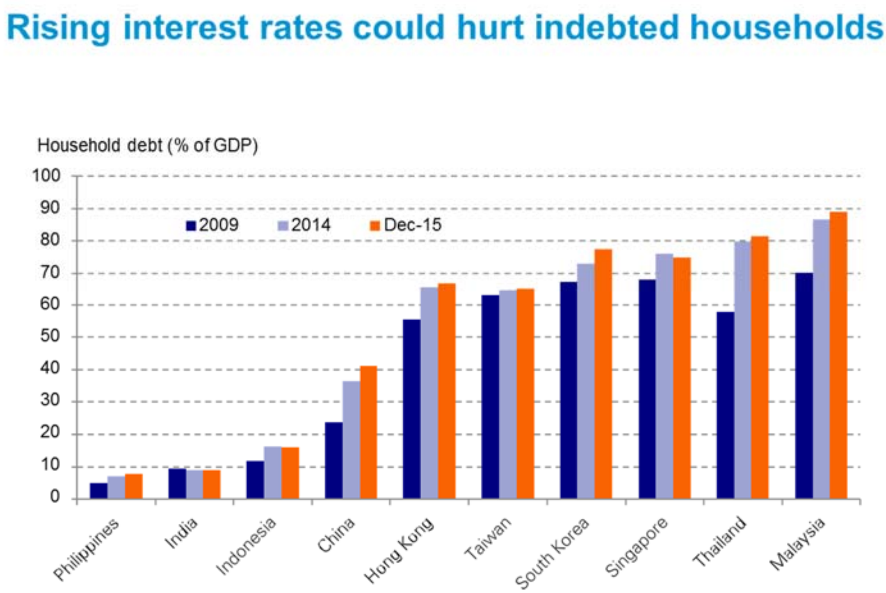


Figure 2.8

This brought in the issue of debt sustainability; a rising SIBOR or rising interest rate was a major source of risk for Singapore's financial stability going forward. On a cross-country basis, the fact that Singapore had high household debt was not a surprise as it had a high ratio of house ownership, which resulted in a fairly high household debt to GDP ratio. This ratio had been going up since 2009, while there were other economies in Asia where it had risen more starkly, e.g., Malaysia and Taiwan, Singapore was in the top four cohort of over 70% household debt-to–GDP ratio which underscored its vulnerability to rises in the interest rate.

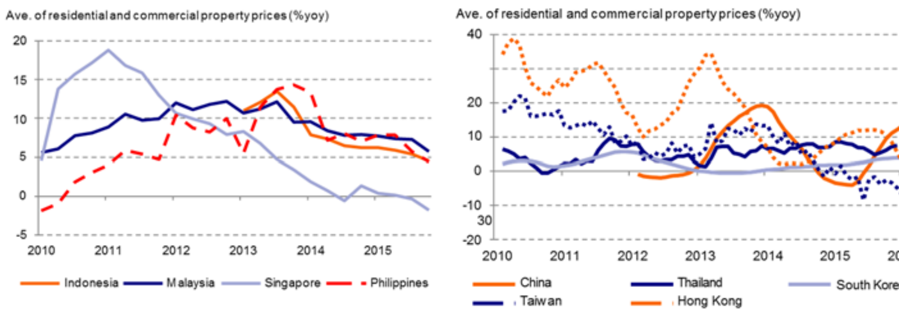


Figure 2.9

In the property sector, the regional view illustrated that property prices have fallen sharply, the regional exception being China, where commercial and residential property prices were beginning to increase. Singapore was one of the first to engineer a property market slowdown through policy measures, and the rest of the region followed suit. Even economies like Indonesia or the Philippines — which have had a relentless rise in property prices in recent years — were beginning to see some of the froth going out. This trend was believed to have continued through Q1 of 2016 despite the lack of full data for these countries. The slowing property sector had a variety of spillover-related issues for the economy, particularly for banks but also on investment confidence for businesses and consumer alike. It remained to be seen how long Singapore could tolerate this sustained decline in property prices. It was also important that some of the external vulnerabilities that have arisen in recent years — not just for Singapore — were regional. For example, exposure to China had risen substantially.

Rising vulnerability to RMB

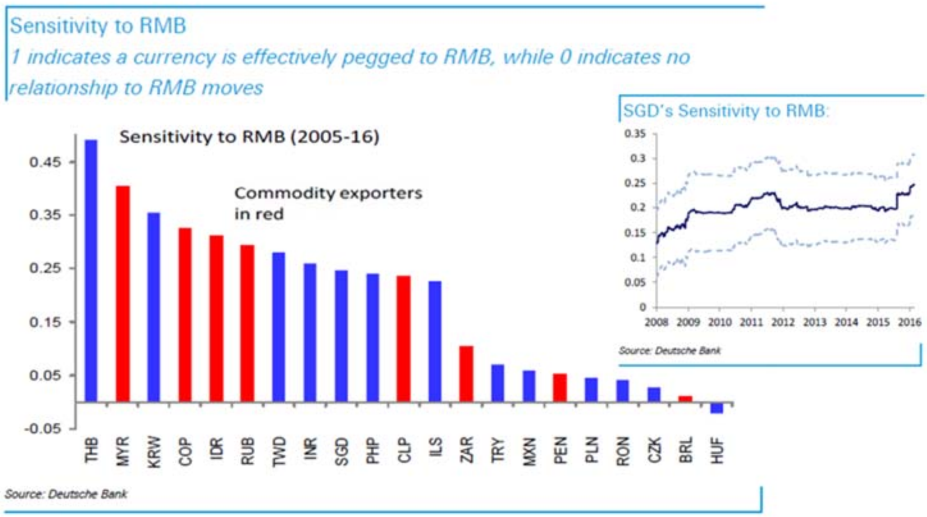


Figure 2.10

Taking the result of an exchange rate regression (Figure 2.10) is to take any given exchange rate and look at it against any third currency to track (using daily data) how these currencies fluctuated. The weights for the US dollar, Yen and Euro are not shown, though they are higher. Asian currencies tend to follow the dollar, but for a wide variety of Emerging Markets (EM), including Singapore, the weight to RMB is substantial. The inset chart in Figure 2.10 illustrates a sensitivity test from a longer, time-series perspective (recursive regression analysis) on the parameter estimate of Singapore dollar's weight to the RMB. It had been rising gradually, and due the dollar strength fading last year and rising concerns of the RMB's weakness, that sensitivity had gone up even further. This underscores the earlier point that Singapore's vulnerability had risen but it was a regional phenomenon.

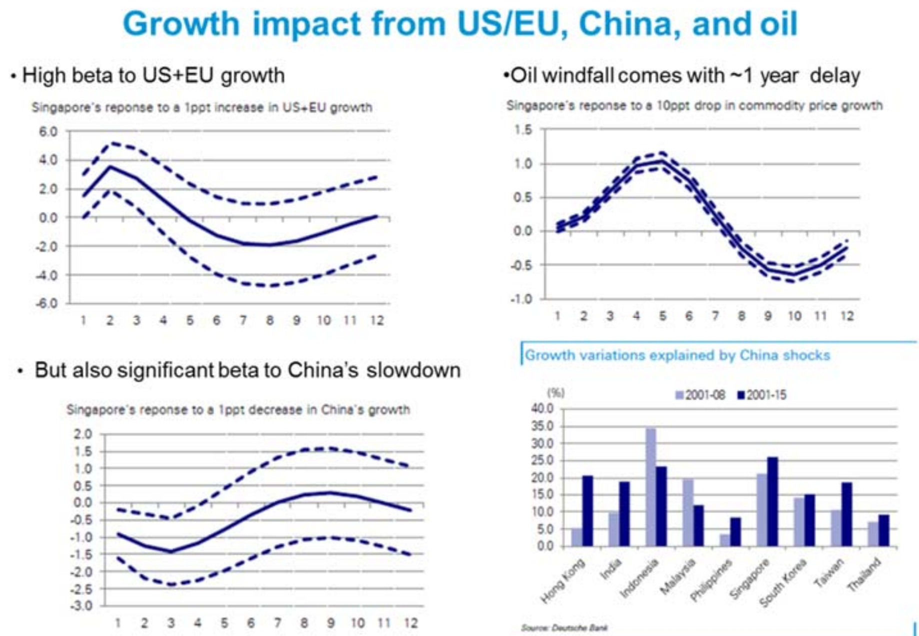


Figure 2.11

In further spillover analysis, the chart in the top left corner (Figure 2.11) shows the exposure to US and EU growth, and the results from the growth regression show that the external demand channel worked heavily for Singapore. Therefore, Singapore is significantly dependent on fluctuations in US-EU growth. China used to be a non-variable data series with its growth rate staying high around 9%, meaning regressions picked up nothing in terms of Asian economic dependence on Chinese growth. However, now that China had started to slow and there was more variation in the data, more exposure to China has been detected. The bottom right corner chart in the same figure shows the cross-country analysis of growth decomposition; how much of the fluctuation of the country's growth is determined by China in past and recent episodes. The takeaway from it is that for many countries in Asia, including Singapore, the growth sensitivity vis-à-vis China has gone up.

2.4 Singapore's Growth Challenges

Before discussing structural vulnerability, the well-worn issue of productivity should first be discussed because it is linked to Deutsche Bank's study on structural scores.

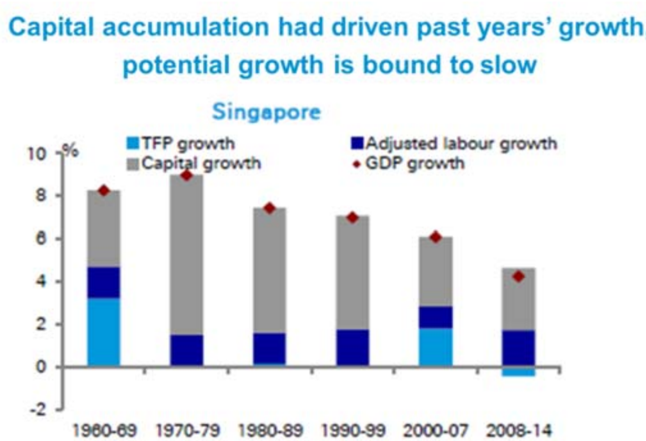


Figure 2.12

Over Singapore's history, the country has been very efficient in making good use of its capital endowment and making fairly good use of its labour force (Figure 2.12). As the labour force started to shrink, the importance of TFP growth becomes more and more important. TFP growth in recent years had been fairly disappointing. To what extent would this issue become critical?

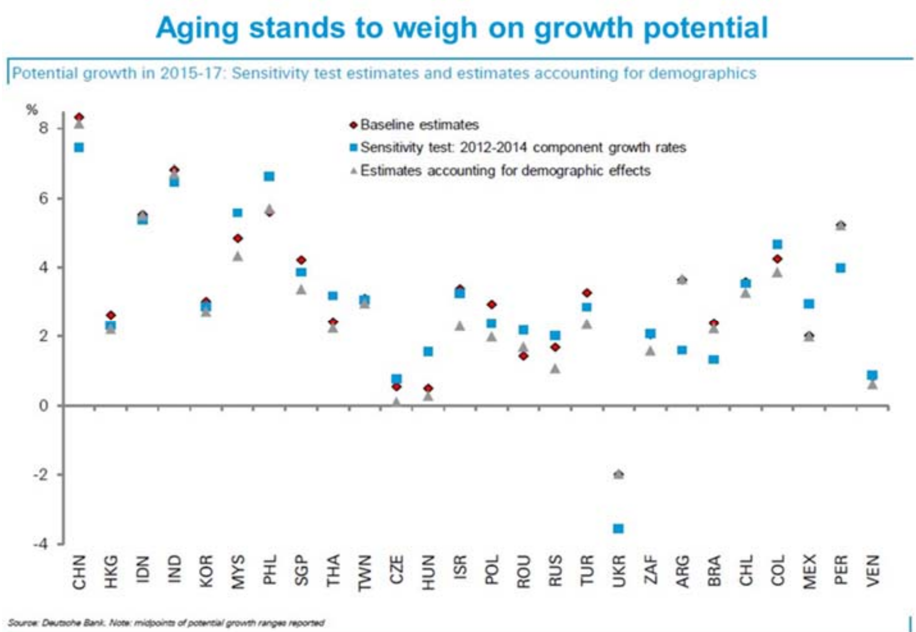


Figure 2.13

Observing the pernicious impact of ageing on growth outlook and the drag from demographics on a wide variety of Emerging Markets (EM), Singapore is somewhere in the middle left corner of the chart (Figure 2.13). The main takeaway was that the baseline estimate of growth potential for a wide variety of economies would have to be revised downward once one starts taking into account the demographic trends, which is towards ageing and rising dependency ratio.

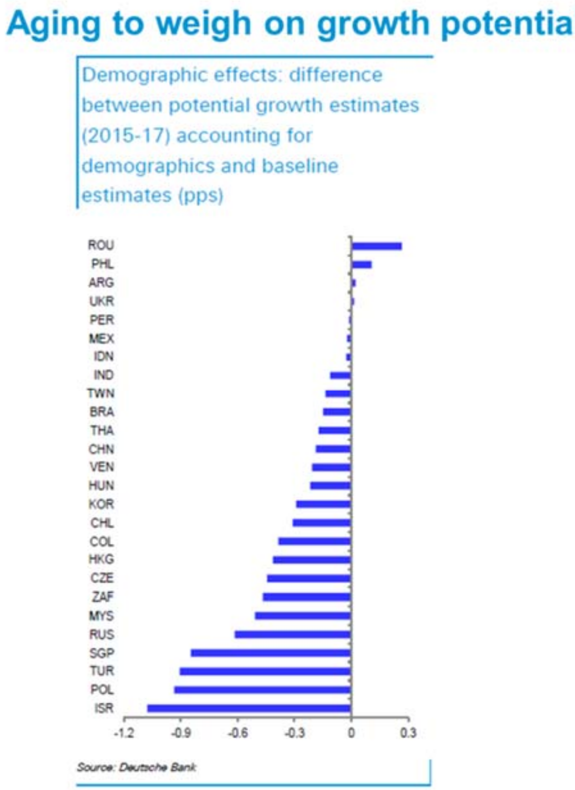


Figure 2.14

The previous chart indicated the difference between the potential growth estimates according to the IMF. When the negative effects of demographic issues were taken into account (Figure 2.14), how much would demographic factors affect growth? Singapore was at the very bottom, and very few other EM economies were in that sort of potential difficulty. In terms of past capital and labour performance, the demographic dynamic would subtract as much as 1% from potential growth.

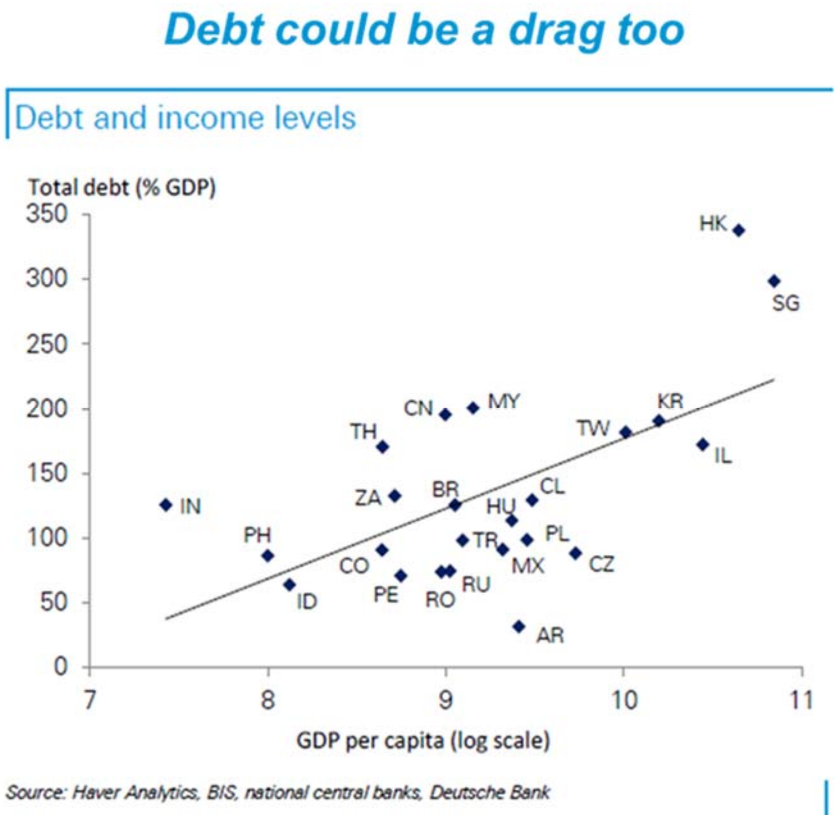
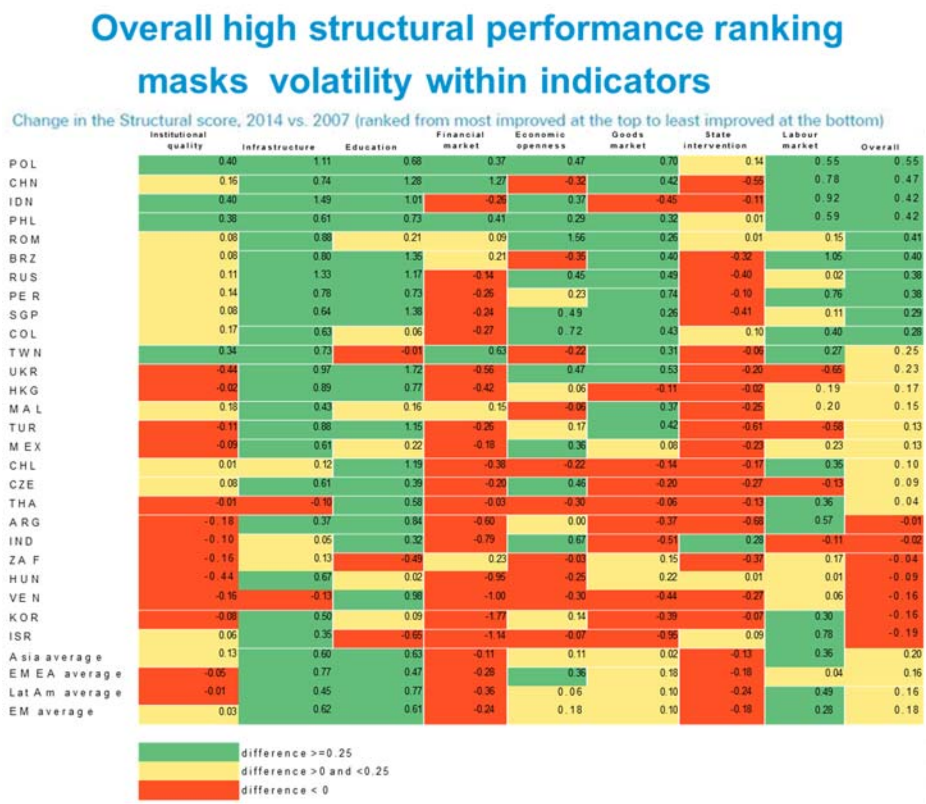


Figure 2.15

One cause of drag is ageing, but the other big drag was debt. The long-term studies of debt and growth show that debt overhang is a real risk, which does weigh in on growth (Figure 2.15). The chart clearly showed that the higher the debt burden, the greater the need to be cognizant of the direction of economic growth. Rich countries tended to be able to afford higher debt levels that poorer countries could not. In these poorer countries, financial sectors were not as developed, credit was not as good but it did pose a question of limits to growth. If an economy grew on the back of a massive debt, there may be limits to further growth. For example, if taxes were cut, people may still not want to consume despite increased spending power because they are already burdened by high debt. Consolidated debt for Singapore and Hong Kong was very high, but because the net asset positions of these economies are good, this does not pose a huge problem. Nonetheless, the extent of how much of an outlier these economies were was striking. Economies like Korea or Taiwan were not poor when compared to Singapore, but their consolidated debt levels are seemingly more manageable and on the line of best fit. It was also striking how much of an outlier China was, which was in the middle of the curve. It was not rich but very highly indebted.

On the issue of structural performance, while Singapore is unambiguously first in a study done by Deutsche Bank on structural strength for most of the Emerging Markets, it was not the fact that Singapore was consistently number one that mattered, but whether Singapore was progressing any further.



Overall high structural performance ranking masks volatility within indicators

Change in the Structural score, 2014 vs. 2007 (ranked from most improved at the top to least improved at the bottom)

	Institutional quality	Infrastructure	Education	Financial market	Economic openness	Goods market	State intervention	Labour market	Overall
POL	0.40	1.11	0.68	0.37	0.47	0.70	0.14	0.55	0.55
CHN	0.16	0.74	1.28	1.27	-0.32	0.42	-0.55	0.78	0.47
IDN	0.40	1.49	1.01	-0.26	0.37	-0.45	-0.11	0.92	0.42
PHL	0.38	0.61	0.73	0.41	0.29	0.32	0.01	0.59	0.42
ROM	0.08	0.88	0.21	0.09	1.56	0.26	0.01	0.15	0.41
BRZ	0.08	0.80	1.36	0.21	-0.35	0.40	-0.32	1.05	0.40
RUS	0.11	1.33	1.17	-0.14	0.45	0.49	-0.40	0.02	0.38
PER	0.14	0.78	0.73	-0.26	0.23	0.74	-0.10	0.76	0.38
SGP	0.08	0.64	1.38	-0.24	0.49	0.26	-0.41	0.11	0.29
COL	0.17	0.63	0.06	-0.27	0.72	0.43	0.10	0.40	0.28
TWN	0.34	0.73	-0.01	0.63	-0.22	0.31	-0.06	0.27	0.25
UKR	-0.44	0.97	1.72	-0.56	0.47	0.53	-0.20	-0.65	0.23
HKG	-0.02	0.89	0.77	-0.42	0.06	-0.11	-0.02	0.19	0.17
MAL	0.18	0.43	0.16	0.15	-0.06	0.37	-0.25	0.20	0.15
TUR	-0.11	0.88	1.15	-0.26	0.17	0.42	-0.61	-0.58	0.13
MEX	-0.09	0.61	0.22	-0.18	0.36	0.08	-0.23	0.23	0.13
CHL	0.01	0.12	1.19	-0.38	-0.22	-0.14	-0.17	0.35	0.10
CZE	0.08	0.61	0.39	-0.20	0.46	-0.20	-0.27	-0.13	0.09
THA	-0.01	-0.10	0.58	-0.03	-0.30	-0.06	-0.13	0.36	0.04
ARG	-0.18	0.37	0.84	-0.60	0.00	-0.37	-0.68	0.57	-0.01
IND	-0.10	0.05	0.32	-0.79	0.67	-0.51	0.28	-0.11	-0.02
ZAF	-0.16	0.13	-0.49	0.23	-0.03	0.15	-0.37	0.17	-0.04
HUN	-0.44	0.67	0.02	-0.95	-0.25	0.22	0.01	0.01	-0.09
VEN	-0.16	-0.13	0.98	-1.00	-0.30	-0.44	-0.27	0.06	-0.16
KOR	-0.08	0.50	0.09	-1.77	0.14	-0.39	-0.07	0.30	-0.16
ISR	0.06	0.36	-0.65	-1.14	-0.07	-0.96	0.09	0.78	-0.19
Asia average	0.13	0.60	0.63	-0.11	0.11	0.02	-0.13	0.36	0.20
EMEA average	-0.05	0.77	0.47	-0.28	0.36	0.18	-0.18	0.04	0.16
Lat Am average	-0.01	0.45	0.77	-0.36	0.06	0.10	-0.24	0.49	0.16
EM average	0.03	0.62	0.61	-0.24	0.18	0.10	-0.18	0.28	0.18

Figure 2.16

From the delta between 2007 and 2014 the experience was mixed and in some areas Singapore had even regressed. Singapore did well on infrastructure and education, though in the latter it had probably reached the limits of standardised scores. It had also done well on economic openness. However, on the degree of state intervention, Singapore had slipped. The variable used to proximate the degree of state intervention was government spending as a share of GDP. Thus, it could be argued that Singapore was increasing its share of spending of GDP but on high-quality spending on healthcare, education and the like, so it should not be penalised.

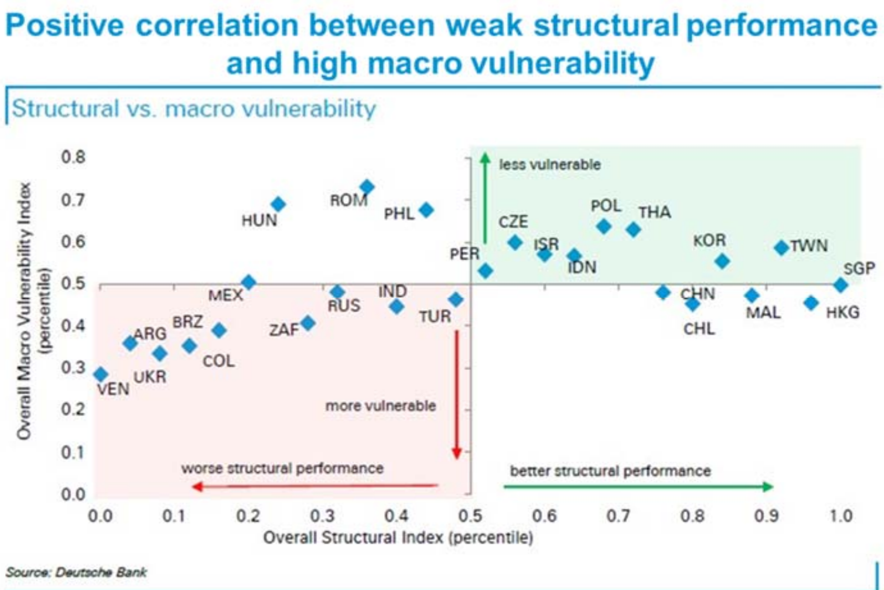


Figure 2.17

The final point is that there was a generally positive correlation between high degrees of structural strength and low degrees of macro-vulnerability (Figure 2.17). Reversing it, countries that were structurally vulnerable could also be macro vulnerable. However, Singapore did not adhere to that relationship well. Most countries could fit on an upward-sloping line through the chart. The structural index is reflected by the horizontal axis, while the vertical axis reflected overall macro-vulnerability. Given how strong Singapore is structurally, its macro-vulnerability should be a lot lower.

2.5 Singapore's Monetary Policy Issues

Deutsche Bank's view is that the success or failure of monetary policy is based on whether the policy is effective in providing countercyclical support to the economy.

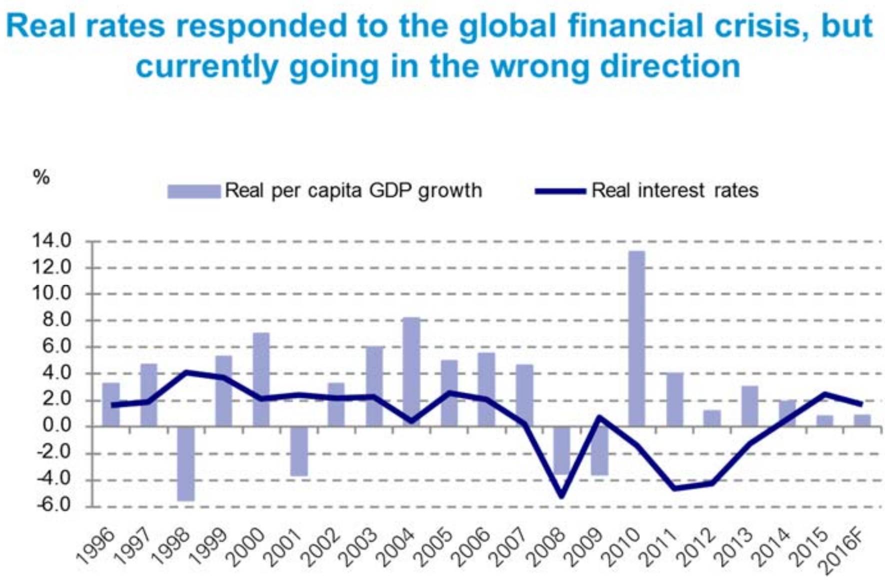


Figure 2.18

In 2008 and 2009, when growth was very poor, Singapore was very successful (Figure 2.18), in making real interest rates substantially negative and thus cushioning the economy. In 2011 and 2012, real rates picked up while real GDP per capita growth had been weakening steadily. This issue becomes starker when looking at the real growth-real interest rate differential for Singapore.

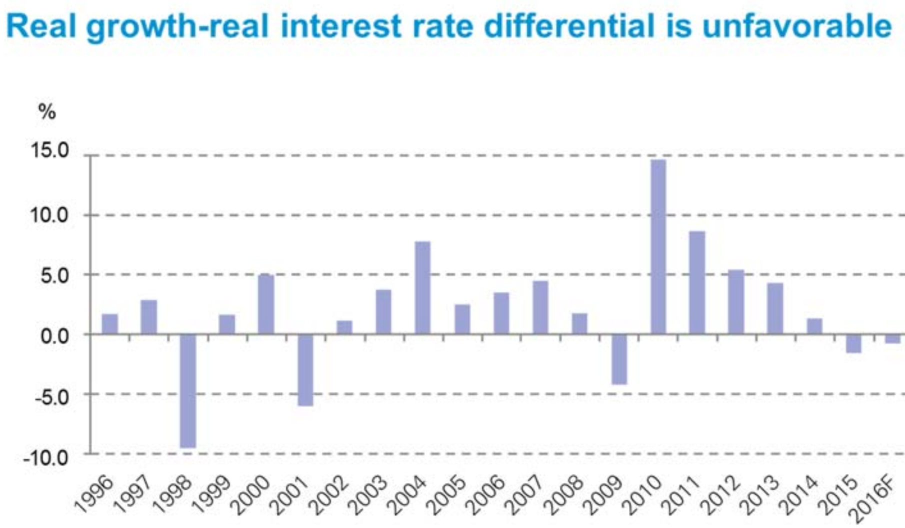


Figure 2.19

Singapore's differential is currently poor, being more indebted than it should be given the cross-country evidence observed. For an economy that was that indebted, it could not afford a negative real growth-real interest rate differential — it had to be positive. The negative differential in Singapore for two years in a row was very problematic for debt sustainability. Whether it was household debt or corporate debt, negative real rates and the negative gap between real growth and real interest rate was going to create debt sustainability issues. So while this report has no strong view on the exchange rate policy of the government, it believes that not having a positive growth-interest rate differential while being highly indebted poses a juggernaut of an issue.

3.
Presentation by Discussant

Mr Ray Farris
Managing Director and Head of Fixed Income Research and Economics
Credit Suisse AG

3.1 Challenges to Singapore's Economic Growth

Credit Suisse is quite cautious on the outlook for growth in the Singapore economy this year and next year. First, both growth and inflation would likely be below the ranges that the MAS had forecast. Second, vulnerability was indeed high, not just in the property market but also at the economy-wide level.

A lot of the vulnerability stemmed from the absence of productivity growth in Singapore; this was a long-standing problem that was odd and difficult to identify. Recently, the cost issue has added to the issue of productivity growth. The MAS had highlighted that wages have grown 3.6% per annum over the last decade — that was a 42% increase in wages in an economy where productivity has contracted. Adjustment had begun; the real exchange rate was almost certainly overvalued and beginning to fall. Picking up on the idea that real interest rates were high and potentially problematic, adjustment was coming through internal devaluation. In many respects policy chose not to use the nominal exchange rate to push through some cost adjustment, instead pursuing policy similar to that of Spain and Greece. That is part of the reason why real interest rates were high.

The risk was real interest rates going up. Datasets in the US have begun to shake off the first quarter torpor that has persisted for the last several years. Therefore, it looks increasingly likely that the US Fed will be able to justify at least one interest rate hike, if not two. And if that begins to rekindle strength in the dollar probably later this year, the likely outcome is a combination of interest rates going up because of the Fed pushing up rates. This is amplified because the currency weakening against the US dollar will result in the premium of Singapore interest rates to US interest rates rising.

There is also a question of state intervention. Credit Suisse argued that fiscal policy has been appropriate so far, though stimulus has been needed. Singapore would be much weaker in growth terms if it did not have fiscal stimulus during the Global Financial Crisis. But the intervention problem was the role of very large companies that had some state relationship. Their cost of capital was generally well below the cost of capital for peers in Singapore and regional peers. One question was whether that allowed these companies to invest in items that did not have the highest return outlooks and also whether that allowed these companies to crowd out nascent entrepreneurial activity in some of the smaller companies.

3.2 Stalled Investment Growth

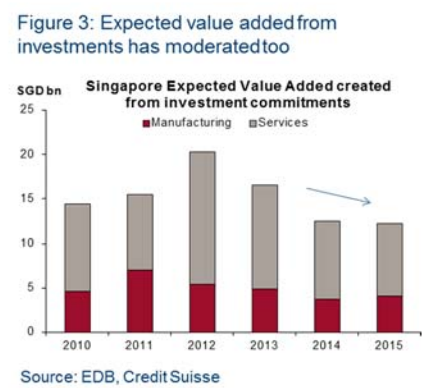


Figure3.1

Investment growth has stalled. Taking that and looking forward using the data that the EDB provides, expected value-add created from new investment commitments is much lower and languishing further. So the numbers suggest that new investment activity is going to yield less of a contribution to the economy in the coming year than it had before.

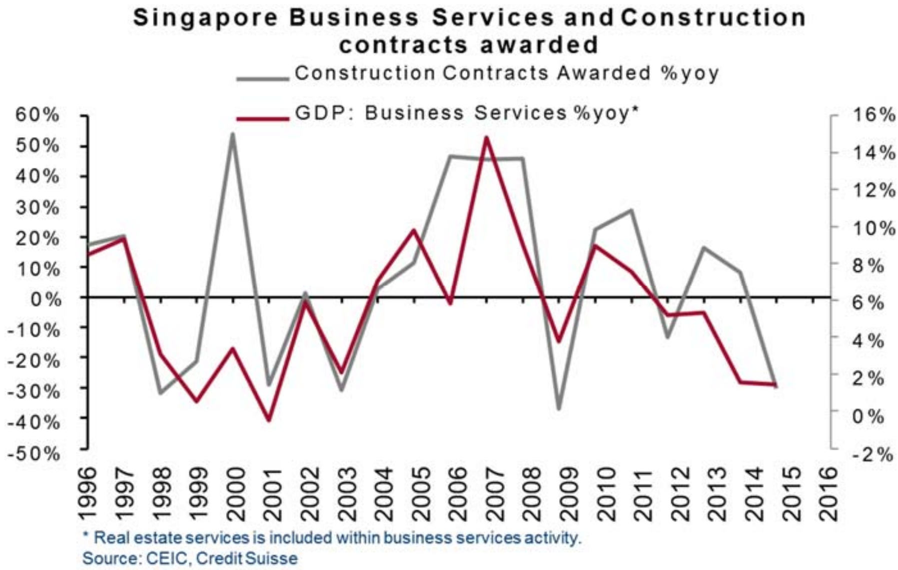


Figure 3.2

The outlook for construction was quite poor. Contracts awarded were falling off a cliff (Figure 3.2), which made sense against the background of the property market getting itself into substantial overcapacity. There had also been a huge infrastructure build-up and that build-up was peaking. Taking that out of the system, it is not clear what will replace it as a driver of growth over the next two years.

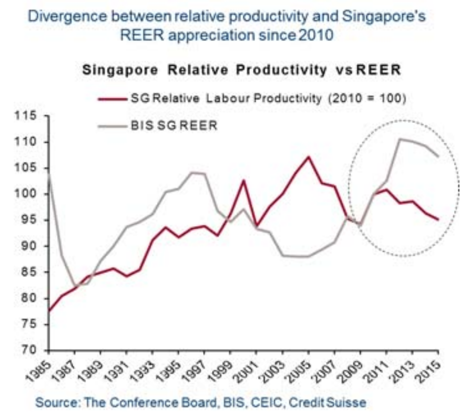


Figure 3.3

Productivity was indeed a well-worn issue as shown by the labour productivity deficit in Figure 3.3, but it remains very important. On the left, labour productivity is lagging behind trading partner labour productivity growth. The chart on the right shows that that is creating a divergence between labour productivity and the real exchange rate.

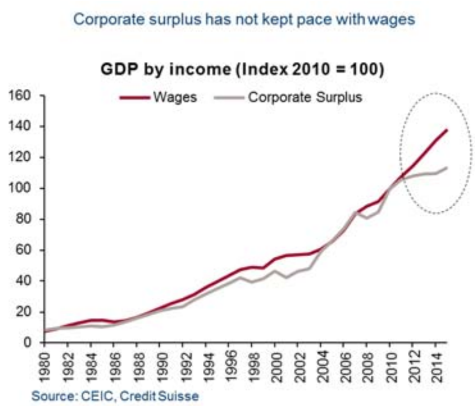


Figure 3.4

As mentioned, wages have continued to grow very rapidly (Figure 3.4), which has been something of a policy objective; and it has far outrun corporate surplus, with unit labour costs have gone up across the entire economy. And as the real exchange rate has appreciated and the cost structure has risen, Singapore is losing market share.

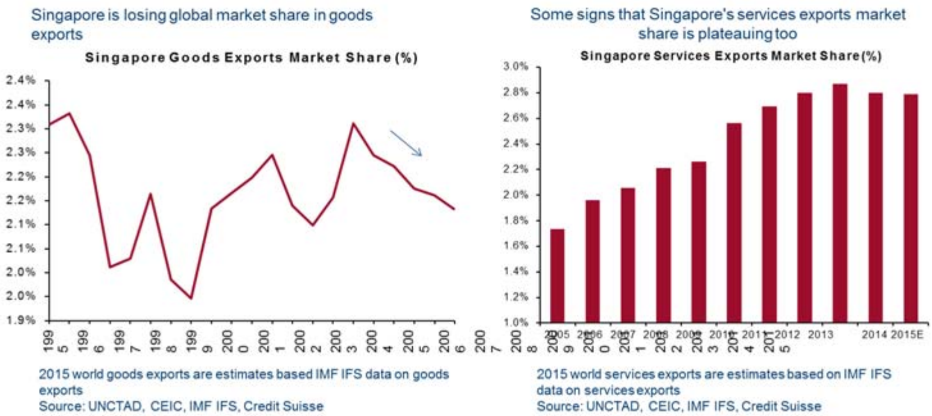


Figure 3.5

It was not just exports that were weak. Market share both in goods and to some extent in services fell as well (Figure 3.5). The result was that some companies are beginning to curtail activities or are relocating. It is interesting that some businesses that Singapore considered important were beginning to show signs of moving out.

In conclusion, the productivity problem relative to cost has placed a fundamental constraint on investment activity, which is likely to continue. Going into a period of US Fed hikes and slowing growth in China, it is going to be a severe drag on the economy. Growth is going to disappoint, inflation will weigh in below forecasts and ultimately further policy adjustment will be needed.

4.
Discussion on Macro-Economic Outlook for Singapore and Implications for Policy

The presentations generated an engaging discussion on the risks facing Singapore's economy, potential growth challenges, and the means to overcome these challenges.

4.1 Singapore's Structural Performance and Investments

A participant related Dr Baig's presentation with Mr Farris's presentation. Dr Baig said that the structural performance of Singapore ranks highly but in terms of improvement it has lagged behind of the Asian countries like China, Indonesia, and Mr Farris raised the issue of weakening investment commitments. One of the areas where Singapore's structural improvement has declined is in state intervention, where Dr Baig suggested increasing government spending. This could imply more economic dependence on the government. Another issue was that of financial market development. Affordability and access to financial services have improved for Singapore but in terms of access to credit and venture capital availability, Singapore ranks low. This is one area that the government could focus on, spurring investments and supporting growth going forward.

4.2 Singapore's Real Interest Rate-Real Growth Rate Differential

A participant commented on the point made by Dr Baig on real interest rates versus real growth rate differential. The participant believed that it was debatable, and a problem only if one believed that growth rate was a permanent prerogative of nations; it is not a problem if deleveraging only happened under the pain of higher interest rates and not under lower interest rates. If interest rates were low enough, it could very well trigger more leverage rather than deleverage. From that point of view, it may be painful in the short term. However, it also demonstrates the continuation of the leveraging problem present in 2008, but have probably complicated the problem further by having no clear exit in sight. So in the short run, which could be as long as three to five years, deleverage carries its own risks but is probably a permanent and better way of achieving competitiveness rather than relying on lower interest rates or weaker exchange rates. This was also alluded to when it was mentioned that Singapore has embarked on internal devaluation.

Dr Baig recognised that the value of deleverage was a debate that was currently raging. Whether one was in the Krugman or the anti-Krugman camp, this issue bedevils economists. His opinion was that the necessity to have positive interest rate growth differential did not require negative real rates; an economy could also have positive real growth, which could allow it to have a decent differential. It is a currently a global imperative to get inflation going, because at such low rates of inflation or deflation, there has been a secular deflation trend globally for the last seven or eight years. This needs to be ameliorated and there are considerations of structural issues, excess capacity, China's role, and so on. But if Singapore could not get decent nominal GDP growth going, which is a function of the deflator and real growth, it is unlikely that the country could go through an orderly phase of creative destruction. It would also be unable to conduct the internal devaluation, which is an absolutely critical component to reforming an economy. It should not be reliant on central bank bailouts. However, with a consolidated debt-to-GDP ratio of over 300%, Singapore simply cannot afford a negative interest rate growth differential.

Mr Farris admitted that he had been somewhat critical of policy. He felt that it was possible to have positive real interest rates and internal devaluation, and it had been the policy preference in Singapore for some time and for as long as possible. However, the focus should be on the vulnerability aspect rather than the "hurt" caused. The policy preference has not hurt a lot in the current cycle, for two reasons; the first being that labour market policy cushioned the impact of what has otherwise been a significant slowing of the economy in key sectors on unemployment, which is reflected in wages continuing to grow despite the slow economy, but at some degree of cost. The second reason is that global growth has been persistently weak, resulting in an absence of a normal Fed interest rate hike cycle. The vulnerability aspect refers to economies being unable to manage an event where the Fed moves faster rather than slower. When the rate structure rises quickly, there are servicing constraints and damage is done in other ways and economies roll over quickly. In fact, he no longer subscribed to the idea of setting the interest rate and letting the system adjust. Instead, as Singapore has a real interest rate, it could let the response to a negative real interest rate be a higher rate of debt growth and greater vulnerabilities — but the community is past the "Washington Consensus", he added. One response was to suppress the interest rate and impose a lot of credit controls to create a structure in the economy that allowed easier debt servicing but difficult debt creation. A lot of ideological opposition to this persists, but it has effectively been enacted in Singapore over the last several years. Also, measures to restrict the rise in household debt and make borrowing for property purchase more difficult have done well. It is possible to target for periods of time that are more meaningful than the "Washington Consensus" of the past, and Alan Greenspan would have had us believe a combination of low real interest rate and degree of control over credit could do.

Dr Baig felt that a prudential macro- and micro-approach to monetary policy was being mooted. He shared an anecdote. A few years ago in Bali, Bank Indonesia had had a full conference on macro-prudential measures; this was under Governor Darman when he was deeply believed in the macro-prudential approach to monetary policy. They brought in the then-EM heroes, Brazil, Turkey and Russia, to speak. Bank Indonesia then gave a presentation about their sectoral lending limits, property market measures and all the other measures that they were implementing, with the Brazilians and Turks chiming in to agree that they were doing the same. It could be argued that at that time, there was an element of hubris involved — that monetary policy's conventional measures had been conquered, and they were coming up with clever ways of surgically attacking portions of the economy. However, the Indian government official said, "I'm very impressed that everyone owned up to macro-prudential measures, because we have been pursuing this for decades. In India you have issues of structural, statutory lending ratios and all sorts of measures decade after decade, and we can say with our experience that it doesn't work." The takeaway was that there are unintended consequences to macro-prudential measures as well. Bank of England has also deeply believed in the idea of a sectoral approach to monetary policy, especially with respect to property prices. But if what has happened in the financial sector in the UK is studied as well as the geographical disproportion — if one side is slowed down it shows up on the other side — that study reveals certain dangers. It is an approach but not a panacea, and it could explain current trends in China.

Mr Farris agreed, saying that such measures had temporal aspects to consider. For example, the US did not have any sort of financial crisis during the Glass-Steagall period, when the financial industry was greatly liberalised. The global economy moved over to a whole different regime where it had a single target and the whole system was supposed to adjust but the financial crisis instead worsened.

Another participant responded to Dr Baig and suggested that what was of foremost importance was the need to generate some inflation. However, Singapore's ability to do that was limited, because it could not afford to have a negative real rate, and to control the external demand side was very difficult. The participant also shared that the extent of the marginally positive real rate was due to weak global demand, hence depreciating the currency and lowering rates would not necessarily help. The participant cautioned that the very high debt-to-GDP ratios had been studied and attributed largely to the corporate sector, for which Singapore is often a corporate headquarter. Thus, on the impact of Singapore's monetary policy on that debt, the underlying debt servicing was not coming directly from the Singapore economy. The idea that Singapore's real interest rates had an impact on the ability to service that debt may not be as strong a case as it is in other countries.

The same participant said that for Singaporean corporations, their debt metrics on both sides of the balance sheet are quite good — still higher than even some advanced economies — and this applies to the banks, the large corporations and even the government. The cost of capital was low for a lot of government-linked companies (GLCs) because there is at least the expectation of some government intervention provided in the debt ratings and so forth. He was not so concerned about the debt level simply because it had a different structure compared to normal countries, and certainly very different from China.

Dr Baig took the point that multi-national companies (MNCs) issued a lot of debt in Singapore, but because Singaporean GLCs' debt-service ratios are also doing well, Deutsche Bank did not give Singapore a dangerous rating on the heat map. At the same time the household debt issue is one that will have to be sustained by Singaporean households, who in some cases have had decent income growth and in other cases have not; the risk of some households falling behind if this situation persists is not trivial.

A participant asked if shifting from internal devaluation to external devaluation would increase the SIBOR and bring about the immediate pain and vulnerability to debt servicing. Dr Baig replied that the issue of external devaluation would be a problem, as it already was. Since 2015, the rate had gone up and there have been several concerns on the mortgage rates rising. That revealed the limitations of monetary policy; being in the peculiar situation where a devaluation of some sort is warranted but at the same time the pain associated with devaluation is substantial and that is the problem with being highly indebted, particularly with households in mind. It was without doubt, a policy dilemma.

A technical point was made on the calculation of real rates. If they were calculated by looking at past inflation and relating that to the actual current interest rate over the next year, then this tended to push up real rates quite a lot. In Singapore, the recent inflation had been very low if not negative. However, another way to look at real rates was to compare the interest rate expected over the next 12 months with the inflation rate expected over the next 12 months. By and large, the inflation was going to be positive over the following months, which was everyone’s rough baseline assumption on a multi-year basis. Another point was that the growth rate versus the real interest rate was akin to automatic debt dynamics, which was described as being a process that hurts. The question is whom does it hurt? If inflation were generated, it would hurt as well, as inflation distorts the price and profit signals used to allocate resources in the economy. Inflation is also a tax on savers and people with fixed income. If inflation is generated it will redistribute wealth and income in ways that are difficult to predict. Singapore has had a long history of keeping inflation under wraps, which makes it quite well regarded by savers. Therefore, not just from Singapore's perspective, the idea that relying heavily on inflation misses the point that inflation sometimes redistributes the income to benefit the wealthy at the expense of the poor. Was this a worthwhile policy goal to pursue?

During the course of their research, Deutsche Bank had tried applying both backward and forward projections, average inflation and so on; these showed that even in 2016 the growth-interest differential would remain negative. Deutsche Bank has a very bullish view on inflation but believes that on average it will remain at 0.1% for the whole year. Olivier Blanchard, formerly of the IMF, had written a prescient essay in 2009 to recommend that G7 economies revise their inflation targets to 4%, which was not well received. But Dr Baig thought there was merit to it. Generally speaking, the IMF's Deflation Task Force's view at the time was that a little bit of deflation was much worse than a little bit of inflation. When the economy has fallen into a flat price trajectory even after commodities has been excluded, as Singapore has, it is condemned to 0% to 1%

inflation for the next few years, which creates a series of distortions in the economy that are undesirable. Therefore, despite the negative impact of inflation, tolerating a temporary period of inflation is more desirable than being resigned to years of disinflation or deflation.

Mr Farris addressed the issue from a monetary policy perspective. Was the most important figure to the economy the exchange rate or the interest rate? Policy asserted that the exchange rate continues to dominate the interest rate quite substantially. If the economy becomes even weaker in late September 2016, the exchange rate is expected to fall about 2% in basket terms. Ultimately, the question is how to get the exchange rate to a level that can stimulate a recovery in the economy. If the exchange rate reaches a level that satisfies the market, the interest rate premium that Singapore runs to US rates will come down. The real challenge is whether markets are assessing the level and the path of the exchange rate as appropriate. This is not an easy task for policymakers.

The discussion moved to developments in China and their potential impact. China's huge economy is slowing while trying to pump up credit and rekindle growth, so it is not truly pursuing restructuring as it should. It is facing capital flight on a significant scale, where the RMB is believed to be vulnerable and there are even scenarios for the option of a significant one-off depreciation. It was striking to see the vulnerability of so many Asian countries, including Singapore, to the RMB. How would China's role in Asia and its impact on the region and Singapore evolve?

Deutsche Bank has studied the latest credit impulse, which is very worrisome. When one looks at credit growth and M2 growth in China, there has been a complete divergence. For the last four to six months, credit growth increased with virtually no corresponding pickup in the momentum of M2 growth. This is because financial intermediaries are lending to one another — company A lends to company B, company C buys company B's bonds, etc. The percolation creates more distortion than anything else. On reserve adequacy, Deutsche Bank has applied the IMF's risk-adjusted reserve metric. Although M2 growth is currently stagnant, there has been an uptick of M2 growth for the last five or six years. This means that the potential claim to the Chinese authorities, in terms of Forex demand, is greater than ever and highest in the EM universe. Those who saw the Mexico "tequila crisis" of the 1990s remember that one of the early warning indicators was the M2-reserve ratio. As M2 expands, potentially all M2 is a switch from domestic-priced to dollar assets, and if that went up it would become very hard to maintain even a crawling peg. Similarly, China's M2-reserve ratio ballooned in the last four to five years. Although China has had very impressive productivity growth, with Chinese companies looking very competitive despite the big pickup in wages, there is a genuine claim that its currency is vulnerable. There were six channels of China-related vulnerability that could affect Singapore, outside of exports: commodity trading, property, tourism, healthcare, education, and gaming. In these areas, the vulnerability to China spending and aversion to big-ticket items was higher. Not only was there evidence of this, the beta of Singapore dollar to RMB has increased and the variability of Singapore's growth explained by the variability of China's growth has also increased. Even on a micro-basis, there was also substantial vulnerability in key sectors: an area that had not been covered was banking. On-lending by Singaporean banks to Chinese corporates in the last few years had exceeded RMB100 billion in value. What would happen to that kind of credit risk was another open question.

Mr Farris felt while growth was going to continue to slow, some multi-faceted stimuli should continue to upkeep growth for the quarter but should fade into the third and the fourth. It is clear that the policy focus of China is on some degree of stability. Debt is overwhelmingly corporate and it is overwhelmingly state-company to state-company, or government to government. A financial crisis in the traditional sense of asset-side defaults of the balance sheet leading to illiquidity on the liabilities side of the balance sheet was exceptionally unlikely. People's Bank of China (PBOC)'s attitude towards providing liquidity in the system is substantially different today from where it was in 2013. Mr Farris doubted that risks of financial system illiquidity would be pervasive any time soon. However, all of that added to rising currency risk. If the PBOC needed to further liquefy the system because of rising defaults and the need to ensure the balance sheet is protected, then the adjustment mechanism becomes an increase in capital outflow and weaker currency. The PBOC would deplete reserves for a while, then give up. What it is doing with the currency is to begin to allow an increase in spot volatility while allowing and identifying capital outflow as one of the reasons why the US dollar keeps strengthening. The real issue in China is that it does not have a lot of external debt, so a 20–30% fall on the currency would not be meaningful at 10% GDP. If inflation rises, the central bank has to stop monetising. If it cannot monetise into rising defaults and rising debt chains, China would then have a financial crisis, which could lead to a massive austerity programme. But as a baseline, growth will slow but not crash. There is rising currency risk, and the likelihood is a little depreciation. China will do a lot to maintain stability till they get to October 2017 and then things are uncertain.

4.3 Causes of Singapore's Growth Slowdown

A participant recalled that a few roundtables ago, much of the discussion centred around how the first 50 years of independence was focused on economic development goals and the next 50 years would focus on social and political development goals. There was a lot of discussion about increasing social spending, being more welfare-friendly and more inclusive in the growth path, and having more flexible labour and immigration policies. How much of the current slowdown was caused by external events and how much of it was caused by unintentional side-effects of the increased focus on social development?

Dr Baig felt that about 1% of the slowdown could be attributed to demographic trends as shown earlier during his presentation, but beyond that, growth is a domestic issue. The global malaise of demand is a major source of drag, but a very wealthy economy like Singapore's should be able to generate decent domestic demand despite its size. Singapore has formal sectors that can be self-sustaining to some extent, so domestic demand does not have to be entirely external-oriented. Even in the presence of the global growth malaise, the onus of having very low real per-capita GDP growth falls on policymakers; it cannot simply be explained away by global headwinds.

4.4 Singapore's Structural Performance

A question was raised regarding the relationship between structural and macro-vulnerability. There was a linear relationship from Venezuela up to Poland before it began inflecting downwards. Was there a point at which the pace of structural reforms would begin to show diminishing utility? And was that something that came through particularly in the analysis that looked at the absolute and relative changes in structural performance?

Dr Baig agreed, pointing out the delta between 2007 and 2014, where laggards like Poland were the top of the list in gaining structural performance. Once a country topped a list, such as being number one in areas like education, it would have hit its limit, though there is an issue of quality of education as well. There is a general view that Singaporeans may be scoring very well, but Singapore is not fostering innovation and creativity. Using these scores as an input for structural assessment is limited in this way — some details are qualitative and cannot be factored into the analysis.

4.5 Singapore's Monetary Policy Under Scrutiny

Mr Bhaskaran summed up some of the issues that were raised, the first was that marrying the data on the Singapore economy with the anecdotal evidence, the sense was that Singapore might be at a tipping point. Was Singapore really at the tipping point? Second, how did the presenters understand the underlying processes in the economy? To him, it seemed like an adjustment to higher costs and reduced competitiveness resulting in relocation, which seemed deflationary. Did they agree or did they think there was more to it? Third, on China, he felt the more likely scenario was not hard-landing versus soft-landing but a series of episodic stressors, maybe localised crises, which could be managed. However, it would also produce mediocre growth, bouts of risk aversion, and volatility in markets. How would Singapore then adjust to that kind of scenario?

A participant commented on Mr Bhaskaran's summary. They felt that the Singapore economy was not so much at a tipping point as laying low and waiting for the right environment. The general global economy, as some had pointed out, was not going to be exciting for some time because of China. Since 2015, the MAS had asked itself how to proceed, which was made more challenging by the oil price shock and Singapore's internal restructuring efforts. First, regarding monetary policy, several steps were taken and all the effects, including interest rates, needed to be accounted for. As was pointed out, it could not be done too quickly because of interest rate repercussions, and timing is important because there was a point at which there was a lot of uncertainty in the market and pressure on interest rates. The points that Dr Baig and Mr Farris brought up imply the industry was not surprised by the MAS's actions, although reports indicate otherwise. When the Fed surprised the market, nothing happened. The industry was not surprised by MAS's actions, though they were according to reports.The MAS's actions were taken carefully because of the complexity and the tradeoffs involved. In monetary policy it was slow, inching downward carefully while tracking the reaction of the market in interest rates, essentially checking if inflation or disinflationary pressures genuinely posed any threat of deflation at all. There is a real need to uncover why the macro numbers are showing these inflation and productivity numbers. As the Ministry of Trade and Industry (MTI) pointed out, the overall productivity does not present a clear view. It is very important to investigate which sector is really causing the productivity problem. For construction sector, there is a need to get the transport sector built up which requires workers. If that were the cause of the productivity drag, it would be tolerable. A large part of inflation was the oil price shock, and it is unlikely that the disinflationary pressures would spread to other sectors, but individual segments of inflation are being closely watched.

On fiscal policy, was it enough? In the event that there is another shock, what would be the next steps? As previously pointed out, one should not overreact because it is important to allow the economy to respond to restructuring efforts. So far things have been going well, without a crash or excessive business closures and retrenchments. However, a bit of that has begun because Singapore is deep into the restructuring process and some of this creative destruction is happening as it is supposed to. The MAS is carefully proceeding with the long-term view. As to the long-term view regarding inflation, the internal balance seeks to guard against strong deflationary pressures over the next few years. The MAS has publicly stated that inflation is likely to be slightly around 2%, which is comfortable for Singapore. Setting expectations are important as well, to ensure everyone understands that each policy move is not going to cause inflation overnight.

4.5 Singapore's Inflation Rate and Disinflationary Pressures

An observation was made by a participant that one area has continued to surprise — the hospitality sector. Its YoY was doing well, working off the base itself, and Changi Airport similarly so as well. He observed that the Merlion platform had been very busy all year, with the arrival stats for 1Q 2016 probably at 13–14% YoY, though it was starting from a low base. Despite the downward revision on the GDP side, the travel industry itself probably did a little bit better. Per capita spending was not as high or growing as fast as the VA as tourism receipts may not be fully indicative of spending. His conclusion was that the hospitality sector's revenue and occupancy rates had stabilised, with productivity from the hospitality side possibly improving this year.

Another participant offered three comments. First, regarding the real interest rate situation, the saving grace had been Singapore's low unemployment rates, high savings rate and Singaporean households having a lot of cash buffer, which serves as mitigating factors for the high debt. Second, looking at macroprudential measures, policymakers had done well. Despite the many cooling measures, the property index barely displayed a downward trend. The third point was that in the past, the MAS had always shied away from an explicit inflation target. However, the MAS now indicated an implicit inflation target close 2%. Was that an official target? How does the MAS see the unpredictability of market reactions complicating monetary policy in the future?

The MAS clarified that the 2% figure was not an official target. The core inflation number had been put out to call attention to core inflation as opposed to the headline number, which has been negative as the media had been reporting for the past seven to nine months. All the headline numbers reflected was the oil, car and property prices, which were not relevant to inflation. The intent was to debunk the view that Singapore was suffering from deflation or deflationary pressures.

Dr Taimur spoke about a checklist of deflationary risks. Was the output gap high and widening? Was there a large debt overhanging? Was there a zero-bound type limitation? Were there asset prices that had overshot and could lead to a boom-bust cycle? Many economies in Asia, such as Korea, Taiwan, Japan, China, and to some extent Singapore, were flashing warning lights. There were a lot of deflation risks independent of the commodity price effect, and using the terms-of-trade shift over the last year-and-a-half as the primary driver to explain the YoY CPI data did not give enough credit to deflation effects. The point that Dr Taimur made repeatedly was that the deflationary pressure the region had been experiencing for more than half a decade was not a function of commodity prices. The overcapacity, boom-bust and overhang-related issues have been present for much longer than the terms-of-trade related volatility that was being seen — and that was a point that ought to inform those who followed or made monetary policy.

Mr Farris commented that that the MAS had done its best in a system where the problems were inappropriate monetary policy or an over-reliance on monetary policy. The biggest issue facing the economy now was very much as Dr Taimur had addressed earlier. There had been no productivity growth for decades and the labour market was moving into a phase where it was not going to be able to deliver much growth. Outside of the traded goods sector there was not much productivity growth. He questioned if construction productivity was powerful enough to overwhelm the robust growth in all the other sectors. He felt that this was the single biggest issue in terms of multi-year growth outlook. In the near term, the two big risks are China and the US Fed having to hike rates fast.

Mr Bhaskaran closed the first session, thanking Dr Taimur, Mr Farris and the MAS team. There were many unresolved issues reflecting the murkiness that generally affected economic policy and development in the world, he added, and there was much that was very hard to divine and anticipate.

5.
Trans-Pacific Partnership: What to Expect and Impact on Singapore's Economy

Mr Daren Tang
Chief Executive
Intellectual Property Office of Singapore

5.1 Preamble

Mr Daren Tang, a trade negotiator and Chief Executive of the Intellectual Property Office of Singapore (IPOS), was deeply involved in the negotiations of the Trans-Pacific Partnership (TPP). Highlighted in his presentation was an explanation of the significance of the TPP starting from the geopolitics of international trade and IP negotiations to how the TPP could help businesses. He also shared his thoughts on the future of the economy from an innovation and intellectual property (IP) perspective.

5.2 Introduction to the Trans-Pacific Partnership (TPP)

On the TPP, Mr Tang had three broad points. The first was that the TPP would be the most significant development in trade in the past 20 years and its IP chapter is the Trade-Related Aspects of Intellectual Property Rights (TRIPS) of our time. TRIPS was one of the key agreements of the World Trade Organization (WTO), which was formed in 1995. Since the failure of the WTO Seattle round in 1999 and the continued impasse in trade talks in the WTO thereafter, there has been an upsurge in trade talks and bilateral agreements in trade activity. Back in 1999, when

Singapore first embarked on the Singapore-New Zealand FTA, there were just a handful in existence. In a span of 15 years there has been tremendous growth. As of February 2016, 625 free trade agreements (FTAs) have been notified to the WTO, of which over 400 are in force. Singapore has always been at the forefront of pushing for bilateral and trade agreements, said Mr Tang, recalling Ambassador Tommy Koh's exhortation that "to be promiscuous in trade is a virtue". Singapore has lived up to that exhortation and now has 20 FTAs in force with over 31 trading partners.

Compared to other FTAs that have been negotiated and concluded over the last 15 years, the TPP is significant because of its size and span. The TPP has 12 countries spanning both sides of the Pacific Rim, including the NAFTA countries: Canada, US, Mexico, Peru, Chile, Australia and New Zealand; and in Asia: Singapore, Brunei, Malaysia, Vietnam and Japan. This grouping brings together 800 million people with a market ranging from US$20 to US$30 trillion in value. TPP partners currently account for $300 billion, one third of Singapore's trade. It would also open up two new trading partners — Canada and Mexico, which Singapore had unsuccessfully tried to conclude FTAs with before. It also increases access to markets that Singapore already has FTAs with. An example was Japan, where tariff savings in the SG-Japan FTA was a fairly modest $30 million; the TPP it will multiply that.

On the IP front, the TPP IP chapter goes beyond anything seen since TRIPS, in terms of range and complexity, especially when compared to

NAFTA's IP chapter. The difference is not only due to expansions to new areas such as Internet service provider (ISP) liability, but also new disciplines related to IP already covered within the TRIPS framework. However, its significance from the trade angle was that the TPP covered a very diverse range of countries, not just economically, but politically, socially and culturally. The breadth of countries prepared to sign on this agreement is what made it a truly global agreement, or at least one with the greatest potential to become so.

5.3 Changing Global Attitudes to Intellectual Property (IP)

The process by which the TPP was negotiated was a reflection of changes in the global economic landscape over the past few years, said Mr Tang. The changes can be seen in the substantial number of flexibilities, carve-outs and transition periods. A specific example is an unprecedented objects-and-purpose clause in the IP chapter. Traditionally, developed countries like the US and Japan have been opposed to including such clauses because they see the IP chapter as a chance to promote their export interests in their technology, brands and content. However, objects-and-purpose clauses tend to balance the tone of the chapter by mentioning other objectives such as the promotion of social and economic welfare. This clause was finally included into the IP chapter because compromises needed to be struck, given the wide range of countries; but at the same time, developing countries had begun to see the value of having a robust IP regime, whilst developed countries moderated their positions amidst substantial domestic criticism of their negotiating positions.

In this way, flexibilities are preserved in sensitive policy areas. One example relevant to Singapore is in parallel imports. In a number of developed countries, IP owners can prevent the parallel imports of legitimate goods. However, the Singapore government's stance is that parallel imports increase consumer choice, especially for a small market like Singapore — and it has fought in all FTA negotiations to maintain this policy. Despite initial pressure from the US and Japan that rights-holders should have the power to prevent parallel imports of legitimate goods, the final negotiated outcome gave parties the flexibility to decide on the most appropriate policy in this area. Aside from these policy flexibilities, the TPP also provides transition periods ranging from 18 months to 10 years, which allows parties the time to implement certain obligations. Despite these flexibilities and carve-outs, the TPP prescribes disciplines that are considered "TRIPS-plus" across a wide variety of IPs. For example, it would require that parties allow for the registration of sound marks — trademarks that are sounds — such as Nokia's ringtone.

The TPP is also the first international agreement to impose disciplines on the recognition of geographical indications in other international agreements. An example of a geographical indication is champagne from the Champagne region of France. The agreement also includes specific disciplines in the sensitive areas of agricultural, chemical and pharmaceutical products. It incorporates detailed disciplines relating to several copyright-related issues, including controversial areas like technological protection measures and rights management instruments.

The final product combined broader and deeper disciplines with flexibilities in sensitive areas. In the mix there was sign-on by a diverse group of economies, reflecting two broader trends in the world. First, developing countries are changing their perspectives on IP as they develop economically. The need to grow domestic technology, brands and content in the next stage of economic development support this, as well as the need to strengthen IP regimes. Second, on the flipside, developed countries are also more receptive towards appropriate compromises, not just in international negotiations but also because increasing IP scepticism in their own courts and the public has moderated their IP positions in the past five years. The confluence of these two factors allowed the TPP negotiators to land on consensus despite these diversities. One of the striking features of the TPP was the participation of countries like Peru and Vietnam, whose GDP per capita were much lower than that of Singapore. Vietnam, and to a lesser extent Brunei and Malaysia's participation in the TPP and their acceptance of the IP chapter said something of the changing perspective on IP and a shift towards using it as a tool for economic development.

5.4 Changes in the International Economic Landscape

Mr Tang said that with the TPP, the world was entering an era of mega-FTAs that will challenge the dominance of multilateral institutions like the World Intellectual Property Organization (WIPO) and the WTO in the international economic landscape. The world is more geopolitically complex now compared to the late 1980s and early 1990s. There are now multiple centres of economic and political influence and power, making it more difficult for any single power to advance its agenda unilaterally. Ironically, the multilateral process has always required consensus from an inner circle of advanced, influential economies. As such, the Doha round of the WTO has been mired in an impasse; and while the WIPO has been marginally more successful in the past years, it continues to only be able to move the normative agenda along in specific areas, for example, creating copyright exceptions for handicapped persons.

The TPP was signed on 4 February 2016 and should come into force in one to two years, American politics willing, but beyond it there was also the Transatlantic Trade and Investment Partnership (TTIP) between the US and the EU, and another mega-regional FTA known as the Regional Comprehensive Economic Partnership agreement (RCEP). The latter is an FTA that has been under the radar as it consists of the 10 ASEAN countries plus Japan, Korea, China, India, Australia and New Zealand. It is another mega-FTA that will draw increasing attention as it headed to conclusion in one to two years' time. With these FTAs jostling, each FTA seems to be positioned by its proponents as a template for yet another larger FTA. There have been suggestions of an FTA of the Asia-Pacific, or the Free Trade Area of the Asia-Pacific (FTAAP), which would include all countries along both sides of the Pacific Rim. It appears that the FTAAP battle lines would be drawn along the lines of the TPP vs. RCEP scenario. As such, IPOS estimated that in the next five to seven years the momentum of IP and trade lawmaking would shift to such mega-regional FTAs. Nonetheless, Mr Tang cautioned against premature talk regarding the demise of multilateral institutions and a frame of mind that sets up a stark opposition between global and regional agreements. Returning to the origins of the Uruguay round of negotiations, many provisions were drawn from regional FTAs that were already being concluded, NAFTA being the most famous and clear example. His thesis was that in time to come the rise of mega-regional FTAs would eventually lead to a return of multilateralism. In a world where the lines between developed and developing countries were blurred, a new consensus was emerging among the new players in the world economic system on the rules of the game for trade, IP and other currencies of the world economic system.

5.5 TPP Benefits for Businesses

Moving on to the benefits of the TPP for businesses, Mr Tang used the example of a company called ShiokGear and how it could take advantage of the TPP. ShiokGear is a Singaporean SME that has patented a technology called “Body temp”. ShiokGear had a textile mill in Malaysia where it produced fabric using special yarn imported from New Zealand. The fabric was then sent for garment production in Malaysia and Singapore, which was a typical practice of textile companies in Singapore. ShiokGear’s market was primarily ASEAN, but it also wanted to export to the US market, set up a manufacturing plant and distributor in Vietnam, protect its patented technology, supply sports attire for the Asian Games in Malaysia, set up an online store and have an ecommerce presence. The first challenge was entering the US market. ShiokGear was not able to take advantage of existing trade agreements; its garments did not quality for preferential tariffs under the US-Singapore FTA because of the yarn-forward rule, which required yarn used to make clothes in Singapore to come from either Singapore or the US. Therefore, textile manufacturers had to import yarn from the US before converting them into textiles to benefit from the US-Singapore FTA. The TPP would change this process as the TPP would allow Regional Accumulation — yarn from any TPP country could be accumulated and made into garments in Singapore before being exported to any other market in the TPP region. This meant that textile manufacturers would be able to get yarn from Malaysia, New Zealand or Australia, and export their clothes or apparel tariff-free to current and new export markets, e.g., Canada, Mexico and the US.

The TPP would also result in less complicated and costly customs delays, as it had disciplines relating to advance rulings on tariff classification that had to be issued by countries in a period no later than 150 days. Express shipments between importing countries and TPP countries would be released within six hours, helping manufacturers who often faced delays at customs. If ShiokGear wanted to set up shop in Vietnam, it would face existing foreign equity restrictions and limits. The TPP would remove these restrictions, and ShiokGear would be able to own its subsidiary 100% with no equity limits or licensing restrictions. In addition, under the investment section of the TPP, should the Vietnamese national or provincial government decide to expropriate the factory, ShiokGear would be able to seek direct recourse under an investor-stake dispute settlement which had been very controversial, but made sense from the perspective of an FDI-exporting country like Singapore. ShiokGear would also be able to setup an online store more easily, as a number of countries in the TPP region and elsewhere had some requirements that data services must be located within that country itself. That requirement was a significant cost to a SME like ShiokGear. However, under the TPP, there were rules to liberalise this requirement. TPP countries would no longer be allowed to force the localisation of data servers, so ShiokGear could make the decision on locating its data servers where it was least costly without having to worry about having to locate it within the country concerned.

There were also rules relating to the adoption of laws to protect online consumers that would help protect consumer confidence. For IP, the TPP would allow a common set of rules relating to patents, trademarks, and designs, so ShiokGear's patented technology, brands, designs and interests in its stable of apparel would be protected and business certainty would be improved. Increased enforcement meant that if ShiokGear faced problems due to varying enforcement standards, it would then enjoy more consistent enforcement. Government procurement was a very controversial area, for example, the Malaysia government was concerned about its potential impact on their practice of reserving certain government contracts for *bumiputras*, but certain sectors were finally opened for procurement. So in the apparel sector, ShiokGear would be able to better compete for government tenders in Malaysia, and the Malaysian government was obliged to improve and increase rules on transparency, and assess tender bids on a more objective and non-discriminatory basis. And if the bid were awarded in an unfair manner, ShiokGear would have the chance to challenge that government in domestic Malaysian procurement tribunals.

Lastly, labour laws were also changed under the TPP. Many companies faced trouble over local labour laws when expanding overseas, but under the TPP, there would be more transparency in what these requirements would be. There was also a discipline in the TPP that prevented countries from lowering labour or environmental standards in order to increase investments.

6.
Presentation by Discussant

Mr Frank Debets
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6.1 Preamble

Trade liberalisation and Free Trade Agreements (FTAs) are important drivers of Economic growth. However, the rhetoric surrounding FTAs does little to clarify the many misconceptions and misunderstandings about them. Additionally, from the perspective of businesses, the compliance requirements of FTAs are difficult to disentangle and manage, combined with a poor understanding of the benefits of FTAs, resulting in many businesses choosing not to take advantage of FTAs.

6.2 Misunderstanding and Miscommunication Surrounding FTAs

There was, and still is much confusion surrounding FTAs. As an example of such confusion, Mr Debets considered the value of including ski equipment in an FTA in Sri Lanka. The agreement between India and Sri Lanka may reduce the duty rate on some such equipment to 0%, a fact that the statistics around total reduction in tariffs, or the potential of the agreement, takes into account. However, trade in ski equipment between India and Sri Lanka is practically meaningless for business. Hence, when

FTAs are studied from a business perspective, their impact may in fact be far lower than macroeconomic figures suggest. Additionally, at first blush, an FTA might appear to have a fairly large impact, for example, at US$2 million worth of duty benefits for qualifying trade. But whether the US$2 million of benefits is spread over two companies or spread over 10,000 companies makes a massive difference in how keen such companies are in using the FTA. Therefore, when executives hear the benefits and statistics around FTAs, and then study the details, business benefits are not apparent, or at least very disappointing. Often such executives never consider FTAs again. So if the messaging is not right at first, an FTA often does not get a second stab.

Another example is the US-Singapore FTA. This was reviewed a few years ago. At a talk where a US Trade Representative official spoke on the FTA, one of the highlights was the significant growth in trade and merchandise from the US to Singapore due to the FTA. Mr Debets said that this growth was at best tenuously linked to the FTA — there is no duty in Singapore, there is little monetary benefit to be gained, and most of that trade went onwards to other parts of ASEAN or Asia. Yet, the belief appeared to be that the increase was entirely attributable to the FTA. Yet another example is the Korea-US FTA that was signed and then took five years to ratify and come into force due to renegotiations. The increase in trade between the US and Korea was far larger during the five-year period when the FTA was not in effect, than after the FTA took effect. The key takeaway is that the communication around FTAs and more importantly, the communication of the potential of new export markets were as important if not more important than the actual measures that FTAs bring into place. It was clear that a number of American and Korean companies had studied the potential of new market access and what could be done with the FTA upon hearing of it being signed. Their conclusion was that many companies felt there were numerous opportunities that did not depend on the FTA coming into force. Once again, communication was more important than content.

Mr Debets then moved on to business considerations. The business strategy of most businesses does not start with trade considerations but with considerations like the growth of their operations, or selling new products into markets. Structural issues, such as the restructuring or rationalising of supply chains, which and how many entities they should have, or new environmental concerns, are often also the focus. These are considerations faced on a daily basis in international companies and even some of the larger SMEs. An FTA, like the TPP, only comes up when these considerations are clearly addressed. While the TPP includes many more aspects of internationalisation than other FTAs, it does not address all business considerations that form part of the strategy of a company driven by business purpose and vision. It would be a bonus if the TPP or another FTA fits into the strategy, but if it does not, businesses would still expand.

Taking a closer look at the departments involved in decision-making, such as the C-suite, sales and marketing, logistics and operations, procurement, and legal departments, there is usually no single department devoted to trade matters. Trade as a discipline usually would not be invested in a single role, and is often managed or contributed to by many departments, with no higher officer specialising in trade. A personal example of Mr Debets' was of a company he encountered, where the head of procurement had managed to save the company about 5% on raw materials procurement, by consolidating into a central procurement office that allowed the company to negotiate bigger contracts. This translated to millions of dollars in savings. However, the change in sourcing then caused the goods the company made to lose their preferential access to other markets, which cost them multiple times the savings. When the CEO asked the procurement executive how this happened, the procurement executive replied that he was evaluated on procuring cheap goods, not on the onward sales price; so unless his Key Performance Indicators (KPIs) were changed, he would do the same again. The takeaway is that executives often do not realise the implications of their action on the trade supply chain and remain uninformed about the risks and opportunities. This makes it easy to understand why many companies have no real strategy around FTAs and do not see all the aspects that are relevant for the company to benefit. Also, the difficult language used in FTAs makes them unlikely to be read in wide circles — so the gut reaction of executives is often to not bother, and not rock the boat as they are running a successful business regardless.

When companies get to a stage where they are considering the broader aspects of their cross-border trade in goods merchandise, their key consideration, as found by a PwC survey of clients and companies, is often the pressure of speed-to-market. How can products or services reach customers quickly and reliably? Duty cost is not necessarily a significant concern; in terms of priority, it is often listed behind compliance with regulatory requirements. When the PwC survey was conducted 10 years ago, cost reduction was listed as the top concern, but it appears no longer to be the top priority. That has partly to do with falling tariffs, changing approaches to market access, etc. The cost-reduction priority has often been replaced by a priority to make use of advantageous supply chain facilities. As a result, many companies are studying suspensions, exemptions, the use of bonded zones, import for re-export and the like, where FTAs seldom come into play. Increasingly, these companies study potential tax benefits less.

An additional consideration is the division of risk, responsibilities and benefits between exporters and importers. Exporters often feel that much effort is required on their part to create a product or a service that would allow their customers to benefit from an FTA. But they often find it hard or cannot model the resultant advantages in terms of market share or profitability. Also, their effort is virtually impossible to charge for in commercial terms; therefore there is no compelling value in making this effort and more value in shifting the burden of effort to their customers instead. Only very large businesses (say a company like Wal-Mart) are able to demand goods that benefit from FTAs from their suppliers, given their commercial clout in the market.

Most companies that Mr Debets has worked with were not aware that services were addressed in FTAs or in the TPP. Similarly, to some extent, for investments. The TPP would offer many benefits around service abilities, investment abilities, etc. These facts are not common knowledge due to insufficient communication around the TPP, including in Singapore — information that was easy to understand and lead businesses to trust and feel that its benefits can have a business impact in the near term. The TPP covers only one of many business considerations, and it is a consideration that is difficult to understand.

6.3 Benefits of the Trans-Pacific Partnership

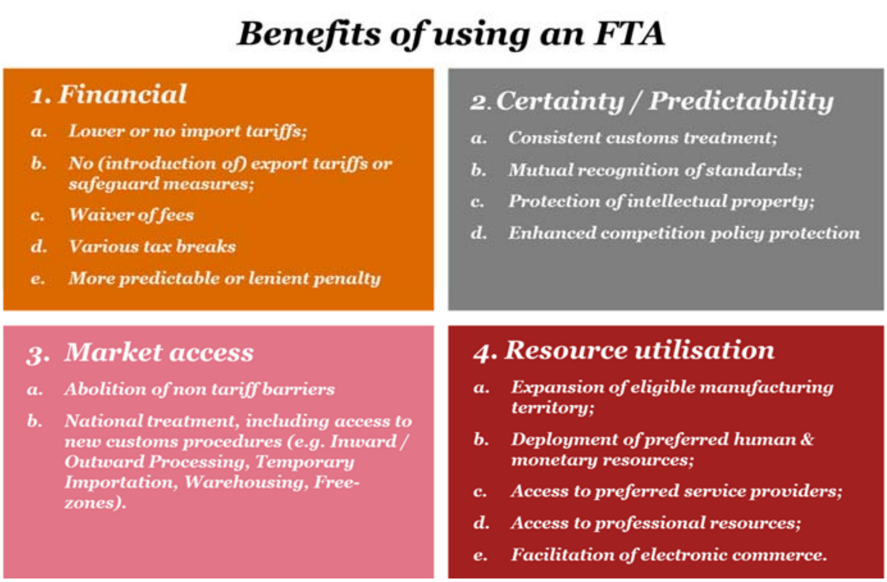

Figure 6.1

By and large, companies often think about FTAs in terms of the benefit listed as 1a only (Figure 6.1), with little appreciation or knowledge of the other benefits that an FTA offers on resource utilisation, protection of investment, service opportunities, etc.

The TPP would be very strong in areas 2, 3 and 4 (Figure 6.1). For example, the TPP would help with the movement of labour: short-term working visas would be easier to obtain. Although such rules would change under the TPP, few people understand or appreciate this, and a discussion to elaborate or clarify is not really happening.

In the area of financial benefits, the difficulty for companies to quantify future savings is enormous. Businesses would have to consider what is being imported, how it is classified for customs purposes, what activities are being carried out, and what services are being used. When considering these variables business often do not know what the future will look like, therefore, financial projections centre on more predictable measures, for example, the direct tax benefits of centralising a procurement function. Moving personnel to Singapore to work in a regional headquarters might lead to an exit tax on deemed future profits, which can be very specifically calculated.

With all the unknowns around trade and customs, businesses might gain US$3 million or lose US$4 million, depending on how it engages in trade. So most businesses decide not to model duty impacts at all, as it is so difficult to know how it will work in practice.

There are many challenges that are hard to overcome, made worse by FTA information that is too far removed from the reality that businesses see on the ground. This is made worse by the required compliance efforts.

Promoting an FTA with an SME or a new company involves determining if a product or service is covered. This poses a difficult task, especially in an agreement the size of the TPP. How can the direct and indirect cost-savings and market growth be quantified, what is the period of return? Unfortunately, many executives do not look beyond one or two years, with some not even looking much beyond quarterly reports. The TPP does not enter into such deliberations as it goes beyond those time frames.

The TPP is different, being broader and covering more areas than other FTAs. Unfortunately, many companies do not know it covers these areas. Being deeper, it provides a superior opening for goods and services; customs procedures, barriers to trade, sensitive sectors — they are all included. This is the result of the negative list approach; which was one of the major advantages of the TPP. Many trade negotiations start with an empty list that grows by opening access to specific products and sectors, and having such concessions returned. The TPP started with everything being open until specifically excluded, making it harder for negotiators to exclude areas, either because they did not want to be seen to be explicitly excluding them, or because they simply never considered them for exclusion.

However, the way the agreement is written makes it difficult to work out whether something is excluded, because many parts of the agreement may have an impact and have to be studied for business benefits or lack thereof.

The equality rules of the TPP would also result in all signatory countries abiding by the same rules and allowing companies to scale up. Currently, a product made in Singapore and sent to Malaysia may qualify for preferential treatment, but not if it was sent to Japan. To use accumulation, a certificate of origin is needed at source, but that requires knowledge of where the finished good will be sent — which many companies often do not know in advance. Many difficulties presented in the existing network of FTAs will not hinder the TPP, so there would be great potential benefits in scaling up using the same TPP rules in all 12 markets.

6.4 Conclusion

The specific benefits for Singaporean companies of the TPP will be the benefit of scale for exporters of products, particularly for SMEs. Nevertheless, care has to be taken when predicting participation, as there are many SMEs with no interest in internationalising. For example, a local hairdresser may well have no interest in international expansion. Therefore, communication and discussion has to be focused on those SMEs that have the willingness and capability to expand internationally. For domestic players, the TPP offers much risk. For instance, traditional

FTAs were focused on goods, and goods access to Singapore has not changed much as a result of an FTA; however, services access to Singapore in the TPP would open up, placing significantly more pressure on companies to become more productive and efficient. It is doubtful whether many companies are aware of or prepared for that. Many companies appear simply not to be looking at future competition. A Singaporean business could consider advertising holidays in Lima, but so could a travel agent from Peru, and the latter would probably have a linguistic and cultural advantage. Education and communication efforts would need to assure businesses that the perceived benefits would not be disrupted or undermined by new competition that had been ignored or overlooked, let alone address the negative sentiment that surrounds these possibilities. A competitive disadvantage is looming for Singapore companies that are not ready; at the same time there is also a risk of missing out on extensive duty savings opportunities in export markets. There is also a market opportunity for companies that can help, i.e., law firms helping businesses read through the text, going through rules and regulations, and an enormous scope for service providers to help Singapore companies internationalise. Regarding the newer aspects of the TPP, the services and investment chapters are generic chapters — unlike for instance, agriculture where there are strong lobby groups that have pushed for specific tweaks — and the markets for these services will be opened up and offer big opportunities for the likes of banks, insurance companies, or any kind of similarly covered service industry.

In conclusion, the TPP is about much more than traditional trade in goods, which most companies think of when hearing about an FTA or the TPP. Many businesses are somewhat sceptical of the TPP's benefits. Nevertheless, it will offer opportunities that business will take up, if the right messaging is used, and if there is an honest communication policy that lists the benefits, challenges and risks, companies that will likely lose out or gain, compliance requirements, and available support.

7.
Discussion on the Trans-Pacific Partnership

Participants discussed the benefits and risks of the ratification of the Trans-Pacific Partnership. A macro-perspective was also taken to better understand the options available to Singapore and Singapore's international trade position.

7.1 Space to Scale-up provided by the TPP

Mr Bhaskaran pointed out that Singapore's small size meant it needed space to scale. Would the TPP provide the kind of scale that enables companies like Grab to scale up to the entire market of the TPP, thus enabling it to become global?

Mr Debets believed that scale was in the minds of negotiators and would not necessarily be impacted by Singapore's size. Nokia was one such example. It had been one of the most successful telecoms companies, but had emerged from Finland, which did not have a large market for phones. Scale is very much a mindset issue and probably leads back to innovation; the likes of an Uber could easily emerge from Singapore. Ambition and, more importantly, willingness to take risks and fail in expansion, are the biggest challenges to Singaporean firms achieving scale.

Mr Tang added to the issue of mindset. His anecdotal evidence from many discussions in the startup space gave him the sense that a sizeable number of startups in Singapore were quite happy being bought out at the S$10–S$50 million range. There seemed to be generally less hunger to take these companies and grow them into unicorns — of more than S$1 billion in valuation. There were some examples like Razer, or a couple of companies that IPOS was working with that were quite aggressive, but there seemed to be less than other countries. This seemed to be a mindset issue, and an attitude issue; what was a good balanced life in Singapore? Generally, for Mr Tang's generation at least, the perception of the good life was to take a professional job or work for a big company or a stable environment, which meant the government or similar kinds of careers. Taking the plunge and being entrepreneurial was seen as a far less viable alternative.

One participant wondered what the government's role was in engaging risk-taking and innovation in Singapore. Was it time to introduce unemployment benefits so that citizens would be more encouraged or emboldened to take on more risks? Were there other areas that the government could look into?

Mr Tang was of two minds about this. While there had been a lot of talk about how Singaporean society was risk-averse, there were also other risk-averse societies in Asia, like Korea and Japan, that seemed to be doing much better than Singapore in innovation and taking products to the market using IP. This was a puzzle that needed further study. As for unemployment benefits, Mr Tang related that in the US, the Democrats were keen to implement some form of FTA unemployment insurance — if joblessness is attributable to FTA liberalisation there would some form of unemployment benefit. In the US context, some economists have suggested that was something that needed to be done.

7.2 Assured Benefits of the TPP

Mr Bhaskaran observed that as a regional hub, Singapore should benefit if TPP resulted in huge increases in trade flows, goods and services, capital movements, and people movement. But how confident could it be of getting those benefits?

Mr Tang believed it to be an issue of educational outreach. An example of a country that did well to ensure their companies reaped the benefits of FTAs was the US. US companies were extremely well-organised and had been very organised for the last 50 years in taking advantage of the trade agreements and the US Trade Representative's trade policy was almost seamlessly intertwined with the business interests of specific companies. This did create problems because in the US there was currently a lot of pushback against perceived corruption in the system, with a sense that the entire US government's trade interest is captured entirely by US corporate interests. Their industry associations were aggressive and knowledgeable, and MNCs often seconded bright, young people with a law background or the ability to read FTAs into these industry associations to understand them technically. They then translated the technicalities of these agreements into tangible benefits for the companies themselves.

Without that translation ability, FTAs would remain arcane agreements that are peripheral to companies' business interests.

A participant shared that his organisation conducted a number of studies on FTA benefits, impacts and development. One thing they studied was FTA under-utilisation, and Mr Debets' presentation made more sense than all the journal articles on FTA under-utilisation.

A participant sought to tap Mr Debets' experience. Have the Koreans or the Taiwanese been just as good as the US good in organising themselves at the SME level to take advantage of FTAs? Mr Debets shared his experience in other territories and what he had observed from colleagues working in other countries. The same struggle happened elsewhere, particularly in getting ecosystems together and companies to group together. This was very important in negotiations, i.e., entering alone as opposed to going in as an industry; negotiators were unlikely to listen because there are too many differing viewpoints. The advantage that countries like Korea had was the big *chaebols*, which were well-linked, so if the government wanted to make a difference, it could simply speak with the senior management — as they were linked one way or another — about what these companies needed to do. They would then drag a big chunk of the economy with them. This was not the case in Japan, Taiwan or Singapore. Another observation he had made when attending the APEC Ministers for Trade conference in the Philippines in 2015 in the Philippines was that there had been a worrying distinction made between SMEs and MNCs — to the extent that the undertone was "if it was good for

MNCs, it was bad for SMEs and vice versa." This was an untrue and dangerous distinction, a point that the SMEs there made strongly, saying that if the governments wanted to help them they should help the MNCs. This made sure that the former had a market of companies to work with. Because if they did it all by themselves, they were not going to grow quickly enough; they could not simply adjust their productivity and efficiency and scale.

7.3 Alternatives to the TPP

A participant said that to date, pre-TPP, Singapore has had trade agreements with many countries including large economies like the US, Japan, Australia and the EU. With the TPP, many other countries would also have preferential access to the US or Japan. Therefore, would Singapore face additional competition where it previously did not? Would it be better to have bilateral FTAs without other countries having similar agreements, rather than a single large agreement where more countries take advantage of the US market? Would Singapore be better off with the TPP or would it better off without the TPP by having bilateral agreements instead?

Mr Tang answered that a country's trade policy was partly political, partly economic, and Singapore's psyche was about remaining relevant to the world. Should the entire world trading system break into regional blocs — especially post-SEATO, or Southeast Asia Treaty Organization, how could Singapore remain relevant in such a system? In a system that allowed multilateral trading, where 140 countries moved lockstep — that was the WTO vision and it was a very grand vision — Singapore would have its place in the sun because the rules of the game were set and generally adhered to. He believed this push had been very successful and multilateralism has been a feature of the world trading system since WW2.

However, if the world broke down into regional blocs, the fear was that Singapore would become irrelevant, which was more of a political fear than an economic fear. Post-WW2, especially in the last few years, economics and politics have become increasingly synonymous, so a lot of what Singapore did — being part of TPP, RCEP — was to ensure that it remained relevant to the world. But beyond that, from the economic perspective, if Singapore were not part of the larger supply chain liberalisation that was going on, it would miss out on certain things. There were items in the TPP that Singapore could not get in its bilateral FTAs, that it could now get in the TPP because the TPP comprises 12 countries and it could tap the power of the bigger partners in the TPP region to open up markets that otherwise would be closed because of Singapore's small market size. For example, Japan opened up its agricultural market as did New Zealand and Canada, which would not have happened without all the agricultural countries. So even from the economic perspective, there were benefits that could create that delta.

Mr Debets felt that the existing agreements were very much geared towards trade in goods, and there was only so much manufacturing that happened in Singapore, so the TPP provided many other possibilities there. He did believe the TPP would open and create more competition both inside and outside Singapore for Singaporean companies, but in that regard Adam Smith's wisdom was relevant; some companies were going to be lost, but should those companies be kept and should the market remain more closed and keep the other companies from growing faster? As an example, in his 20 years' experience in Singapore he still got annoyed with the Internet connectivity or cable TV provisions; this came down to competition and some of the providers like Starhub and Singtel could do much better if only they were pushed — but they were not being pushed. So in that respect, as a consumer he very much favoured trade liberalisation to make things much easier.

A participant pointed out that there was a political question of whether the US would ratify the TPP. Given the amount of work that had been done by negotiators around the region, should the US decline to ratify the TPP, was there some sense among negotiating circles that there might be a push to continue with a smaller group of countries, for example, what was currently going on between Singapore and Australia — a TPP-style agreement but on a bilateral level.

Mr Tang clarified that under the TPP, the agreement would only come into force if six countries ratified it, and they had to constitute 85% of the total GDP of the TPP region. This meant that the US and Japan effectively had veto rights over the entire agreement. If neither the US nor Japan ratified it, then the entire agreement would not come into the force. A number of the anticipated benefits were a result of interrelated negotiations, such as Japan opening up its agricultural market because there was a complex calculation including the ability to access the US automobiles market more fully. It would not be easy to carry on without the US. The nature of the horse trading that was going on towards the end, of which there were thousands of such negotiations being made at the last minute, made it impossible to delink the TPP from the US. So if the US did not ratify, the negotiators would have to return to the drawing board and perhaps the RCEP would become the template for FTAs in the future.

Mr Debets was quite certain that ratification by the US would occur in January or December. It had significant political goodwill even in the US, despite all the rhetoric around it that suggested otherwise. In fact, the TPP ratification hinged only on the US — if the US agreed, Japan would agree; if the US disagreed, Japan would disagree. Mr Tang added that Japan had already agreed and were going to put it to the Congress in a few weeks' time. Japan's Liberal Democratic Party was going to ratify the TPP and it was the only party that could do it, as it had to move their agriculture and farming lobby, which they had. Mr Debets added that he felt the Singapore-Australia negotiations served as an example, where there were many fresh perspectives, but also narrower priorities. The broader the negotiations, the better the deal; negotiating bilaterally 20 times would produce varying results than negotiating once with 20 countries would.

7.4 Impact of the TPP

A participant wondered what explained the trade recession so far in the past two to three years. Other than weak external demand, were there any other factors driving the weak trade environment?

Mr Debets felt there was no single answer. In 2009 trade had dipped significantly. By end-2010, it was back on its long-term trend line. In the last two years it had flat-lined. Part of that had to do with what had been mentioned earlier on: the defragmentation of supply chains, vertical integration within the US and China — part of it resulting from non-tariff measures; and creeping trade protectionism — part of it was caused by the slowdown in demand in many big markets. It was not a single aspect, but a confluence of many.

A participant further asked if it would be better for negotiations to remain bilateral. The participant felt that given the way globalisation and production were growing, monopolistic relationships were unsustainable and Singapore might have use its Smart Nation platform to enable trade. Could one of the missing TFP drivers be technology, and how would that help Singapore in restructuring its economy?

Mr Tang noted two points regarding the restructuring of Singapore's economy, by using TPP as an opportunity to restructure. First, trade was going to be increasingly driven by such regional groupings, Singapore was part of it so the least it could do was consider how this could be leveraged. Second, Singapore could serve as a platform — which it has been good at — using its relative advantages in being bilingual and bicultural. One signal that came through very strongly in the TPP was that Singapore, being neither East nor West, neither North nor South, and friendly to all countries, allowed it to act as the bridge and facilitate many agreements. It was why Mr Tang had been asked to chair the IP negotiations; there was trust in Singapore being the facilitator. An exemplar of this was Tommy Koh, who had chaired some significant conferences because of the perception that he was a neutral but well-informed and highly-technically competent interlocutor. This was Singapore's role and it could be leveraged for more economic benefits. One observation Mr Tang made that connected to a number of trends, i.e., the TPP or RCEP driving the world at the regional level, trade liberalisation, the opening of markets, was that there was a growing consensus that domestic innovation was as an additional engine of growth. Intellectual property was key to that process, so it was critical for economists to find ways to measure it, and talk about it. Just because it was intangible did not make it valueless, and there have not been enough conversations surrounding intellectual assets, knowhow in the region and the world.

Conclusions

The 25th SER highlighted some observations about Singapore's short- to medium-term outlook at a time when global economic conditions were worsening in the session on macro-economic outlook and policy. The special focus session looked at the Trans-Pacific Partnership and its benefits for Singapore.

1. Macro-Economic Outlook and Implications for Policy

There appeared to be a series of risks facing Singapore:

- Weakening regional growth momentum partly caused by the commodity headwind and partly by the defragmenting of the regional supply chain.
- Sustained deflation or low inflation had driven up real interest rates, combined with high levels of corporate, public and household debt, posing a severe debt-sustainability issue.
- Increasing regional and domestic vulnerability to the RMB and dependency on US-EU and Chinese growth
- Demographic trends toward aging and rising dependency ratio made the need for Total Factor Productivity (TFP) growth more urgent, however, Singapore's TFP growth had been poor for several years despite rising wages.
- Debt overhang was a critical challenge facing Singapore's economy and the worsening real growth-real interest rate differential did not bode well for Singapore's ability to surmount the challenge.

However, there were some actions that could be taken to mitigate these risks. First, improving Singapore's financial system in the areas of access to credit and venture capital could spur investment and support future growth. Second, macroprudential measures that allowed easier debt servicing but more difficult debt creation could cushion the impact of an interest-rate hike; however, care has to be taken to ensure that this does not result in a bubble, e.g., China's "shadow banking" industry.

In view of this economic outlook, there was much debate over the approach to deleveraging and making the growth rate-interest rate differential positive. There was clear consensus on the importance of reducing the debt overhang and improving TFP growth to improve the growth of the economy.

2. Special Session: The Trans-Pacific Partnership

The Trans-Pacific Partnership was the most significant development in trade in the past 20 years — comprising 12 countries, it will combine 800 million people with a market size of US$20–US$30 trillion. It differed from previous FTAs in several areas:

- First, it took a negative-list approach, i.e., starting with the full range of economic sectors and negotiating concessions for each sector, as opposed to starting with a blank list and negotiating for select sectors.
- Second, it went beyond trade in services that was covered by traditional FTAs to include trade in services as well as non-tariff

measures, e.g., the liberalisation of local labour laws and the lifting of foreign equity restrictions.

- Third, it encouraged competition by lowering compliance requirements, e.g., the US-Singapore FTA's yarn-forward rule that required firms exporting clothes to the US to use yarn from Singapore or the US. Under the TPP, clothes exports to the US would receive TPP benefits if they used material from any TPP member.
- Fourth, the IP chapter of the TPP was the most comprehensive and complex IP chapter ever written into an FTA. The chapter set a common set of IP rules while including a large degree of flexibility and carve-outs, and even included ISP liability to ensure compliance.

However, there were several obstacles facing the ratification and utilisation of the TPP:

- First, for the TPP to come into force required at least six countries to ratify it, and they had to constitute 85% of the total GDP of the TPP region. This effectively gave the US and Japan veto power, given that Japan had publicly agreed to ratify it, ratification then hinged on the US and its politics.
- Second, for Singaporeans to take advantage of the additional space provided to scale up a change in mindset was required. The existing mindset was observed to be generally risk-averse, in favour of working for MNCs or the government. Despite Singapore's seemingly high rank in the Global Innovation Index, it was very poorly ranked in converting R&D inputs into outputs.

- Third, the TPP benefits and compliance requirements had to be communicated clearly to encourage firms to take advantage of the opportunities and benefits offered by the TPP, while being aware of the increased risk of competition. Previous FTAs had been poorly communicated, with most companies failing to understand the benefits and compliance requirements and choosing not to utilise the FTAs instead.
- Fourth, new methods for modelling the financial impact of non-tariff benefits of the TPP, e.g., supply chain rationalisation, or Intellectual Property were needed for companies to promote utilisation and improve clarity on the benefits of FTAs.

There was a clear consensus that the Trans-Pacific Partnership was one of the most significant developments in the region, and its marked departure from traditional FTAs posed a wider range of opportunities and risks than before. Despite the increased risks, it was in Singapore’s broader interests to ratify the TPP, as promoting multilateralism ensured that Singapore remained relevant to the world, as well as improved Singapore’s bargaining position to achieve better concessions and consumer welfare through increased competition. Singapore could mitigate these risks by playing upon its traditional strengths as a hub and a neutral but technically competent location for businesses.

It was noted that while the present trend was towards mega-FTAs such as the TPP and RCEP, it remained to be seen if this trend might persist. There was a possibility that these mega-FTAs may pave the way for the return of multilateralism building on the norms and rules developed in the mega-FTAs.

Appendix 1: List of Participants

Chairperson
Mr Manu BHASKARAN
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Speakers
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Camtech Management

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Ms Deborah TAN
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Discussants
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Chief Economist
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Mr Jimmy KOH
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Economic-Treasury Research
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Mr Thomas LAM
Chief G3 Economist
Economics Research
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Mr Adam LE MESURIER
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Appendix 2: Curricula Vitae of Presenters, Discussants & Chairperson

Presenters and Discussants

Taimur Baig joined Deutsche Bank in 2007. He is in charge of the Asia Economics team and its products. His team prepares regular analyses and forecasts of Asia's 10 largest economies. He advises the bank's management and clients about regional risks and opportunities. Prior to joining the bank, Dr Baig spent eight years at the International Monetary Fund (IMF), based in Washington DC, where his last position was Senior Economist. During his career in the IMF, he covered monetary policy and exchange rate issues in Japan, India, Argentina, Saudi Arabia, Pakistan, and the Philippines. He also worked for two years in the IMF's fiscal affairs department, focusing on fiscal policy implementation in emerging economies. Dr Baig studied at the University of Illinois at Urbana-Champaign, the London School of Economics, and Wabash College. He has published numerous articles and reviews on economic policy and analysis, including in *Review of International Economics* and *IMF Staff Papers*.

Ray Farris is a Managing Director and the Head of Fixed Income Research and Economics, Asia Pacific Division at Credit Suisse. Prior to this, Mr Farris was at various times Head of Asia Macro Strategy, Head of the Global Emerging Markets Strategy team, Head of the Asia-Pacific Macro Product Research team, Head of Fixed Income Strategy for the Asia Pacific region, and Head of Global Foreign Exchange Strategy (based out of London, 2007–2011). Ray joined Credit Suisse in February 1998 from BZW Asia, where he was Head of Asian Economics in the equity division. He holds a degree in Economics with highest honours from the University of North Carolina, Chapel Hill, and a Master's degree in Finance with distinction from London Business School.

Daren Tang is Chief Executive of the Intellectual Property Office of Singapore (IPOS). He leads IPOS in its vision to be a global partner of an IP-driven economy, and to build Singapore's future growth with innovation fuelled by IP. Mr Tang also represents Singapore in all international IP negotiations, which include those at the World Intellectual Property Office and World Trade Organization, as well as in Free Trade Agreements such as the Regional Comprehensive Economic Partnership agreement, and the recently concluded Trans-Pacific Partnership agreement, which he chaired.

Frank Debets is the Managing Partner of PwC's Asian Worldtrade Management Services (WMS) practice, based in Singapore. He is the project and client relationship manager for some of the largest WMS clients, both globally and in the Asia-Pacific region. He chairs the Supply Chain Management Committee of Singapore's AmCham, the Regional Trade Committee of Singapore's EuroCham, is an invited member of the Singapore Customs Advisory Committee and an FTA Advisor for IE Singapore.

Before transferring to the Asia-Pacific region in 1999, Mr Debets worked in PwC's London office for six years, and as a Research Associate at INSEAD business school in Fontainebleau. Mr Debets received a Master's degree in Econometrics (Operations Management) from the Erasmus University in Rotterdam, Netherlands, as well as a diploma in Systems Analysis from Hull University, UK. He is a member of the UK Institute of Export.

Jeslyn TAN is a Senior Economist at the Monetary Authority of Singapore (MAS). She covers developments in the Singapore economy, with a primary focus on the surveillance and analysis of economic trends and their impact on the economy.

Chairperson

Manu BHASKARAN is an Adjunct Senior Research Fellow at the Institute of Policy Studies. He is also concurrently Partner and Member of the Board, Centennial Group Inc, a policy advisory group based in Washington DC where he heads the Group's economic research practice. Mr Bhaskaran co-leads the Institute's work in the area of economics. His major area of research interest is the Singapore economy and the policy options it faces. Prior to his current positions, he worked for 13 years at the investment banking arm of Société Générale as its Chief Economist for Asia. He began his professional career at Singapore's Ministry of Defence, focusing on regional security and strategic issues. Mr Bhaskaran graduated from Cambridge University with a Masters of Arts and also has a Masters in Public Administration from Harvard University.

Appendix 3: Abbreviations

ASEAN	Association of Southeast Asian Nations
CPI	Consumer Price Index
EM	Emerging Market
FDI	Foreign Direct Investment
Fed	Federal Reserve
FTA	Free Trade Agreement
FTAAP	Free Trade Area of the Asia-Pacific
G3	Group of Three
1.1.1.a.i.1.1 G7	1.1.1.a.i.1.2 Group of Seven
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GLC	Government-Linked Company
GOS	Gross Operating Surplus
IMF	International Monetary Fund
IP	Intellectual Property
IPOS	Intellectual Property Office of Singapore
ISP	Internet Service Provider
MAS	Monetary Authority of Singapore
MNC	Multi-National Company
MTI	Ministry of Trade and Industry
PBOC	People's Bank of China
PMI	Purchasing Manager Index
QoQ	Quarter-on-quarter
SAAR	Seasonally Adjusted Annualised Rate
SEA	Southeast Asia
1.1.1.a.i.1.3 SEATO	1.1.1.a.i.1.4 Southeast Asia Treaty Organization
SER	Singapore Economic Roundtable

SGD	Singapore Dollar
SMEs	Small and Medium-Sized Enterprises
TFP	Total Factor Productivity
TPP	Trans-Pacific Partnership
TTIP	Transatlantic Trade and Investment Partnership
UK	United Kingdom
US	United States
USD	United States Dollar
WIPO	World Intellectual Property Organization
WTO	World Trade Organization
YoY	Year-on-year