OPINION:

Thriving in a low growth world

David Skilling

December 2015

Singapore needs to adjust its economic policy approach to sustained lower growth rates

Economic news over the past few weeks suggests that Singapore is in a new low-growth normal. The Ministry of Trade & Industry estimated that Singapore grew at 0.6% in the September quarter, or 1.9% growth on an annualised basis. And the MAS downgraded its growth forecast for 2015 to close to 2 per cent, narrowed from an earlier forecast of 2-2.5%.

This weak growth is not unique to Singapore. Growth rates across Asia – and globally – are well below their historical trend rates of growth. The IMF's World Economic Outlook, released in October, marked down its 2015 global growth forecast to 3.1% - largely because of emerging markets weakness – before a slight recovery in 2016 to 3.6%.

And excluding Ireland and Iceland, which are recovering rapidly from a deep crisis, the current average growth rate across the small advanced economies group is under 2%. For many small advanced economies, 1-2% growth rates will be the norm for the next period. Singapore's experience is in line with this.

However, this is an unusual growth profile for Singapore. To be sure, Singapore has experienced low (and negative) growth rates previously, but this has generally been in periods of regional or global crisis: the Asian financial crisis (1997/98), SARS (2001), and the global financial crisis (2008/09). Sustained growth at 2% or below is unusual in Singapore's post-independence experience.

And even if the global economy recovers more rapidly than is expected, Singapore's growth rates would likely remain structurally lower. Singapore now has one of the highest levels of per capita income in the world, and cannot expect to sustain the growth rates of just under 6% that it averaged between 1990 and 2007. 2-3% growth rates are more common for countries at Singapore's state of development, and the weak external environment is pushing these growth rates lower.

So how should Singapore best adjust to these new low growth realities, and continue to thrive and prosper? Does the Singapore model work in a 2% growth environment, or are changes required?

In thinking about these questions, it is important to note that many other small countries have been operating at growth rates of around 2-3% for some time, and continue to generate good outcomes on measures such as employment, wages, and productivity. This suggests that Singapore can continue to do well in a low growth rate environment as long as it responds appropriately. But equally, a failure to adjust a growth model optimised for higher levels of growth may be costly.

Drawing from the international small advanced economies experience, I suggest three priority areas for action to better position the Singapore economy for these lower growth rates.

First, defensive actions to align Singapore's cost structure with lower growth realities. Over the past couple of decades, Singapore has become a very costly location, on a range of measures such as wages and rent. Part of this reflects Singapore's increasing prosperity, and has been covered by productivity growth – but not all. Singapore's unit labour costs have been growing by more than 3-4% over the past couple of years, and Singapore is routinely ranked as a costly location in international surveys. Anecdotal evidence from firms, as well as economic data, suggests that Singapore's cost competitiveness is becoming a problem.

When income growth is robust, margins can grow even with cost increases. But in periods of low growth, sustaining competitiveness – at both firm and national levels – is increasingly related to the level and growth in cost structures. Wage and cost growth needs to be tied more tightly to productivity growth – and expectations regarding future cost increases need to adjust to reflect likely future GDP growth (say 2%) rather than the 4-5% before the crisis. Given the current position, a significant downward shift in cost structures – and in increase in productivity – is needed for Singapore to sustain its competitive position.

Indeed, in several other small advanced economies with high cost structures, such as the Nordics, there are active efforts underway to reduce cost structures and improve productivity. There is a sense in these economies that cost growth has outstripped productivity improvements, weighing on the competitive position of firms in global markets.

Some of the recent increase in Singapore's costs is due to restrictions on migration, and the drive to a more productivity-driven growth model. This is the right approach, but care needs to be taken on the speed of this process, so that cost increases do not get too far ahead of productivity growth.

Second, a greater focus on managing economic risks and building resilience. In a low growth environment, economic volatility becomes a bigger issue – for both the national economy as well as individuals. A shock of any given magnitude is more disruptive when the economy is growing at 2% than when it is growing at 4-5%. And the IMF among others are pointing to a growing array of material global economic and financial risks.

Small countries tend to respond to these risk exposures through some combination of building a diversified portfolio of sectors or activities (to reduce the exposure to specific shocks); building buffers, such as fiscal reserves; as well as ensuring that the economy is flexible to adjust to shocks. Singapore has many of these attributes. But it should not be complacent. Finland provides a cautionary example of an innovative, well-managed economy that was hit by a coincidence of major shocks, and has not grown since 2012.

And there are several exposures that may become more pronounced in a low growth environment. For example, Singapore's level of debt has increased substantially over the past decade – with higher lending to both companies and households. The McKinsey Global Institute estimates that Singapore's debt load increased by 129% of GDP between 2007 and 2014 to a total of 392% of GDP. A slowing economy may make it more difficult for some firms and households to service this debt.

Third, and more positively, a deliberate growth strategy. Although growth will be harder to generate than before the crisis, Singapore's choices will have a material impact on its growth potential. For a small country like Singapore, this will necessarily involve strong internationalisation performance by Singapore-based firms. In a low global growth environment, small countries need to identify very specific growth opportunities in global markets.

Singapore has long been deliberate about positioning itself to capture value from changes in the global economy. But a greater contribution from innovative domestic firms expanding internationally is required in order for Singapore to capture maximum value from more sluggish global markets. Singapore has benefited enormously from attracting firms to locate in Singapore, but a low growth environment places a premium on internationalisation by Singapore firms.

Overall, a low growth global economic environment will demand serious action from small countries like Singapore. But small countries may be better able to adjust to the lower growth reality in a quick, flexible way than many large countries. Indeed, small advanced economies continue to out-grow their larger counterparts (just). Small countries, including Singapore, will need to respond creatively – and with urgency – in order to thrive in a new low growth world.

This op-ed was published in the Opinion pages of Singapore's Straits Times on 1 December 2015

About the author

Dr David Skilling is the founding Director of Landfall Strategy Group, which was established in 2011. David advises governments, companies, and financial institutions in several small countries, and writes regularly on global macro, globalisation and geopolitics from a small country perspective. David has recently served as Senior Advisor to the Secretary of Foreign Affairs & Trade in New Zealand, and as a Fellow at Singapore's Civil Service College. Previously, David was an Associate Principal with McKinsey & Company in Singapore, as well as being a Senior Fellow with the McKinsey Global Institute. Before joining McKinsey, David was the founding Chief Executive of the New Zealand Institute, a privately-funded, non-partisan think-tank. Until 2003, David was a Principal Advisor at the New Zealand Treasury. David has a Ph.D. in Public Policy, and a Master in Public Policy degree, from Harvard University, as well as a Master of Commerce degree in Economics from the University of Auckland. David was named as a Young Global Leader by the World Economic Forum in 2008.

About Landfall Strategy Group

Landfall Strategy Group is a Singapore-based research and advisory firm that provides advice on strategic issues to governments, firms, and financial institutions, particularly in small advanced economies. We provide distinctive perspectives on emerging global trends, working with decision-makers to understand key global changes and how governments, firms, and institutions should respond and position themselves in the emerging global economic and political environment.

contact@landfallstrategy.com

www.landfallstrategy.com

twitter: @dskilling

LANDFALL
STRATEGY GROUP