

## **Lee Hsien Loong: Remaking the Singapore economy**

Keynote address by Mr Lee Hsien Loong, Deputy Prime Minister of Singapore and Chairman of the Monetary Authority of Singapore, at the Annual Dinner of the Economics Society of Singapore, Singapore, 8 April 2003.

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### **Introduction**

I agreed to speak on the theme of Remaking the Singapore Economy many months ago. It seemed an appropriate subject to talk about, given that we were engaged in a major exercise to remake the Singapore economy. As part of the exercise, we pondered the likely risks that might derail our recovery and longer-term plans - a double dip in the US economy, more terrorist attacks, the war in Iraq going awry, and oil prices shooting up. But events have a habit of taking plans by surprise. I did not imagine that we would be fighting the threat of a new and dangerous disease.

### **SARS**

SARS has significantly disrupted our economy. It has affected not only tourist spending but also domestic consumption. We are not yet certain how prolonged or serious the impact of SARS will be. It will depend not just on how we manage the problem in Singapore, but also on how widely the disease spreads around the world. But certainly our first half growth will be affected, and we will have to revise down our growth forecasts for the year.

The Government has acted decisively to contain the outbreak. We have set up a ministerial taskforce to deal with all aspects of the problem. We are tracking the situation closely, and will take further steps as these become necessary.

Singaporeans must be psychologically prepared for the problem to stay with us for some time. Each of us will have to learn more about the disease, adjust our habits and take sensible precautions, so that we can protect ourselves, our families and the people around us, and carry on with our lives. SARS is not just a medical issue; it is a test of how well Singaporeans can respond collectively to resolve a serious problem facing our society.

### **Synopsis**

The same ability to respond collectively is critical to our remaking of the Singapore economy. So far the debate on economic reforms has focussed predominantly on Singapore's present situation, and indeed on our immediate problems. We need to take a step back from the close-up snapshots of where we now are, and see our challenges in a historical and international perspective.

The story of a country consciously restructuring its economy to adapt to a changed environment is not unique to today's Singapore. It is a recurring theme in world economic history. Tonight, I will explore the challenges of remaking the Singapore economy against the broader context offered by the lessons and experiences of history. In particular, the experiences of Japan, China and UK offer useful insights into the process of our ongoing reforms. What matters is not just sound economic policy, but effective leadership, a collective response from the people, social cohesion and political will, to see difficult changes through and make them work.

### **Economic reforms around the world**

#### ***Japan***

Japan is my first example of an economy transforming itself fundamentally. For two and a half centuries up to the middle of the 19th century, Japan was ruled by the Tokugawa Shogunate. It was inward-looking and insular. The Tokugawas only allowed coastal vessels that could not make ocean voyages. Foreigners landing on Japanese soil, even if by accident, faced severe punishment. But in 1853 Commodore Perry arrived in Tokyo Bay with a quarter of the US navy - the "Black Ships". This demonstration of US military supremacy forced Japan to open itself up to foreign trade and influence.

Behind its closed doors, Japan had fallen behind the West. It became clear that the Tokugawa regime was not able to lead the country into the new era. So in 1867 a group of young samurais led a coup to overthrow the Shogunate. They restored the Meiji Emperor, and ruled Japan in his name.

The reformers were determined to make Japan a strong country again. They made a decisive break from feudalism and set about systematically modernising the country. Their strategy was to learn from the West and set Japan on the path of industrialisation. They succeeded brilliantly. Within 40 years, the Japanese Navy defeated the Russian fleet in battle (1904-1905). Japan's take-off continued right up to the onset of World War II. Economic historians have estimated that Japan experienced a 14-fold increase in income levels over this period.

Total defeat in World War II reduced Japan to ruins. After the war, Japan faced the massive task of reconstruction and development. Japanese firms cooperated with the Americans, raised their technical expertise, and benefited from institutional reforms of the Occupation period for a new, market-based economy. By 1950, the pre-war zaibatsu conglomerates were dissolved and family control had been eliminated. The zaibatsu system was replaced by the keiretsu system, built around the main banks, which shared large cross-shareholdings with the corporate sector. Control passed from shareholders to top managers. Managers and workers worked together as one to rebuild the country. The whole system was underpinned by the consistent and coherent political leadership of the Liberal Democratic Party, supported by an elite civil service. This strategy yielded 30 years of unparalleled growth. By the 1980s, Japan had become an economic superpower.

But the formula did not work forever. In 1990, the excesses of the bubble economy ended in the collapse of Japan's property and stock markets. Japan entered a prolonged period of stagnation, whose end is still not yet in sight. Policies and institutions had not kept up with the demands of globalisation. The keiretsu model and the lifelong employment system were too rigid to adapt to the rapid changes of the new economy. And changing the economic model would mean radically altering the social and political framework as well. This time, the national consensus for reform, and the will to change, has proved elusive. But given Japan's past ability to remake itself, it would be hasty to conclude that it will not do so again.

## **China**

China offers an interesting contrast to Japan's experience of modernisation. In the 18th century, at the zenith of the Qing Dynasty, Emperor Qian Long promulgated a "closed door policy" to restrict foreign trade to the single port of Canton, cutting China off from Western technology and influence. In 1793, Britain sent Lord George Macartney on a diplomatic mission to request for broader trading opportunities and diplomatic representation in Beijing. The request was refused. The Emperor declared in his reply to King George III that China "possesses all things in prolific abundance and lacks no products within its own borders". The shiploads of manufactured products from the ongoing Industrial Revolution in Britain failed to alert China to the technological progress beyond its shore.

Within 50 years, China's weakness and backwardness became painfully obvious. China was forced open by the western powers, and compelled to sign unequal treaties with them. Amidst internal unrest and foreign invasions, the Qing dynasty made repeated attempts to reform and modernise itself, but all these efforts failed. China was in political disarray, and the turmoil continued into the 20th century.

Under the Communists, China established a centrally planned economy, rejected free markets and the profit motive, and emphasised egalitarianism. The economy grew rapidly in the early years but the communist system, plus upheavals like the Great Leap Forward and the Cultural Revolution, led to inefficiency, backwardness and chaos.

In 1977, after Mao Zedong died, Deng Xiaoping returned to power. He made a decisive break with Maoist dogma, and launched far-reaching market reforms under the slogan "Reform and Open Up". The profit motive, and the new social attitude that to get rich was glorious, unleashed huge energies and transformed the lives of hundreds of millions of Chinese people. By producing widespread benefits across the country, Deng's reforms became entrenched and irreversible, even though they are still far from complete. Deng had accomplished what successive reformers and modernisers had tried and failed to do for a century.

## **UK**

Post-war Britain offers a third example of a remaking of an economy, although on a smaller compass. Emerging from the post-war reconstruction of Europe, Britain shared in the world economic boom of the 1950s and early 1960s. But by the mid 1960s, the "English disease" had set in. The country was plagued by militant trade unions, poor management, and unsustainable state welfarism. Industries that had once been world leaders fell behind. British governments were trapped in a cycle of stop-go policies, chronic balance-of-payments difficulties and sterling crises. The heavy involvement of the state in economic activities and transfers had led to a dead end.

Margaret Thatcher swept into office in 1979, bringing with her a strongly held and clear political philosophy: to reduce the role of the state in the economy and rid the country of its "wasting disease". Thatcher embraced the free-market views of Friedrich Hayek and Milton Friedman. She resolved to break the monopoly of nationalised industries and curb the oppressive power of the trade unions. She revamped policies, cut back the role of government and the extent of the welfare state, and privatised inefficient public enterprises. She confronted the unions and defeated them, notably in a prolonged miners' strike. In short, she succeeded in changing the prevailing economic paradigm from a socialist welfare state to a much more laissez-faire system.

Thatcher had to tackle strong vested interests, and could only reshape Britain's economy and society with the support of the people. This was by no means an easy task after three decades of heavy state welfarism. Yet she won four successive elections and, with them, the mandate to make fundamental changes to the country. Her reforms outlasted her - even the Labour Party, to be elected, had to reinvent itself as New Labour and espouse policies not so different from what the Conservatives stood for.

## **The remaking of Singapore**

Singapore too has had to remake itself to get to where we are today. Since independence, we have always been on the move, adapting to an ever-changing environment. Being a small and open economy, we are constantly subject to the vagaries of the external environment. We have thrived by being nimble and efficient, and by doing what is in the long-term interest of our people. These attributes have taken us from third world to first in one generation. In the process, we have remade ourselves at least twice.

### ***Third World to NIE***

The first phase of our take-off, from third world to NIE, started at the time of independence. Our success despite great uncertainties and dangers was the result of several paradigm shifts. The first shift was to industrialise our economy. Our entrepot trade had reached its limits, and going forward, the only way to create more jobs was to build a manufacturing sector. We started industrialising even before we joined Malaysia. Indeed, one major reason for Merger was to create a Common Market, so that our factories could sell to all the states of Malaysia. Such an import-substitution strategy was then the conventional wisdom for developing countries. Our factories produced mosquito coils, cosmetics, toys and garments, and we protected locally assembled cars, refrigerators, air-conditioners, and even a sugar factory with tariffs and quotas.

But this vision of a Common Market of 10 million people did not materialise. Singapore never succeeded in getting its products into the rest of Malaysia tariff free. For this and other reasons, Singapore separated from Malaysia in 1965. We were now left with a domestic market of less than two million people. An import substitution strategy had become patently unworkable. We made another paradigm shift, to re-orientate our industries towards serving world markets. We dismantled the import barriers protecting our industries, which forced them to hold their own against global competition.

We also had to overhaul our labour relations. We had inherited the adversarial style of labour-management relations from the British. Worse, the communists had infiltrated the unions and used them to foment unrest and chaos. After independence, with the Communists defeated, the government worked with the unions and employers to alter the nature of industrial relations. In 1968, we passed the Employment Act and the Industrial Relations (Amendment) Act, to vest the power to hire and fire clearly with employers. We replaced the old adversarial approach with a cooperative tripartite relationship based on trust and confidence. This was institutionalised in 1972 with the setting

up of the National Wages Council. Since then we have enjoyed harmonious labour relations, a precious and unique advantage in attracting foreign investments to Singapore.

Unlike other emerging Asian economies like Korea and Taiwan, we also opened the door fully to MNC investments. It was the fastest way for us to create jobs, penetrate overseas markets and bring in Western and Japanese technologies. Other countries in the region eventually followed, making Southeast Asia a major production location, which in turn benefited Singapore.

These remaking and growth strategies succeeded, and brought full employment and steadily rising incomes. Over time, we moved into higher value-added activities. After two decades of robust growth, Singapore had transformed itself into a newly industrialised economy. But in the early 1980s, rapid wage increases outpaced productivity gains, and when the international economy turned down in 1985, we fell into a deep recession. We had lost competitiveness vis-à-vis other regional economies.

### ***NIE to First World***

The 1985 recession forced us to reassess our economic policies. We formed the Economic Committee, whose report refocused our growth strategy. To restore our cost competitiveness, we reduced employer CPF contributions (from 25% to 10%), and implemented two years of wage restraint. We began making wages more flexible, by introducing variable components into remuneration packages and cutting back on seniority-based pay. We cut direct taxes sharply (from 40% to 33%), and laid the ground for introducing the GST a few years later. Competitiveness and flexibility became important yardsticks for economic policy and collective bargaining.

In our overall development strategy, we put more emphasis on the services sector as a major growth engine, alongside manufacturing that had long been a key driver. In manufacturing, we made a conscious effort to assimilate and adopt new technology from the advanced economies, moving up the value chain as our incomes and capabilities rose.

These policy changes worked better than we had hoped for, aided by favourable external conditions. East Asia was undergoing an economic boom, the global electronics industry was expanding rapidly, and the US economy was experiencing its longest post-war recovery. For a decade until the Asian financial crisis broke in 1997, growth averaged 9.2% a year. By 1994, per capita income had doubled to US\$20,000, well in the league of developed countries. Within a generation, the lives of Singaporeans have been transformed beyond recognition.

### ***Towards a knowledge-based economy***

We always knew that as our economy matured, and we approached income levels of the developed world, our growth would slow down. But we did not expect the transition to be so sudden and difficult. The Asian Crisis was a major setback for the whole region. Before the region could fully recover, the US economy went into recession. In Asia, China continues to prosper, which is both a major opportunity and a huge competitive challenge. On top of that, September 11th and the discovery of terrorist groups in Southeast Asia linked to Al-Qaeda, signalled a new and troubling long-term problem. In these troubled circumstances, we entered the third phase of our economic development.

We needed to rethink all our economic policies and strategies. The Economic Review Committee (ERC) report sets out what policies we need to change, and what new strategies to pursue. The ERC made many specific recommendations to prepare Singapore for the transition to a knowledge-based economy. But underlying them all are three fundamental, related ideas:

Firstly, we must promote innovation, creativity, and entrepreneurship.

Secondly, we must deregulate and liberalise the economy, to allow enterprise to flourish.

And thirdly, we must encourage self-reliance complemented by community support, and minimise dependence on the state.

These ideas emphasise that private enterprise must increasingly lead growth, and that to continue to thrive, we must be willing to venture into the unknown, explore new ideas, and establish new enterprises. To succeed, the initiative must come from individuals rather than the state. The government's role is to facilitate the creation of wealth and to enable individuals to do well. It is not to provide handouts or excessive social safety nets.

Many Singaporeans, particularly the workers, feel instinctively that the ERC changes are far-reaching, and worry that we are moving too fast. On the other hand, some analysts and journalists have faulted the ERC recommendations for not being bold enough. I hope that setting the changes within this larger philosophical context will help to bring out their true significance. Much more so than the two previous paradigm shifts of the 1960s and 1985, the current one calls for a mindset change - on the part of everyone. That is the fundamental remaking that we are striving for.

Singapore is by no means alone in facing the challenges of a fundamentally altered landscape. The other NIEs also face similar environmental changes, and are also searching for new strategies and policies. South Korea has been revamping its chaebol-centred industrial system and has also opened up its economy to foreign investment and competition. Taiwan is confronting the hollowing out of its manufacturing industries to mainland China, while Hong Kong is adjusting to the deflationary consequences of its currency peg system. Compared to these other countries, we are not badly off, though we are still far from having solutions to all our problems.

### **Lessons drawn**

What lessons can we draw from these international and historical comparisons? How do they apply to Singapore in the current remaking process?

#### ***Remaking is essential***

The first lesson is that no system works forever. As the external environment changes, and as economies evolve, institutions and policies that used to work can become outdated or even dysfunctional. Countries will adjust incrementally over time to these changes, but eventually incremental change is not enough. Then it becomes necessary for countries to break the mould and remake themselves - a difficult but essential process.

This applies directly to us. However difficult the changes we have to make, the status quo is not an option. Our system is still working - the economy continues to grow, investments are still coming in, business carries on. But the world around us has changed, and is continuing to change. If we delay adapting ourselves to the changing environment, we will only make the eventual adjustment harder and more painful.

The ERC's proposals to remake the economy will not be the final solutions to our problems. Policies will need to be constantly reviewed and updated as situations unfold. New challenges will arise, and we will need to set fresh goals for ourselves. We will need to remake Singapore again, and again. But the more promptly and flexibly we can adjust our policies, the less traumatic and disruptive the remaking will be.

#### ***Leadership***

Second, strong and far-sighted leadership plays a key role in countries making the successful transformation. Such leadership can come from one or two key individuals, like Deng Xiaoping in China or Margaret Thatcher in Britain. Or it can be a group, as in the Meiji Restoration, where the young samurais who led the reforms remained in key leadership positions for a whole generation. In the current crisis too, the different responses of the NIEs partly reflect the different nature of their political leaderships.

Singapore being so small and open, able, committed leadership is doubly important to us. We do not enjoy the advantages of the other NIEs - the larger critical masses of South Korea or Taiwan, or the proximity of Hong Kong to Southern China. To make up for this, we need the highest quality leadership that we can muster. Our size makes us more vulnerable, but also gives us a nimbleness that other countries cannot match. However, this demands responsive, forward looking leadership, and not blind flying on autopilot.

Indeed, we must place our hopes not in a few key leaders, but in a broad leadership group at many levels across all segments of society - in government, in the business sector, in the labour movement, and in academic and civic groups. The more we develop such a leadership group, the better our chances will be."

### ***Collective response***

Third, while strong and visionary leadership is necessary, it is not enough. To be effective, the leadership must evoke a response, a resonance from the society as a whole. The society must rise to the challenge of changing itself and establishing a new order. There needs to be broad consensus among the population in support of the changes.

In the Meiji Restoration, crucial roles were played by the peasant class that formed the armies and the merchant class that financed the military. In 19th century China, the reformers failed because of infighting within a weak leadership, as well as the advanced state of decay of the entire society. But a century later, Deng Xiaoping's reforms took root as the people experienced the benefits of rapid growth and the widespread improvements in living standards. In post-war Britain, the turning point in the public mood began with a sense of humiliation when the Labour Government had to call in the IMF in 1976, after the Exchequer ran out of money.

In Singapore, our previous remakings succeeded because we mounted a strong collective response - at independence a determination to beat the odds and survive, in 1985 a sense that if we made sacrifices together, we could make our economy competitive again. Without that sense of group interest, we could not have cut employer CPF rates, nor restored our competitiveness in a way that few other countries could do.

This collective response continues to be critical. In our current remaking, the key changes are in our mindsets, and the main driver of change is private initiative and enterprise. To succeed, the change must come from the people themselves. In this process, the government can only play an encouraging and facilitating role.

The additional challenge for us is that this time, the motivation for remaking ourselves is less obvious. Previously we were catching up from behind, but now we are at developed country standards of living. Why do we need to sacrifice what we already enjoy? Yet if we do not accept the sacrifices and change, not only will we not make progress, but we will even likely lose what we already have. No union leader who has visited Shanghai doubts this. It is the reality that we must get home to every Singaporean.

### ***Social consensus and political will***

Fourth, reform and restructuring is never a purely economic exercise. Success depends critically on social and political factors. Economic reforms are not painless. There will be winners and losers, at least in the short-term. Therefore there must be political support for the changes, a willingness to accept the pain of the transition, and a confidence that those adversely affected will be helped. This depends on a feeling of shared nationhood, of going through thick and thin together. To maintain the social compact, a balance needs to be struck between pushing through needed changes without delay, and spacing them out to reduce the political pain.

Thus the Meiji reformers' slogan was *fukoku kyohei*, meaning "rich country, strong military". Their objective was not just better lives for individual Japanese, but a strong Japan taking its rightful place among the nations of the world. This assertion of Japan's role in world affairs led to the Pacific War. Margaret Thatcher believed in a strong Britain too, but hers was a very different model. She famously declared that "there is no such thing as society", only individuals, and that people must look to themselves rather than the government. But she went too far down this path. When she persisted in implementing the poll tax in 1990, the people revolted, and even her own party turned against her. The Iron Lady was out.

In Singapore, consensus building is especially important as the remaking is to lead to an economy more reliant on private enterprise and individual effort. This can only work if Singaporeans feel that the system is fair to all, and benefits everybody over the long run. Hence we have worked hard to strengthen the social and political consensus in support of our remaking plans. We involved and consulted Singaporeans as widely as possible. We worked in partnership with both the employers and the trade unions in policy deliberations. We have introduced major reforms carefully, to minimise the disruption and side-effects, as we have done with the tax and CPF changes. We are providing social support to those adversely affected by the changes, to ensure that no one is left behind, without undermining the incentive to work. Our concern is not just social cohesion, but racial and religious harmony. If remaking our economy splits our society along racial or religious lines, we will be in deep trouble.

This will be one of our most difficult challenges for a long time to come. Our future depends on Singaporeans being resilient and self-reliant, yet we must make sure that those who are truly unable to cope get the help they need. We will continually need to balance these two objectives, to ensure that we do not have any free riders on our ship, and yet that all of us will reach the destination together.

## **Conclusion**

This will not be the last time that we have to remake the Singapore economy. Companies find it difficult to successfully ride even one wave of changes. For countries, the challenge is even greater as they have to be ready to transform themselves repeatedly.

If a company fails to remake itself it goes under. The creative destruction of the market economy then recycles the freed-up resources to other more productive purposes. But if a country fails to remake itself, the consequences for its people are dire. The experience of Japan and Germany over the last decade shows how difficult and painful this process can be, even in wealthy, advanced countries. What more for a small and vulnerable economy like Singapore?

Over the past three decades, we have built up significant strengths that will stand us in good stead for the challenges ahead. We have weathered many shocks since independence - regional recession in the mid-1980s, and most recently, the Asian financial crisis and global electronics downturn. Each test has made us stronger. We must now rise up to the latest challenge, and by remaking our economy, lay the basis for many more years of progress and prosperity for Singapore.