

SG: national vs domestic growth

- An aging population, rising cost pressure and the risk of losing FDI is compelling Singapore to step up efforts to internationalise local companies
- This outward investment strategy should yield positive returns in the longer-term judging from the experiences of Japan and Taiwan
- Investing in higher growth economies in the region will help Singapore sustain income growth in coming years
- Investors and policymakers will focus more on national income and less on domestic product

Singapore hopes to redefine its growth strategies. It aims to build its “external wing” by promoting value creation and helping companies venture overseas. The aim is to enable local companies to become global players so as to sustain Singapore’s longer-term economic growth [1].

This is important because of Singapore’s fast aging population and rising business costs. The risk is that the economy may lose its appeal to FDI going forward. In addition, the need to generate tax revenue to fund higher social spending associated with an older population has compounded the challenges. As such, local companies are now expected to be the next growth driver for the economy.

Policy measures to internationalise local companies were introduced in the last budget. These efforts were further intensified in the most recent Budget 2016 [2]. If successful, there will be a marked shift in Singapore’s economic structure in the longer-term. The value creation and income generated by Singaporeans and Singapore companies based overseas may rise substantially. In contrast, domestic contributions from international MNCs may fall over time.

With the possible shifts in economic structure, there may be a need to re-examine how economic growth is measured in Singapore. The focus will gradually shift towards Gross National Income (GNI) from Gross Domestic Product (GDP).

GNI versus GDP

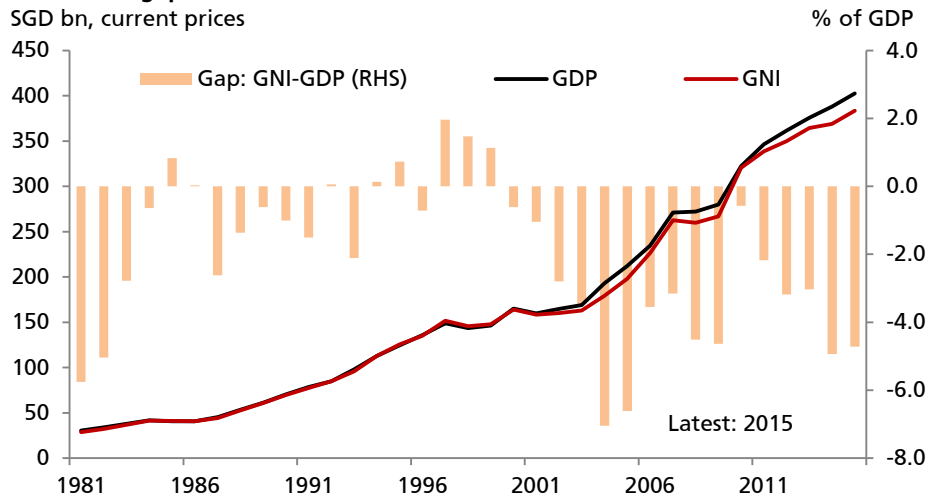
The conventional way of assessing economic growth in Singapore, as with most countries, is by measuring the change in the Gross Domestic Product (GDP). GDP is defined as the value of all goods and services produced within the geographic boundaries of the country. Note this includes the value-added by foreigners and foreign entities in Singapore but omits the incomes earned by Singaporeans or Singapore companies based overseas.

However, if the presence of MNCs in Singapore fades in the longer-term and if Singapore companies are successful in venturing overseas, then GDP could under-represent the true improvement in Singaporean income(s).

Another way of measuring economic growth is by using the Gross National Income (GNI) [3]. GNI measure the income earned by Singaporeans regardless of

Another way of measuring economic growth

Chart 1: Singapore GNI vs GDP



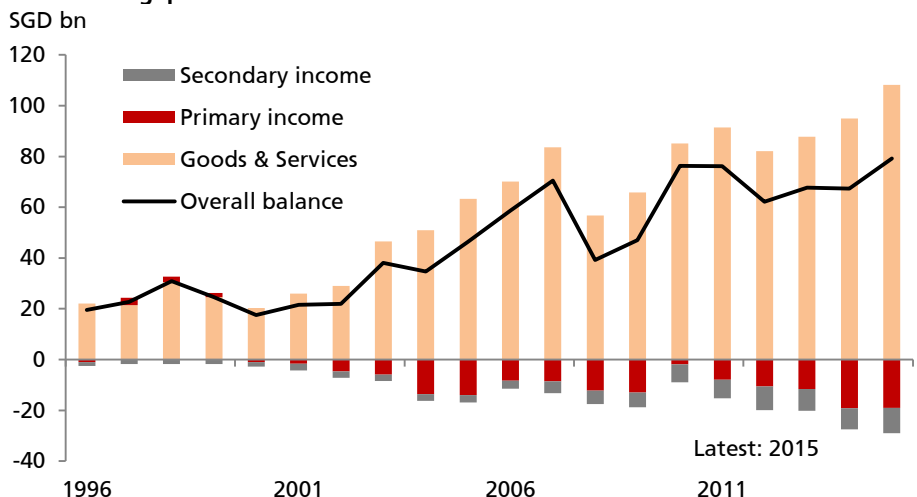
whether it is earned domestically or abroad. This indicator will more accurately capture the income and/or value created if Singapore’s economic structure becomes more outward driven as mentioned above.

Historically, Singapore GNI has been lower than GDP (Chart 1). The gap between both averaged about 2.2% of GDP over the past 25 years but could rise to as high as about 7% seen in 2004. This negative gap between GNI and GDP reflects the rising net primary income payment abroad within the current account (Chart 2). That is, there has been a net outflow of income from the economy, which has been a drag on the current account. This arises mainly from the repatriation of profits by MNCs, which is significantly more than the incomes that were remitted back to Singapore by residents or overseas based Singapore companies.

GNI could potentially outstrip GDP growth

But this may change going forward. If local companies are able to internationalise successfully and/or there is increased offshoring of MNCs, then the GNI could surpass GDP. GNI growth could exceed GDP growth if Singapore is able to successfully build up its “external wing”. While the effect may not be immediate, experience from Japan and Taiwan indicates that this phenomenon could emerge after a period of significant outward direct investment (ODI) by local companies.

Chart 2: Singapore's current account balance



Experiences of Taiwan and Japan

The “Lost Decade” is often used to describe how the Japanese economy slumped into a long period of economic stagnancy after the bursting of the asset/credit bubble in early-1990s. But the economy didn’t perform that badly if measured by GNI. GNI increased by 9.6% over the past 25 years, nearly double the pace of nominal GDP growth (5.5%).

GNI and GDP in Japan began diverging since the 1980s (Chart 3). This coincided with the period of active overseas investment by Japanese firms. The sharp appreciation of the yen after the Plaza Accord, together with the persistent rise in domestic wages, have forced many Japanese manufacturers to relocate their supply chains to emerging markets to mitigate the cost burdens and preserve competitiveness.

The GNI-GDP gap widened at a faster pace from mid-2000s and reached a record 4.6% of GDP in 2015. This reflected the intensifying of Japan’s ODI efforts. Sluggish growth in the domestic market, decline in the asset markets and the rapidly aging population are “push” factors that compelled Japanese firms to explore alternative opportunities overseas.

Strong growth in emerging Asian markets, China’s WTO accession in 2001 and the establishment of Japan-ASEAN Comprehensive Economic Partnership Agreement (CEPA) in 2008, are additional factors driving Japanese overseas activity. Overseas sales helped offset the fall in domestic demand, which allowed Japanese firms to maintain the overall earnings performance.

Taiwan also saw such a trend. The GNI-GDP gap in Taiwan also emerged in the 1980s when the country’s ODI started to take off (Chart 4). Similarly, Taiwan also experienced rapid wage growth and currency appreciation in the 1980s. Offshore investment was used as a strategy by companies to cope with domestic cost pressures.

Drawn by China’s low labour costs, strong growth prospects and greater market openness after the WTO accession, Taiwanese companies stepped up their investment in mainland China in the early-2000s. The expansion of investment on the mainland well benefited Taiwanese firms, on both the cost and the revenue fronts. As a result, many Taiwanese firms emerged as important players in the global IT manufacturing sector during this period.

In both Japan and Taiwan, GNI growth has outperformed GDP growth for many years. It reflects companies’ abilities to profit from overseas investment. At the macro level, both countries reported sizeable primary income account surpluses, which boosted the overall current account position significantly (Chart 5

Japan and Taiwan’s ODI efforts have paid off

Chart 3: Japan: GNI vs. GDP

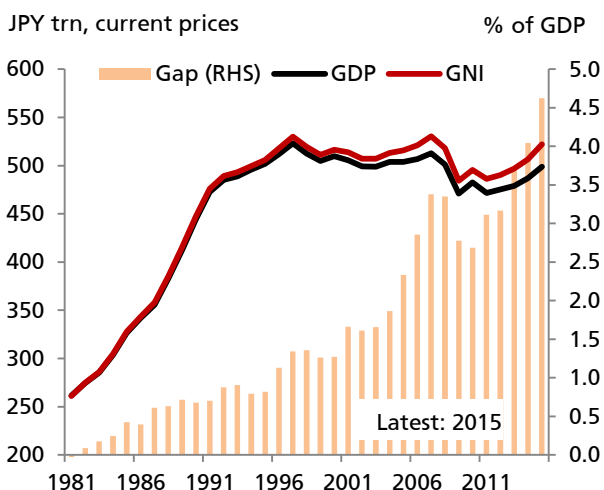


Chart 4: Taiwan: GNI vs. GDP

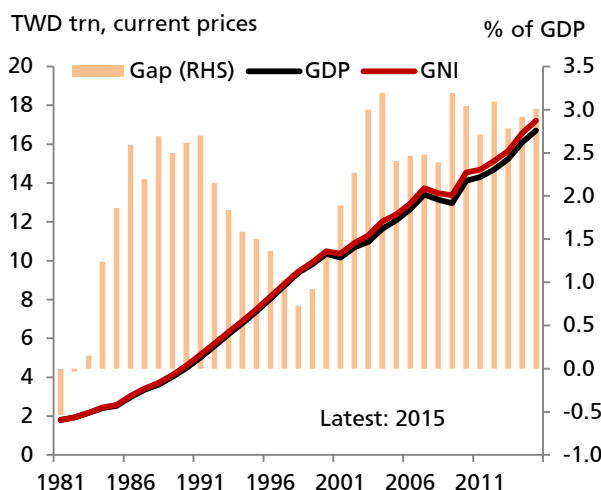


Chart 5: Japan: current account balance

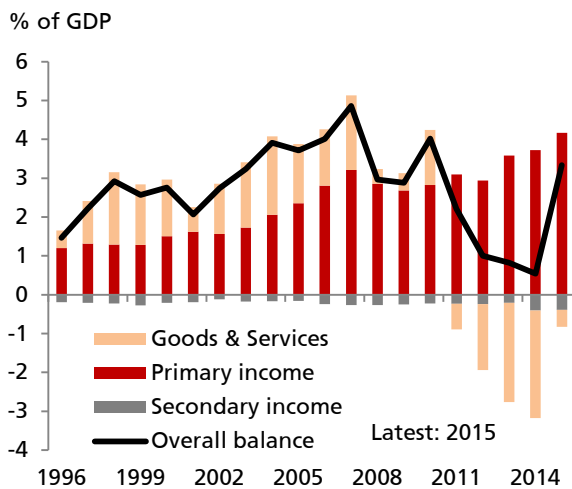
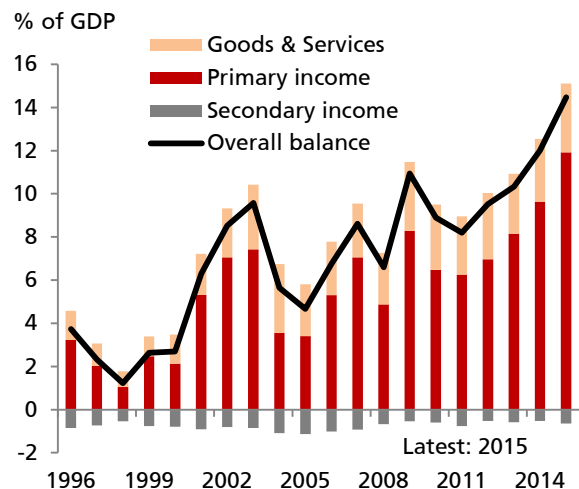


Chart 6: Taiwan: current account balance



and 6). This is in contrast to the case for Singapore where there has been a deficit in the income balance (see above).

Singapore's outward direct investment

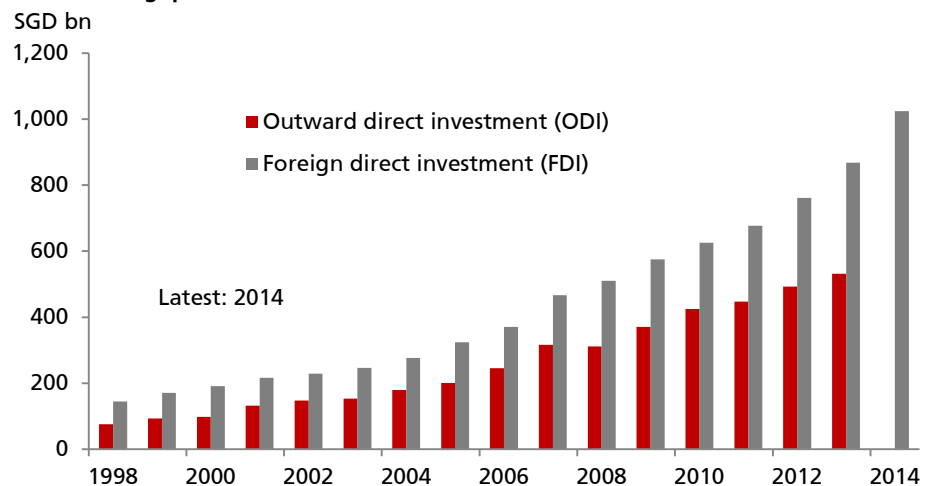
Internationalisation is another word for this process. In this regard, Singapore could follow the same path as Japan and Taiwan. Singapore's ODI has been rising steadily over the years but remains small compared to FDI inflows (Chart 7). If ODI can be increased, the existing negative gap between the GNI and GDP could be narrowed.

From the policy perspective, while FDI and the presence of MNCs will remain a key feature of Singapore's economic landscape, having a pool of globally successful local companies could help sustain national incomes in the face of rising domestic cost pressures and the challenges of an aging population.

Policy implications

Singapore is a developed economy with one of the highest per-capita GDPs in the world. In spite of restructuring efforts, productivity growth over the past five years has remained elusive. Excluding the rebound year in 2010, productivity growth averaged a mere 0.4% per annum between 2011 to 2015.

Chart 7: Singapore's ODI vs FDI flows



Policies to focus on GNI growth

The phenomenon of low productivity gain is synonymous with many advanced economies simply because growth in these “mature” economies has been relatively slow due to structural constraints and demographic shifts. Singapore is not the exception in this regard, due its advanced stage of development and demographic profile.

Yet, it is possible to overcome this “productivity trap”. The key is to expand regionally and to tap on the higher growth elsewhere. If productivity / GDP growth cannot be lifted above other advanced countries due to an aging population and a shrinking labour force, then investing overseas may help overcome the growth limitations. Other countries in the region are already embarking on such internationalisation efforts. For example, China is now pursuing a “one belt, one road” growth strategy.

Rather than be constrained by domestic GDP growth of mere 1-3%, Singapore can invest in higher growth neighbouring countries that offer 5-6% growth / return. Income generated in the process would be reflected in GNI and contribute to national income and tax revenue.

The bid to tackle the challenges of an aging population, to seek sustainable income / productivity growth, and to overcome the rising cost pressures could arrive at the same solution: the internationalisation of local companies. Policies are increasingly aiming at this end. Conversations will increasingly revolve around Gross National Income rather than Gross Domestic Product.

Notes:

- [1] “SG: the next growth driver”, 4 Feb16 and “SG: old problem, new approaches”, 27 Jan15
- [2] “SG budget: shaping Singapore’s future”, 24 Feb15 and “SG budget: balanced and transformative”, 28 Mar16
- [3] Noting that the term Gross National Product (GNP) is a misnomer since GNP is not a measure of production, the 1993 United Nation System of National Accounts (SNA) recommends the use of the term Gross National Income (GNI) in place of GNP. GNI is equal to GDP plus net income from abroad, which is the income balance of the BOP accounts

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