ARTICLE FOR THE EDGE

SINGAPORE: THE IMF RAISES STRUCTURAL CONCERNS

The International Monetary Fund (IMF) recently issued its Article IV report on Singapore, which is like a report card on the country's economic performance. The overall assessment was a positive one: the economy is recovering, inflation is low, the external sector is robust and the banking sector is in the pink of health. Monetary policies including macro-prudential measures appear to have been effective in addressing cyclical issues.

However, the IMF pointed to some areas of potential concern. These have caught our interest because they carry important policy implications. First, is the IMF's view that Singapore has an excessively high current account surplus and the other is the innovation deficit – the gap between the effort Singapore has put into innovation and the results from all that effort.

How serious are these areas of weaknesses and what can be done about them?

Current account surplus: too much of a good thing?

Singapore has run persistent current account (CA) surpluses for around 30 years. Last year, the CA surplus stood at 19% of GDP, up from 18% in 2015. In the IMF's assessment, Singapore's "cyclically-adjusted CA balance is substantially stronger, by 2.5-8.5% of GDP, than consistent with fundamentals and desirable policies". The external surplus may seem uninteresting to the ordinary Singaporean but it carries huge implications.

- For one, if Singapore is deemed to have excessively high current account surpluses, it becomes exposed to the protectionists in the United States for whom a large external surplus is evidence that the country is manipulating its currency unfairly and so deserving protectionist measures against its exports.

- Second, if the CA surplus could reflect some deep underlying imbalance in the economy. After all, the current account balance is the difference between savings and investment, so too large a surplus indicates that either savings are far too high or investment is too weak.

The first risk – that excessive surpluses could lead to protectionism – should not be under-estimated but it can probably be managed. While Singapore has an overall external surplus it actually runs a large deficit in goods and services trade with the US, making it less of a target. It is also an important strategic ally with whom the US has already concluded a free trade agreement – the process of negotiating that agreement probably allowed the two countries to resolve many contentious issues, so creating an amicable understanding between the two.

However, the second cause for concern merits some deeper thought. Singapore's policy makers disagree that the country has an excessive surplus, arguing that Singapore's "city-state geography" and its status as a pre-eminent global financial, trading and production hub inevitably leads to high corporate savings and therefore to a high CA surplus. But Hong Kong is also a city-state economy which is a global financial and services hub and yet its CA surplus has averaged around 3% of its GDP in 2011-2016, compared to Singapore's 19%. Moreover, Singapore's overall private savings rate, at around 37% of GDP, is almost double that of our peer group – according to the IMF. So, it does seem possible that Singapore's CA surplus could be excessive.

That being the case, is there an imbalance somewhere that requires policy correction? To answer that, we need to understand where the imbalance might be – is it that households are saving too much or is it the corporate sector or is the government? Or is the problem that our investment rate is too low.

Unfortunately, investigating this is tricky. Singapore does not provide savings data broken down into household, corporate and government savings as many other countries do. Moreover, as the IMF has pointed out over and over again, Singapore does not provide enough budgetary information in the standard IMF format so it is difficult to assess the actual government surplus the way the IMF and other international economists define it. Looking at the elements of savings and investment that could have contributed to this problem, the following picture emerges:

Household savings could be excessive for a number of reasons:

- First, job and income uncertainty has risen in Singapore because the uneven economic recovery has not really boosted the labour market. Middle-aged PMETs (professionals, managers, executives and technicians) have borne the brunt of this weak labour market in recent quarters. So, it is a fair assessment to make that precautionary savings must have risen.

- Second, Singapore is an ageing society without a state-funded universal pension as in most advanced economies. Singaporeans have to save at a high rate in order to fund their retirement.

- There is now a third reason which reinforces the second reason. Singaporeans had not really appreciated the fact that their Housing & Development Board (HDB) flats are on a 99-year lease whose value will go to zero at the end of the lease. Now that the government has, rightfully, clarified that the government will take back the property once the 99-year lease is over, Singaporeans better appreciate that their flats, which are the main store of wealth for most households, will be worth nothing and returned to the government after 99 years. Now, 99 years might seem like a long time but academics have estimated that the value of the 99-year lease property will start to fall sharply well before the 99 years are up – one estimate is of a sharp fall once 60 years have passed. So, parents who had wanted to provide a bequest to their children or liquidate their homes to realise cash to fund their retirement now have to worry that putting so much of their savings into property, as Singaporeans have done, could leave them in a decidedly uncomfortable position in terms of their retirement and other savings targets.

It is also quite possible that corporate savings are much higher than other countries. The profit share of GDP is much higher in Singapore than other developed economies, so retained profits (= corporate savings) will tend to be a high share of GDP as well.

Government savings are also likely to be relatively higher in Singapore when measured according to internationally accepted accounting standards, given the high degree of fiscal rectitude. As the government does not release data on the true value of our surpluses and how the investment income generated has grown over the years, it is not possible to quantify how excessive government savings are.

A low investment rate could also be a problem. Investment as a share of GDP has been steadily declining: from a peak of around 45% in the early 1980s to 30%-plus in the 1990s and now just above 20%. But this is roughly in line with similar falls in comparable economies such as Hong Kong and Taiwan – though South Korea still invests at the rate of about 30% of GDP.

Should we worry about the innovation deficit?

We can now turn to the second broad area of concern raised by the IMF. The IMF pointed out how public spending on research and development (R&D) has grown by leaps and bounds. This spending amounted to about 2.5% of 1991 GDP in 1991-95, soaring to a whopping 4.5% of 2016 GDP for the 2016-2020 plan. This is likely to help boost Singapore's R&D capacity and help promote Singapore as an attractive location for many R&D-related activities.

However, the IMF pointed to two possible gaps in the R&D space. First, R&D spending by private industry was inordinately low when compared to Singapore's peer group. After a quarter of a century of immense government effort at boosting R&D, private sector R&D remained low. Second, while Singapore was phenomenally effective at mobilising inputs for innovation, the actual outcomes in innovation were relatively disappointing, resulting in an innovation efficiency performance that was in the bottom half of the class.

The IMF conceded that it was very difficult to analyse why Singapore suffers from such a low innovation efficiency performance. The discussion in its report identified several reasons for the weakness in innovation, of which two struck as interesting:

- One reason could be cultural: Singapore's notorious a risk-averse culture could be holding Singaporeans back from achieving more in innovation.

- Another reason could be the lack of scale economies. Silicon Valley innovators could achieve low unit costs quickly by being able to rapidly scale up in the massive American consumer or business market. Smaller European countries such as Sweden could do so because of the single European market. And Israel could do also leverage off the US market because of its extensive links with the US.

So, what are the policy implications of these areas of structural weakness?

The imbalances identified by the IMF are real and merit a policy response. Here are some of the considerations:

- First, there is a pressing need for the government to consider expanding social safety nets in two areas. Some form of tax-funded state pension is probably needed to further improve retirement adequacy. Studies of retirement systems usually suggest this as one of many pillars of a sound retirement funding system – ours relies too much on just forced savings through the Central Provident Fund and the individual's own discretionary savings. Another area is some sort of insurance against sudden losses of income either due to unemployment or to a business failure. In a world in which disruptive technologies and upheavals will become commonplace, it will become more necessary to provide a basic level of sustenance. This will not only reduce the need for precautionary savings, it will also spur greater risk-taking and entrepreneurship – and so improve the innovation deficit as well.

- Second, the Singapore Government may want to consider a policy of extending the 99-year lease for HDB properties, clarifying on what terms and at what price it is willing to do so. That would take care of a new source of uncertainty – otherwise, ordinary Singaporeans would likely squirrel away even more money to build up savings given that the largest store of wealth for most Singaporeans – their HDB flats – may not be as valuable as thought.

- Third, we need to do more to provide businesses located in Singapore with the ability to scale up – to address one of the possible reasons for shortfalls in innovation. In the past, the thrust of our free trade agreements with our friends has been to improve our connectivity and enhance Singapore as a base for manufacturing production or as a regional hub. In future, our trade negotiators should aim at expanding our existing trade agreements and negotiating new ones which would give Singapore-located firms more unfettered access to large markets elsewhere – not just to sell into that market but to operate in those markets with similar ease as that country's companies. Another thing it could do is to revive the Singapore-Johor-Riau growth triangle initiative so as to create an immediate hinterland with considerable scale.

In short, Singapore has done well to ride through the cyclical weaknesses of the past two years. But we need to do more to address some key structural weaknesses.

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