

# 'New Economy' Collapse: The Singapore Story

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Over the last year, since the “New Economy” bubble entered its final death throes, the economy of the city of Singapore, once held up by the International Monetary Fund (IMF) and other Western institutions as the Asian model for development, and the safest location for foreign investment in all of Asia, has been collapsing, even more rapidly than its already distressed neighbors, and with no end in sight. What happened? The Singapore story addresses the question: What happens to a country, which is *not really* a country, when the global financial bubble disintegrates?

## A Bank For Opium, Tin, And Rubber

First, a brief but necessary overview of Singapore’s history.

The island of Singapore was acquired from the Johore Sultanate (today, a state of Malaysia), by British East India Company agent Stamford Raffles in the early 19th Century. The British needed a transshipment point for the Bengal opium that they were foisting on China, and Singapore was ideally located midway between India and China, guarding the southern gate of the strategic Strait of Malacca.

In addition to being a giant opium warehouse, Singapore was also used as a staging area by the British, for their Opium Wars against China. As opium drained the productive sectors of the Chinese economy, Qing China resorted to selling its only remaining productive asset—people—for cheap labor. Southeast Asia (and other parts of the world) saw an influx of laborers from China, for menial jobs, such as land clearing, mining, etc. This mass of migrant laborers added to the lucrative market for British opium, and banks were needed to facilitate the exploitation of the market, as well as to manage the profits. Hence, the origins of Singapore as a banking center. The first bank in Singapore was the Union Bank of Calcutta, set up in 1840, just as Britain’s First Opium War was militarily forcing China to accede to the “free trade” of Indian opium. Eventually, Chinese immigrants ventured into banking as well. The first local Chinese bank in Singapore was the Kwong Yik Bank, founded in 1903.

As the British extended their colonial rule over the Malay Peninsula (Malaya), Kuala Lumpur was eventually chosen as the administrative center. However, Singapore remained as the center for banking.

After India gained its independence in 1947, Malaya, the world’s largest producer of tin and rubber, became even more

valuable to the British. Malaya’s tin and rubber exports to the United States were major sources of dollars, desperately needed by the British during the immediate post-war period. The longer the British Empire could hold on to Malaya’s tin and rubber, the more dollars it could obtain—especially during the Korean War (1950-53), when the price of rubber and tin reached “dizzying heights.”<sup>1</sup> In 1953, a dozen British agency houses (trading companies) controlled 75% of the nearly 2 million acres under plantations (mainly rubber).<sup>2</sup> Even up to 1968, fully 75% of the investment in the rubber industry, and 60% of tin production, was in the hands of foreign companies.<sup>3</sup>

The Communist Emergency in Malaya gave the British a justification to prolong their stay in Malaya—to fight the Communists. The Emergency was actually a war, but the term “emergency” was chosen, so that insurance claims could continue to be made on any damaged tin mine or rubber estate.

As a result of the Emergency, Malaya’s independence, instead of coming shortly after World War II, as for India, was delayed until 1957. However, Malaya’s independence came *without* the banking center of Singapore, which the British continued to rule as a colony. The British continued to play an active role in Malaya even after independence, as the Emergency officially continued until 1960. Even after 1960, there were still sporadic Communist insurgent activities.

In 1961, the intent was announced to merge Singapore, together with the British colonies of Northern Borneo (Sabah, Sarawak, and Brunei), with Malaya, to form a single nation to be called Malaysia. Indonesia opposed this move, but agreed to abide by the results of a UN fact-finding mission to Sabah and Sarawak (Brunei opted out of the proposed federation), to ascertain the will of the population regarding the union. However, Indonesia was provoked into launching a low-intensity war (called the “*Konfrontasi*”) against Malaysia, when Malaysia was officially declared into existence, prior to the release of the official findings by the UN fact-finding mission.

With a still smoldering Communist insurgency, and a low-intensity war with Indonesia, the British were able to convince Malaysia that a continuing British military presence was crucial. There were no attempts to nationalize British-owned rubber plantations or tin mines.

## A British Administrative Invention

In 1965, Singapore separated from Malaysia over political differences. Singapore had no independent history prior to 1965, but had historically been a part of Malaya. The percep-

1. Ranjit Gill, *The Making of Malaysia Inc.* (Celangor, Malaysia: Pelanduk Publications, 1985).

2. James Puthuchear, *Ownership and Control of the Malayan Economy* (Singapore: Eastern Universities Press, 1960).

3. Gill, op. cit.



*Singapore's father-and-son investment team, Senior Minister Lee Kuan Yew (center) and Deputy Prime Minister Lee Hsien Loong (inset), still cannot, at least publicly, come to terms with the fact that the global financial crisis is systemic, not cyclical.*

tion that Malaya and Singapore were two separate political entities was a British administrative invention. The British decision to grant independence to Malaya in 1957, without including Singapore, helped reinforce that perception, and this helped to create a fault line along which the later separation would eventually occur.

The Malaysian economy was then still largely in foreign hands. In 1957, the year of independence, more than 50% of identifiable capital stock was owned and controlled by foreigners, mainly British and other Europeans. About 70% of profits earned by registered companies were netted by controlling foreign interests, and mostly repatriated. At the end of 1970, thirteen years after independence, of the 38 commercial banks in Malaysia, 22 were foreign-controlled. This pattern was repeated in the insurance industry. At the end of 1970, of the 89 insurance companies registered, 81 were foreign-owned. Many of these companies were originally in-house divisions of trading companies, or branches of companies originally established in Singapore.<sup>4</sup>

Because of the separation, Malaysia lost the best port in the region, and its financial center. Singapore henceforth became an offshore financial center, a convenient place for capital from surrounding countries to be transferred, free from the controls of Kuala Lumpur, Jakarta, etc. From here, private capital would be able to deal with nations on a "sovereign" basis, with the offshore British-controlled banking center itself declared to be a sovereign state.

4. Gill, *op. cit.*

However, even with the presence of the banks, Singapore—an island 3.5 times the size of Washington, D.C., with no natural resources, which still today must import water from Malaysia to survive—*could not* have continued to exist as a separate political entity without foreign investors.

Singapore's excellent harbor, and its strategic location, lying on the international sea-lanes between the oil-producing countries of the Middle East and the major oil-importing nation of Japan, made it a natural choice for building oil refineries. Singapore's first oil refinery was built by Shell in 1961. However, the oil refinery industry only started to expand very rapidly during the second half of the 1960s—*after* independence—driven by the industrial growth of Japan, as well as the U.S. war in Vietnam. Today, Singapore is the third-largest oil-refining center in the world, after Houston and Rotterdam. In 2000, oil refining made up 12% of Singapore's manufacturing sector.

### **A Bank For The Post-Industrial Society**

However, the bulk of Singapore's manufacturing was to come not from oil refining, but from electronics. The key behind the growth of electronic plants in Singapore, was the concept of the free industrial zone. These zones were set up specifically for foreign investors, with their own set of conducive tax and labor laws, applicable only within those zones.

The main lure was cheap labor, especially cheap *foreign* labor. According to a study by the Singapore Ministry of Trade and Industry (MTI), foreign labor contributed to the bulk of Singapore's Gross Domestic Product (GDP) growth in the 1990s. About 41% of that growth was achieved on the

FIGURE 1



back of the inflow of foreign human resources. The MTI found that the local labor force alone, would not have been able to generate the average quarterly GDP growth of nearly 8%, between the first quarter of 1991 and the fourth quarter of last year. According to the Singapore Population Census of 2000, Singapore's working population stood at 2.09 million last year. Of that total, 612,200 workers, or 29.2%, were non-residents.

Riding on the post-industrial society's addiction to cheap labor and financial speculation, Singapore's citizens emerged, by the year 2000, with a per-capita purchasing price parity GDP of around \$25,000—one of the top ten in the world. Singapore has more than \$100 billion in reserves, and all of it is managed by the Government of Singapore Investment Corp. (GIC).

Singapore's investment-manager-for-life, Senior Minister Lee Kuan Yew, holds the chairmanship of the GIC. His son, Lee Hsien Loong, is the Deputy Prime Minister of Singapore, chairman of the Monetary Authority of Singapore (Singapore's Central Bank), and vice chairman of the GIC. Although the GIC is government owned, it functions like a private investment company. Singapore's opposition leader, J.B. Jeyaretnam, has accused the GIC of a lack of adequate disclosure on how the funds are invested. Lee Kuan Yew dismissed those accusations, saying that the money was in safe hands.

### The Bubble Pops

East Asia's feeble recovery from the Asian currency crisis of 1997-98, was based on the "New Economy" financial bubble fuelling demand in the telecommunications and consumer electronics sectors. However, that recovery is now being seen for the hoax it really was.

Eight of the more prominent Singapore Internet CEOs, saw their combined paper wealth soar to as high as \$800 million in 1999, only to plunge by around 80% to \$150 million as of April 2001. The banks resorted to force-selling the (worthless) shares of those CEOs who were unable to meet their margin calls.

Singapore's state pension fund organization, the Central Provident Fund, is losing money. As of June, most of its investments had a full 12 months of negative absolute quarterly returns. For the first quarter of 2001, 85% of the trust funds, and 84% of the insurance-linked plans the Fund had invested in, lost money. Singapore's pensioners are not unique in their predicament. Hong Kong's Mandatory Provident Fund saw returns of *negative* 9.5% for the year to date, as of June 2001.

Manufacturing accounts for only one-quarter of Singapore's economy (services comprise a full 65%). Half of that manufacturing production is in electronics, which accounts for close to 70% of Singapore's exports. In April, electronics output fell 8.5% against the previous year. By June, it was 26%, and in August, 37.5%.

In June 2001, the government-linked Chartered Semiconductor of Singapore, the world's third-largest wafer fabrication company, closed one of its three fabrication plants because new orders had dried up. As recently as the first quarter of 2000, fabrication utilization at this company was at 104%; a year later, it was 61%. Chartered went on to lose \$31 million in the first quarter of 2001, \$107 million in the second, and more than \$120 million in the third.

Singapore's Flextronics, one of the largest electronics contract manufacturers in the world, announced in October that it was laying off 10,000 employees (15% of its total worldwide workforce), due to falling revenue.

Singapore's electronics-addicted GDP contracted by nearly 1% for the second quarter of this year, when compared to the same period last year, and 6% for the third. Overall, the Singapore economy is expected to *contract* by 3% for 2001, compared to a growth of nearly 10% last year. In July, the Singapore dollar hit an 11-year low.

As GDP contracts, so will employment. In the first quarter of 2001, there were 3,230 layoffs, but 23,210 new job openings. In the next quarter, there were 5,631 layoffs, but only 3,289 new job openings. The *Singapore Straits Times* ran a forecast in October that there will soon be 80,000 unemployed in Singapore. This means an unemployment rate of 4.5%, up from 2.8% last year. However, this does not include the 16,000 who have been put on shorter work weeks. There are now only six jobs for every ten job-seekers.

With the need for imported foreign labor becoming less, 1,000 Malaysians have been losing their jobs in Singapore each month, from January to August of this year. This represents 10% of the total of 80,000 Malaysians employed in Singapore. Foreigners without a job are eventually shipped home. When cheap labor is in demand, it is imported, and the



*The Port of Singapore, the busiest in the world. Since the “New Economy” bubble entered its final death throes, the economy of the city, once held up by the IMF as the Asian model for development, has been collapsing even more rapidly than its already distressed neighbors.*

population grows; when the demand evaporates, the excess is returned.

The systemic nature of the crisis spilled over on to the Singapore stock market. In July, Singapore’s Port of Singapore Authority, operator of the world’s busiest container port, cancelled its plans to sell shares, because, in the words of its chairman, the initial public offering (IPO) market is dead. Government-linked Neptune Orient Lines, the sixth-largest container ship operator in the world, also cancelled its IPO plans.

Even Singapore’s small local steel industry has not been spared. The steel division of government-linked Natsteel runs mini-mills, producing steel for the construction industry. In mid-2001, the weakening local construction industry caused it to axe 125 employees (20% of its steel workforce). In fact, Singapore’s steel company is more electronics than steel. Its NatSteel Electronics subsidiary is one of the top ten contract manufacturers in the world, and its NatSteel Broadway subsidiary is the largest integrated contract manufacturer in southern China.

Recently, in an attempt to keep the economy afloat, free-market champion Singapore launched an \$11.3 billion stimulus package. Part of the package consisted of government shares totalling \$1.5 billion, which were distributed *free of charge* to 2.1 million eligible receivers. Immediately after the handout, 150,000 cashed in the government shares, each getting between \$100 and \$1,000.

## **The Singapore Problem**

However, trying to save a deflating domestic bubble economy is only second to the most pressing problem Singapore is facing. That is, where to park all that “pulp and paper” — all \$100 billion of its reserves — in such a way that it won’t evaporate. As the global financial system unravels, Singa-

pore’s investment managers are frantically trying to preserve the country’s paper values. There is no place within Singapore to park that \$100 billion, due to the simple fact that Singapore is not really a country. Singapore was created by the British, as a floating bank, immune from the governments of Southeast Asia, to siphon and control capital flow, from around Southeast Asia. Therefore, the reserves must go overseas, out of Singapore’s banks, into something tangible.

Agence France Presse reported on May 22, that about one-half of the GIC’s funds have been invested in North America, about one-quarter in Europe, and the balance in Japan and East Asia. Over the past year, there has been a major shift of Singaporean capital into American equities. Singaporean investors became the second-biggest group of Asian traders on American bourses, after the Japanese. Singaporeans became net buyers of American stocks, with purchases exceeding sales by \$11 billion (around one-tenth of the nation’s reserves).

Singapore, Inc.’s three main arms — its telecom company, airline, and banks — have been on an overseas buying spree, *regardless* of market conditions, before it is too late to spend the money. In September, Singapore Telecom (SingTel) spent \$9 billion, nearly one-tenth of the nation’s reserves, to acquire Optus, Australia’s second-largest telecom service provider. This deal is the largest foreign investment ever made by a Singaporean company. The deal was pushed through, even though acquiring Optus would *decrease* SingTels annual earnings by 36%! From March to October, the stock value of Optus fell by 43%, while declining sales led the firm to implement a \$50 million cost reduction plan.

SingTel also made plans to raise \$2 billion in October through bond issues, in order to fund further acquisitions. Weeks later, SingTel spent \$600 million for a 22% stake in Telkomsel of Indonesia. The Telkomsel stake represents the largest-ever Singaporean investment in Indonesia, a country which may be turned into another Argentina by IMF and World Bank looting.

Ansett Airlines of Australia is owned by Air NZ, which is in turn, partly owned by Singapore Airlines. Last year, Air NZ reported a loss of \$250 million. This year, it reported a loss of nearly \$600 million, as Ansett declared bankruptcy. Singapore Airlines, and Singapore-based Brierley Investments, had to pump in more than \$100 million in new equity to help keep Air NZ flying. Singapore Airlines now owns around one-third of the teetering Air NZ.

After Sept. 11, Singapore Airlines’ load factor fell by 19%. It suffered an 88% drop in profits, and is looking to defer delivery of new planes, reduce capacity, and cancel certain routes.

Another example of the desperation of Singapore’s investment managers is the case of the Development Bank of Singapore (DBS), Southeast Asia’s largest lender, which earlier this year paid \$5.5 billion for Dao Heng Bank of Hong Kong, even though Dao Heng was trading at two and one-

half to three times its book value—an implied goodwill of at least \$2.8 billion! DBS then made an unsolicited \$5.2 billion bid for the Overseas Union Bank of Singapore, in order to gobble up the competition. In July, DBS Philippines took control of the number-two bank in the Philippines, Bank of the Philippine Islands. DBS was in talks to buy Taiwan's Far Eastern International Bank, but the deal fell through. There have also been reports of DBS eyeing a stake in Malaysia's second-largest lender, Commerce Asset Holding, and in acquiring 51% of Bank Central Asia (BCA), Indonesia's largest private bank, from the Indonesian Bank Restructuring Agency (IBRA). The stake is estimated to be worth \$900 million. BCA was transferred to the IBRA by the Salim Group when it suffered a liquidity crisis during 1997-98.

However, Dao Heng itself proved more than enough to swallow. In August, Dao Heng's new owner closed 12 of its 71 branches in Hong Kong. Later in October, 10% of Dao Heng's staff was laid off, and one in five branches will be shut down by December. In that same month, DBS market capitalization was half of what it was at the start of the year—a loss of almost \$4.5 billion. Senior executives' pay has been cut by one-fifth.

In November, the contradiction between huge expenditures and collapsing profits caught up with DBS, which surprised investors with a \$1.2 billion new share placement, while posting a 20% fall in nine-month earnings. This new share placement would result in a 12% dilution for existing shareholders. The timing of the share placement—while the IPO market is essentially dead—showed how desperate DBS is for capital. The stock market is in such a dismal state, that even DBS Vickers Securites, the second-largest brokerage in Singapore, had to lay off 250 employees in September.

DBS is not alone when it comes to problems. At around the same time, the United Overseas Bank of Singapore announced that it would cut 2,000 staff, or 15% of its workforce, to reduce costs, despite the plea from Singapore Prime Minister Goh Chok Tong for businesses to cut jobs only as a last resort.

The Singapore government owns 69% of SingTel, 38% of DBS, and a significant piece of Singapore Airlines.

### **The 'Other Shoe'—Derivatives**

Besides share prices, the other shoe waiting to drop is the derivatives crisis. The Singaporean banking system became addicted to derivatives after the Asian financial crisis of 1997-98. DBS Group Holdings' financial derivatives business surged last year, with the underlying principal amounts traded up by more than 11 times over 1999, to more than \$80 billion. To see how fast derivatives have grown in Singapore: Of the DBS derivatives financial instruments held for trading in 2000, the underlying principal foreign exchange derivatives amounted to \$48 billion (against just nearly \$3 billion for 1999), while interest rate derivatives came to \$28 billion (against just nearly \$3.5 billion for 1999). Equity derivatives

totalled nearly \$5 billion (against zero for 1999).

For a glimpse of what is at risk, look at the Singapore-based Asia Pulp and Paper (APP). APP, the world's fourth-largest paper maker based on capacity, lost \$220 million because of derivatives contracts. APP also admitted that the contracts were not reflected in its financial statements. That loss was enough to help push it into bankruptcy, on debts of more than \$13 billion—the largest bankruptcy ever in Southeast Asia.

APP used to be owned by the Sinar Mas group of Indonesia, controlled by the Widjaja family. The Widjajas also controlled Bank Internasional Indonesia (BII), now under the receivership of the Indonesia Bank Restructuring Authority. However, Sinar Mas still owes more than \$1 billion to BII. This reflects the Widjajas' use of an Indonesian bank to route capital out of Indonesia, to their Singapore-based private businesses (i.e., APP). It also sheds light, on Singapore's role as a capital market.

### **Systemic Nature Of The Crisis Denied**

Singapore's father-and-son investment team still cannot, at least publicly, come to terms with the fact that the present global financial crisis is systemic, and not cyclic. In May 2001, Singapore's Prime Minister Goh said that the economy was only in a slowdown, not a crisis, that it is a cyclical, not a systemic problem. Just a few weeks earlier, Deputy Prime Minister Lee Hsien Loong had said that slower growth was caused by a cyclical U.S. economic downturn, rather than the spillover of systemic problems. These back-to-back cyclical-not-systemic denials, merely underscore the severity of the problem.

In October, the Singapore Prime Minister finally conceded, "The recession we have, is very, very bleak." Unfortunately, Singapore is not in a recession—bleak or otherwise. Singapore, and the rest of the world, is in the midst of a *systemic economic collapse*.

However, Singapore's leadership is still counting on the "New Economy" to come back from the dead. As the member states of the Association of Southeast Asian Nations (ASEAN) are trying to coordinate a united response to the collapse of the U.S. "importer of last resort," looking to ASEAN financial and infrastructure agreements involving China, Japan, South Korea, and India, Singapore continues to cut "private deals," in the form of Free Trade Agreements, with countries including Australia, New Zealand, the United States, and Japan. Other ASEAN leaders have questioned whether Singapore is creating a "backdoor access" into ASEAN for the developed nations to exploit weaknesses in their economies.

As Singapore's precious reserves continue to evaporate, regardless of where they are parked, it remains to be seen: Will it continue with its doomed role as a British banking outpost for globalization, or take the alternative path, and help build the Eurasian Land-Bridge.