
THE ROLE OF THE STATE IN AN INCREASINGLY BORDERLESS WORLD

Prize Winning Essays of the
MAS-ESS Essay Competition 2002



MAS-ESS ESSAY COMPETITION 2002

The Role of the State in an Increasingly Borderless World

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Foreword

The Monetary Authority of Singapore (MAS), in collaboration with the Economic Society of Singapore (ESS), jointly launched the MAS-ESS essay competition in 2001. Our objective in this competition was to encourage students, economists, analysts, and other members of the public to engage in deeper thinking and discussion about important global trends and policy issues. In doing so, we hoped to foster greater awareness and understanding of such issues among the wider public in Singapore.

The second MAS-ESS essay competition was held over April to September last year, on the theme "The Role of the State in an Increasingly Borderless World". We were heartened by the good response to the competition, which saw a significant rise in both the number of submissions as well as quality of the essays. Indeed, the ideas expressed in these essays offer refreshing insights into the role of the state in the new and challenging economic landscape.

We have decided to compile the prize-winning essays, together with the keynote address by DPM Lee Hsien Loong and welcome remarks by Dr Khor Hoe Ee, President of the ESS, at the 2002 ESS Annual Dinner and MAS-ESS Essay Competition Awards Ceremony. The essays are available for download on both the MAS and ESS websites, at www.mas.gov.sg and www.ess.org.sg, respectively.

We hope that the MAS-ESS Essay Competition will go some way towards stimulating greater interest and debate on economic issues in Singapore.



KOH YONG GUAN
MANAGING DIRECTOR
MONETARY AUTHORITY OF SINGAPORE

May 2003

Welcome Remarks by Dr Khor Hoe Ee, President of the ESS
The ESS Annual Dinner and MAS-ESS Essay Competition Awards Ceremony
8 April 2003

A warm welcome to the Annual Dinner of the Economic Society of Singapore (ESS). I am so glad to see so many of you. We want to thank you for taking the time off your busy schedules to attend tonight's dinner and giving us your support. We are very pleased that our Deputy Prime Minister, Mr Lee Hsien Loong and Mrs Lee can be with us. We are very heartened to see the good turnout tonight, particularly in light of concerns over SARS.

For those who are not familiar with the ESS, the Society has a long history. It was established in 1956 as a non-profit organization of professional economists and economics graduates. Its primary objective is to raise public awareness, and stimulate public interest and debate in economic issues. Some of our key activities, like the annual seminar on "Understanding the Singapore Economy", have a strong educational element, and are aimed at promoting a better understanding and appreciation of current economic issues.

In the year ahead, the Society is planning to organize a number of seminars and lectures on various topics of interests, including round-table discussions on topical economic issues of the day. The funds raised tonight will in part go towards supporting these activities.

One of our major activities, which we jointly organise with MAS, is the Essay Competition. Tonight, we will be presenting prizes to the winners of the second MAS-ESS Essay Competition that was held last year. The theme of the essay competition was "The Role of the State in an Increasingly Borderless World". It attracted a total of 73 essay submissions (47 in the Open Category and 26 in the Student Category). Not only was the number of essays significantly higher than in the inaugural year, but the quality of the essays submitted was also much better than before. We are honoured that our guest-of-honour DPM Lee Hsien Loong has graciously agreed to give out the prizes during the Awards Ceremony later this evening.

Let me now say a few words about the essays themselves.

As I mentioned earlier, the theme of the essay competition was "The Role of the State in an Increasingly Borderless World". Far from heralding the demise of the state in the face of increased globalisation, all three prize-winning essays from the Open category emphasise the continued relevance of the state and argue that its role has become even more important in certain areas.

The first prize-winning essay, by Dr Shin Jang-Sup, introduces the concept of mobile versus non-mobile factors of production, and uses this framework to argue that the role of the state has become more critical, even as an economy becomes more open to globalisation.

The essay debunks a widely held view that market forces would replace or make unnecessary much of the role previously undertaken by the state, noting that there are certain important functions that only the state can undertake. As the pace of globalisation accelerates, the role of the state in helping to develop and enhance the country's competitive advantage becomes even more critical.

Going forward, the author notes that Singapore needs to now pursue a two-pronged growth strategy, in which it should increasingly emphasise the creation and acquisition of higher-end capabilities rooted in its territory (such as R&D) in conjunction with its traditional role of attracting FDI. Here, the state would be the principal agent responsible for re-gearing the strategic focus and developing the necessary capabilities and institutions. Indeed, as the

ultimate system manager of the national economy, the state should maintain its leadership in transforming the economy for the next phase of development.

Indeed, the current global crisis over the SARS outbreak has reinforced the authors' argument about the critical role of the state in a borderless world. Globalisation has brought immense benefits to many countries but it has also exposed countries to intense competition from abroad and the risk of cross border contagion. We saw this vividly during the Asian financial crisis when investors panicked across the region and brought about the collapse of regional currencies and asset markets. In the SARS crisis, we are witnessing a different kind of contagion – the spread of a deadly disease across countries through international travel. The decisive response and cooperation of governments of the affected countries will be critical in bringing the outbreak under control. Once again, we are reminded of the critical role of the state in managing cross border risks in the era of globalisation.

Many of the themes covered in this and other essays, have been the subject of intense public debate and scrutiny recently, particularly in light of the government's efforts to fundamentally review Singapore's development strategy, through the establishment of the Economic Restructuring Committee or the ERC for short. Some of you here tonight may have even participated in the various sub-committees in one form or another.

Tonight, we are therefore privileged to have with us the Chairman of the ERC, our Deputy Prime Minister Mr Lee Hsien Loong to give the keynote address for the evening. DPM Lee has been very much involved in the economic reform and restructuring of the Singapore economy over the years. As you know, he was also Chair of the 1985 Economic Committee which was convened to review the progress of the Singapore economy and to identify new directions for its future growth (The Singapore Economy: New Directions). We are therefore very honoured to have him here today with us. DPM will address us on the topic: "Remaking the Singapore Economy" shortly. May I wish you a pleasant evening.

Keynote Address by Deputy Prime Minister Lee Hsien Loong
The ESS Annual Dinner and MAS-ESS Essay Competition Awards Ceremony
8 April 2003

REMAKING THE SINGAPORE ECONOMY

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.

The Role of the State in an Increasingly Borderless World

First Prize-Winner, Open Category

**By
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Summary

By focusing on the interaction between mobile factors and less mobile factors in the process of globalisation, this paper argues that the role of the state becomes more important as the pace of globalisation accelerates, contrary to the popular perception that it should be diminished. This is mainly because, as mobile factors obtain more freedom to choose locations across national borders, the quality of less mobile factors becomes more important as 'complementary assets' in attracting mobile factors to a national economy and the state is the least mobile factor ultimately responsible for managing the national system.

This paper also argues that the very success of Singapore's complementing strategy in the era of globalisation has necessitated the state to move to a two-pronged strategy, in which it needs to attempt seriously to acquire higher-end capabilities that are securely based on its territory, while trying to exploit ever-expanding complementary business areas as it has done previously. This is because, on the one hand, there is a limit to acquiring these capabilities through a complementing strategy, and on the other hand, MNCs' inward investment into this advanced country increasingly seeks higher-tier suppliers as complementary assets.

1. Introduction

In general, globalisation is a process whereby the market gains more power over the state by weakening the state's control over cross-border flows of products and services. A popular perception is that countries should allow a greater role to market forces and reduce the role of the state, to conform to this power shift. However, this paper argues on the contrary that the role of the state becomes more important in determining national competitiveness with the progress of globalisation.

This paper starts by drawing a distinction between mobile factors and less mobile factors in the process of globalisation and discusses changes brought about by the increased mobility in the world economy (section 2). It pays attention to the fact that mobile factors do not work by themselves, but interact closely with less mobile factors in a given territory. It then emphasises the heightened role of the state in determining competitiveness of nations as an agent least mobile, but ultimately responsible for providing mobile actors with 'complementary assets' (section 3). For Singapore, which has pioneered growth through utilising this interaction mechanism between mobile and less mobile factors, the challenges from the recent acceleration of globalisation may have been less daunting than other countries. However, as the economy has reached the status of an advanced country, globalisation poses a new set of challenges that its state is not really well-equipped to deal with (section 4). In conclusion, a summary of previous discussions and general policy implications are provided.

2. Challenges of Globalisation

The key word in globalisation is 'mobility'. I would define globalisation as "a trend increase in mobility of products, services, and factors of production across national borders". Mobility in the world economy has been increasing continually since the Industrial Revolution, but, until recently, it was confined mostly to that of products, which can be more rightly referred to as 'internationalisation'. "The basic division of labour within the productive process was primarily organised within national economies" for more than two centuries after the Industrial Revolution, as Hobsbawm (1979: 313) points out.

Globalisation has recently become a central subject in academic and policy-making discourse, mainly because the increase in mobility has been extended significantly to factors of production and services from the late 20th century. The central carriers of factors of production across national borders, i.e., multinational corporations (MNCs), took off in the 1960s and have become increasingly dominant forces in the world economy.¹ They have rapidly expanded the global production networks and their cross-border activities are now extended even to research and development (R&D). It was also from the late 1970s that financial markets began integrating globally, witnessing the growing role of global financial institutions as the main carriers of services across borders.

The ever-increasing competition among corporations and financial institutions in advanced countries was a basic underlying force in the spread of globalisation.² However, the

¹ MNCs have been of course present from the latter half of the 19th century. The stock of FDI in the world economy was also very high in the early 20th century, reaching "over 9 per cent of world output in 1913, a figure which had not been surpassed in the early 1990s" (Bairoch & Kozul-Wright 1996: 10). However, a little over half of FDI went directly to the primary sector during this period. Moreover, MNCs were not a major driving force in the world economy and the growth of FDI in the manufacturing sector was mainly a substitute for trade in response to rising tariff barrier (Kenwood & Lougheed 1994). This was quite different from the trend in the late 20th century when trade liberalisation progressed hand in hand with the rapid spread of global production networks by MNCs.

² For instance, global production in the semiconductor industry started by cut-throat competition among Silicon Valley firms to reduce production costs that eventually resulted in shifting their assembly processes, which could be performed out by unskilled labours, to developing countries in the 1960s (Henderson 1989; Grunwald & Flamm 1985).

decisive acceleration of globalisation in the 1980s and onwards was supported by two concurrent developments in technologies and regulations, which facilitated easier movement of products, services, and factors of production across borders.

First, there was a blossoming of information and communication technologies (ICTs). As a major breakthrough in 'space-shrinking' technologies, the ICT Revolution has enabled firms to co-ordinate their operations on the global scale more easily thanks to drastic falls of costs involved in information creation, processing, storage and delivery.

Secondly, major regulatory changes in the world economy took place. The U.S. and the U.K. initiated liberalisation of their domestic economies and pushed for liberalisation of international trade and investment from the 1980s. The wave of liberalisation advanced to other developed countries and to developing countries. In this process, the World Trade Organization (WTO) was formed as a new regulatory framework to ensure freer flow of products and investments.³

The increased mobility has brought about major changes in the world economy as follows. First, it has increased the volume of financial, technical, managerial and other resources available for individual countries, providing them with greater potential for economic growth. For countries that are mainly receivers of foreign direct investment (FDI) or portfolio investment, the greater availability of foreign capital and technologies has opened a possibility to accelerate the pace of economic growth by reducing time and effort taken in mobilising their own resources. For countries that already have their own advanced corporations and financial institutions, the acceleration of globalisation is a big opportunity to expand their businesses. In a nutshell, the higher mobility is translated into a bigger market, facilitates further division of labour in the world economy, and provides individual countries with a greater opportunity for economic growth.

Secondly, however, the increased instability is a Siamese twin of the higher growth potential. As MNCs are organising their productions on the global scale, they are more ready to change production sites if new needs arise from competition or technological progress. From the viewpoint of individual countries, this means production activities become more 'footloose'. Global financial institutions also manage their investment portfolios on the global scale and become more footloose as they tend to liquidate their investments in regions or countries as soon as they sense the slightest signs of deteriorating prospects. They then reconstruct their portfolios according to the revised assessment of financial risk across the globe. The growing incidence of financial crises in the era of globalisation can be understood as a consequence of the increasing mobility in financial resources across national borders.⁴

Thirdly, there has been a great 'power shift' between mobile actors and less mobile actors. In the 1960s and 1970s when East Asian countries and Latin American countries began their industrial development, MNCs were commonly regarded as entities to be accepted cautiously and therefore it was a norm that they operated under heavy government regulations. But now they are regarded as 'engines (at least catalysts) of growth' by a broad spectrum of policy-makers, academics and international institutions, and it is widely accepted that deregulation is a necessary step to attract MNCs' investments for the benefit of individual countries.⁵

³ For explanations of the progress of globalisation, refer to Dicken (1998); Dunning (1997); Julius (1990); Ernst (2002); Crafts (2000).

⁴ According to Eichengreen & Bordo (2002: 16 & table 6), the number of financial crisis increased from 21 during 1945-71 to 44 during 1971-97 for industrial countries, and from 17 during 1945-71 to 95 during 1971-97 for emerging markets, respectively. During 1971-97, a randomly-selected country had as high as 10-12% probability of experiencing a financial crisis.

⁵ For this swing in opinion, refer to World Bank (2000); Dunning & Hamdani (1997); Lipsey (1997).

Of course, this power shift is not entirely one-way traffic. As competition among MNCs or financial institutions intensifies, an opportunity also emerges for recipient countries to extract gains by exploiting their competition. However, the power shift towards mobile actors has been decisive on the whole. The global players have become stronger in enforcing their logic of accumulation upon the running of the world economy while national governments have been under pressure to change their earlier practices of economic management.

3. The Role of the State in an Increasingly Borderless Economy

One ironic thing about globalisation is that, as more and more factors become mobile, national competitiveness is more critically dependent on less mobile factors, i.e., less globalised ones. Among other factors[MC1], the national government is arguably the most immobile one (we cannot move the Singaporean government to Japan, for instance). In this respect, the role of the state becomes more important with the further progress of globalisation, contrary to the popular perception that it should be diminished as an economy becomes globalised.⁶

Underlying this observation is the fact that the state is *the ultimate system manager of the national economy*, which is responsible for providing mobile actors with 'complementary assets'. In determining the location of production or provision of financial resources, the mobile actors consider 'location-specific factors' which will complement their own assets.⁷ If location-specific factors of a country are not adequate, mobile actors do not come to, or leave, the country. The character and quality of location-specific factors, which are by definition less mobile, determine the 'stickiness' of mobile assets.

Among the location-specific factors, there are certainly non-man-made factors like natural resources and geographic position, upon which national governments can hardly exert an influence unless they attempt to change territorial boundaries. Earlier FDI by MNCs in the late 19th and early 20th century were in fact heavily related with the extraction of natural resources.⁸ In the current state of the world economy, however, man-made location-specific factors like policy, institutions, infrastructures and so on, are far more important in locational decisions made by mobile players.⁹ Within a given territory, the state is the principal agent responsible for providing these man-made complementary assets to attract mobile assets.

A basic assumption in the popular perception that the role of the state should be reduced in the era of globalisation is that market forces would replace or make unnecessary much of the role previously undertaken by the state as an economy is more broadly exposed to forces of globalisation. There are certainly some roles of the state that can be substituted for by the market. For instance, if domestic companies and financial institutions grow sufficiently to raise foreign money with their own credit and manage financial risks by themselves, many of the state's supports and regulations over international financial transactions become redundant.

However, there are also other important functions that only the state can undertake. For instance, policy formulation and implementation is one of the state's unique responsibilities,

⁶ The following is an example of this view: "... a major feature of concentration and centralisation in late capitalism is its international scale, which makes most nation states relatively insignificant elements within the operation of a world economy dominated by a small number of companies which are larger and more wealthy than many individual states (Johnston 1982: 61).

⁷ Refer to Dunning (1988; 1997)

⁸ In a similar vein, imperial aggressions during this period had to do with competition among nations to secure non-man-made location-specific advantages around the globe.

⁹ Even in the case of natural resource-seeking FDIs, it requires a stable business environment and infrastructure for extraction and delivery of natural resources, which are part of man-made location-specific factors.

although the market situation may indicate or affect its direction. The state is also a basic provider of human capital required for economic development. The market cannot provide a legal system, which is essential in the working of the market. Political and social conflicts are resolved mainly through the state apparatus. And these functions of the state, to which the market can never provide alternatives, are still critically important in determining the quality of location-specific factors.

What should be noted is that the role required for the state in the era of globalisation is more than a Smithian minimal one. When a country attempts to attract FDIs, it is often the case that its state needs to tempt them with an array of 'incentives'. Especially when host countries compete to attract FDIs, the role of incentives becomes more important. The provision of incentives inevitably contains elements of industrial policy because the state needs to decide what kind of incentives will be given, who will receive them, which sector will be given priority and so on. This is an unavoidable consequence when the state acts as a pro-active creator of complementary assets for inward FDIs, not simply a passive recipient of FDIs dictated by static 'factor endowments'.

Along with the role of promoting inward FDIs, the state needs to perform the role as a regulator of cross-border flows of products and services. In the previous section, I have stressed the connectedness of the positive and negative aspects of globalisation: The increased mobility has opened a great opportunity for a country to grow faster by utilising a greater availability of resources and markets whilst it has increased instability in the world economy. On the whole, the economic performance of the world economy during the period of accelerated globalisation is far from encouraging. As table 1 shows, per capita income growth rate in the world economy actually decelerated as the pace of globalisation accelerated and this trend is more marked in developing countries than in developed countries.¹⁰

There is no doubt that the role of the state should be changed with the acceleration of globalisation since previous policy tools like tariff protection, subsidies for local industries and so on become less available and effective. However, this does not lead automatically to a wholesale reduction in the role of the state. On the contrary, its role as the ultimate provider of location-specific advantages becomes more important. Its role to minimise possible downside effects from the increasing instability of the world economy is also equally important. The role of the state requires revitalisation, rather than diminution, with the progress of globalisation.

4. The Role of the State in Singapore

Singapore has developed through, what I have named, a 'complementing strategy'.¹¹ Unlike other East Asian Newly Industrialising Economies (NIEs) like Korea and Taiwan, which put heavy regulations on FDI and nurtured local industries at the beginning of their industrialisation,¹² Singapore aggressively attracted MNCs' investments by providing them with complementary assets like infrastructure, human capital, fiscal incentives and so on. From the beginning, its strategic focus was to exploit a complementary relationship with advanced countries for its own benefit, rather than to establish local industries in competition with them.¹³

¹⁰ The per capita income growth rate of the world has dropped from 2.7% during 1961-80 to 1.2% during 1980-99. For the same periods of comparison, the figure for developing countries has fallen from 3.2% to 1.5% whilst that for developed countries has decreased from 3.6% to 2.0% (World Bank 2001).

¹¹ Refer to Shin (2002)

¹² Taiwan, however, shifted its policy from the 1970s to attracting MNCs' investment and forming joint ventures between local companies (or research institutes) and MNCs in high-tech industries whereas Korea continued promoting local entrepreneurs in high-tech industries and maintained its 'substituting strategy' for economic development (Shin 2002).

¹³ Lee (2000); Mirza (1988); Huff (1994); Low (1998); Wong (2001)

This strategy originated largely from the country's special economic and political conditions. It had developed as an entrepôt open to foreign trade, investment and labour, and, as a former British colony, it had a large English speaking population, which formed an environment conducive for MNCs to operate in. On the other hand, its relation with its neighbours was not easy from the start of its nationhood and it could expect a greater possibility of success by connecting its economy directly to the 'First World', rather than relying on these unstable and often hostile neighbours for markets and resources.

In the 1960s when Singapore started its industrialisation, this kind of complementing strategy was an exception among developing countries. However, thanks to the rapid progress in globalisation thereafter, the strategy has been increasingly adopted as a norm for economic growth for developing countries. Even Britain, its former colonial ruler, adopted this strategy of attracting FDIs when it attempted to revitalise its economy in the 1980s. In this respect, the complementing strategy was a Singaporean innovation that has later spread broadly to other parts of the world.

Although Singapore's complementing strategy was geared to utilising market forces in the world economy on a greater scale, it was not in the least letting market forces dictate the running of the economy. The role of the state was crucial as the prime agent to formulate and implement this development strategy. It directed its efforts at two major areas. First, it provided foreign investors with competitive and continuously-upgraded complementary assets, as the least mobile actor in its territory. Its role was elevated to that of an active promoter. Officials of the Economic Development Board (EDB) were no less than missionaries of 'Singapore Inc.' for attracting investments from all over the world.¹⁴ Secondly, the state itself assumed the role of investors through government-linked companies (GLCs), filling areas where MNCs were not interested but which the Singaporean government regarded as strategic to the country's development.¹⁵

As compared with other developing countries, the acceleration of globalisation has posed relatively less difficult challenges to the Singaporean state during its development period. Globalisation is basically a process of diminishing distinctions between domestic and foreign markets, and those between domestic and foreign capital. For countries that had established a system to promote local industries through mobilisation of local resources with tight controls over cross-border flows of products and services, globalisation was a serious challenge to overhaul their systems.¹⁶ However, Singapore's economic management system had been already established on the basis of little distinction between domestic and foreign capital (or markets), and therefore the state faced relatively less problems in system transition following the acceleration of globalisation.

Related with this, Singapore also faced relatively less problems from the increasing instability of the international financial market. Since it relied on MNCs for capital and technologies, it had little need to draw foreign debt.¹⁷ Similarly, the corporate debt level was

¹⁴ Refer to Chan (2002); Schein (1996).

¹⁵ Reflecting this, the public share of gross fixed capital formation in Singapore was 35.6% in the 1960s, 26.7% in the 1970s, and 30.3% in the 1980s (Singapore Department of Statistics, *Singapore National Accounts*, various years).

¹⁶ From these different challenges of globalisation to individual countries, we may find one reason why Korea fell into a financial crisis in 1997 while Singapore and Taiwan weathered it relatively unscathed. Korea had relatively more formidable challenges to adjust its system following the acceleration of globalisation and the financial crisis can be understood as a consequence of failing in surmounting those challenges (refer to Shin & Chang 2003).

¹⁷ For instance, the ratio of Singapore's external debt to its Gross Domestic Product (GDP) was 22% in 1982 much lower than Korea's 52%. The figure was higher than that of Taiwan (12.8%), but Singapore's foreign debt was mostly burdened by MNCs with their own credit and the Singaporean government did not regard it as its own debt (Shin 2002).

also relatively low because local companies, being normally engaged in complementary areas of MNCs as subordinate partners, were less required to raise a large amount of investment funds.¹⁸ The lower levels of foreign debt and corporate debt, combined with its strong position in foreign reserve, were factors that helped Singapore to be less vulnerable to external financial shocks, although its financial market was wide open to international financial flows.

However, this does not imply that what lies ahead of the Singaporean state is an easy task, or it will be all right if it simply sticks to the previous way of managing the economy. It is still a formidable task to anticipate the next growth area and attract investments there while providing and upgrading necessary complementary assets. As the pace of globalisation accelerates, the state needs to accelerate its efforts at upgrading complementary assets in the economy.

In particular, as the income level of the country reaches that of an advanced country, the state seems to face a challenge that is qualitatively different from previous ones. One weakness of the complementing strategy lies in the relative underdevelopment of domestic technological capability. This is because countries adopting complementing strategies do not have strong incentives to invest in R&D as MNCs are sources of major technologies. Reflecting this, Singapore's expenditure on R&D investment had been very low even until the early 1990s when it reached the advanced country status.¹⁹ And the weakness in the private sector R&D capability is more pronounced in comparison with other East Asian countries, as figure 1 shows.

While Singapore remains a catching-up country, it might have been sufficient to try to find business areas that MNCs were willing to part with and attract them by providing complementary assets. Fortunately for Singapore, the acceleration of globalisation has continuously expanded the complementary business areas even to higher-end manufacturing and service sectors, and lengthened the life span of the complementing strategy. However, it seems to me that there is a certain limit to the attainable growth through the complementing strategy because of the difficulty in acquiring core technologies.

From the viewpoint of MNCs, the core R&D capability, which is related with the development of new products and processes, is the last thing that they will transfer to local subsidiaries. In fact, one principal reason why MNCs globalise their operations is that economies of scale and scope involved in their core R&D activities are ever-increasing and they have to recoup the costs in new technology development.²⁰ It does not make economic sense for MNCs to separate their core R&D activities geographically. It is still an overall trend that MNCs concentrate their higher value-added production processes, including R&D, in their home countries. Although MNCs set up regional R&D centres, technologies transferred or developed there are mostly limited to those related with adapting their products to rapidly-changing local market conditions.²¹ No matter how far globalisation progresses and no matter how hard

¹⁸ The corporate debt-equity ratio of Singaporean firms, including that of MNCs, was therefore around 123% during the 1980-91, much lower than that of Korea (383%) during the same period (Shin 2002).

¹⁹ The gross expenditure on R&D (GERD) of Singapore was 0.21% in 1981 and increased only to 0.84% in 1990. During the same period, Korea's figure jumped from 0.65% to 1.95% whilst Taiwan's rose from 0.84% to 1.66%. Singapore's GERD began increasing sharply only after it reached the advanced country status and its state invested heavily in R&D in the 1990s. In 1999, Singapore's GERD nearly levelled that of Taiwan (1.84%), though still lower than that of Korea (2.46%) (Wong 2001; Hou & Gee 1993; Shin & Chang 2003, figure 2.7).

²⁰ Refer to Freeman & Hagedoorn (1995); Pavitt & Patel (1999).

²¹ Amsden *et al.* (2001: 3) point out this aspect with their case study of the hard disk drive industry as follows. "In 1995, Southeast Asia (mostly Singapore) had virtually no nationally controlled HDD companies, but it accounted for as much as 64% of final global assembly and 44% of total global employment ... Southeast Asia's wage bill, however, was only 13% of industry wages worldwide. Developed economies (Europe, Japan and the US), by contrast, controlled the ownership of the HDD industry's leading enterprises and were responsible for virtually all of its R&D. These economies accounted for less than one-third of both final assembly and total employment but captured more than three-fourths of the HDD industry's wage bill".

recipient countries try to attract them, there is no complementary asset for core R&D capabilities.²²

Moreover, as competition among MNCs intensifies and 'time-to-market' becomes more important, MNCs look for investment sites where 'higher-tier' suppliers provide them with some technologies and production capabilities that they urgently need to develop but do not have time to implement. If 'lower-tier' suppliers are in a subordinate position to MNCs and rely on them for major technologies, these higher-tier suppliers have their own technologies and work with MNCs as nearly equal partners.²³ Since Singapore's per capita income level has reached that of advanced countries and it is increasingly difficult to maintain price competitiveness of lower-tier suppliers, the creation of higher-tier suppliers or upgrading previous lower-tier suppliers to higher-tier ones becomes all the more important as a new injection of complementary assets.

These high-end capabilities, i.e., core technological capabilities possessed by MNCs and technologies owned by higher-tier suppliers, are crucially important in maintaining Singapore's advanced country status, because other advanced countries keep moving ahead by leveraging on them, while less advanced countries also continue to climb up the technology ladder. In this respect, it seems that Singapore has now arrived at a stage when these higher-end-but-less-transferable capabilities become more and more important for its future growth. And this presses Singapore to pursue a two-pronged growth strategy: It needs to attempt seriously to acquire higher-end capabilities that are securely based on its territory, while trying to exploit ever-expanding complementary business areas as it has done previously.

Here again, the state is the principal agent responsible for re-gearing the strategic focus and developing necessary capabilities and institutions. As the ultimate system manager of the national economy, the state should maintain its leadership in transforming the economy for the next leap. In Singapore, the role currently required for the state is more than that of system manager because the local private sector is relatively underdeveloped as a result of the complementing strategy. It should be extended to compensate for the relative lack of capability in its private sector.

Singapore's current push towards nurturing 'technopreneurship' and building a 'regional knowledge centre (or hub)' can be understood in this context. These are no more than state-initiated efforts to develop higher-end capabilities that are rooted in the territory and interact with mobile factors. The existence of higher-tier suppliers becomes increasingly crucial in attracting MNCs' higher-end investments and it is desirable for the state to promote them with available incentives. The existence of strong research institutes and a dense network of cooperation between research institutes and companies residing in Singapore are also essential for a knowledge centre.

The current discussion on the restructuring of GLCs can be also put into a similar context. At stake is not simply whether the restructuring will make GLCs, which are already efficient in international standards, more efficient or not. The allegations of GLCs' 'encroachment' of SMEs' business areas and 'stifling' competition have also more to do with distributional questions than long-term growth questions. Both GLCs and local private companies are important constituents of less mobile actors responsible for higher-end capabilities within Singapore. This is not to deny that GLCs need to globalise or regionalise their operations in order to seize business opportunities arising from the acceleration of globalisation as well as their own growth. But this is what they do naturally as corporations. It

²² A similar argument can be made to the marketing capability, especially in relation with brand names. Singapore has depended its marketing channels predominantly on those of MNCs and has only a few internationally established brand names of its own. This is because brand name is also the last thing MNCs are going to transfer to others.

²³ For conceptual distinction between 'higher-tier' and 'lower-tier' suppliers and their relative importance in the process of globalisation, see Ernst & Kim (2002).

seems to me that a higher priority of the state policy should be given to the question of what kind of mix between GLCs and local private companies will be appropriate for Singapore to create core technological capabilities and a pool of higher-end suppliers, than that of how to help globalisation of GLCs.

Although the state may set a policy direction correctly, it is also a demanding job to implement it successfully since there are institutional backlogs and social attitudes accumulated from the previous development path. It may be easier to change formal institutions but it takes time and is often very difficult to change informal institutions. However, the state is again the agent that is mainly responsible for directing and managing this transition. The future success of the Singaporean economy also hinges on the state's capability to deal with this institutional transition.

5. Conclusions

By focusing on the interaction between mobile factors and less mobile factors in the process of globalisation, I have argued, contrary to the popular perception, that the role of the state becomes more important as the pace of globalisation accelerates. This is mainly because, as mobile factors obtain more freedom to choose locations across national borders, the quality of less mobile factors becomes more important in attracting mobile factors to a national economy and the state is the least mobile factor ultimately responsible for managing the system.

I have also argued that the very success of Singapore's complementing strategy in the era of globalisation has necessitated the state to move to a two-pronged strategy, in which it should increasingly emphasise the creation and acquisition of higher-end capabilities rooted in its territory in conjunction with its traditional policy of attracting FDIs. This is because, on the one hand, there is a limit to acquiring these capabilities through a complementing strategy, and on the other hand, MNCs' inward investment into this advanced country increasingly seeks higher-tier suppliers as complementary assets.

I have painted a broad picture on the role of the state in the era of accelerated globalisation and attempted to draw policy implications for Singapore. The actual ways individual states respond to globalisation would be diverse across countries, reflecting their differences in their previous paths of development, stages of development, structure of economy and so on. There will be no 'one-size-fits-all' solution for any country. However, the fact remains that the state should not refrain from carrying out its creative role as the system manager in its territory, without succumbing to the 'market-will-do' rhetoric currently prevalent in the academic and policy-making discourse.

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Table 1. Economic Performance by Country Groups during 1961-1999

Country group	1999 GDP per capita ¹ (\$US)	Average annual growth rates (%)					
		1961-69	1970-79	1980-89	1990-99	1961-79	1980-99
Developing countries ²	1,301	2.9	3.4	1.6	1.5	3.2	1.5
East Asia & Pacific	1,177	2.4	5.0	5.7	5.8	3.8	5.8
South Asia	446	1.8	0.5	3.5	3.4	1.1	3.4
Europe & Central Asia	2,135	n.a.	n.a.	n.a.	-2.6	n.a.	n.a.
Middle East & North Africa	1,979	n.a.	n.a.	-1.2	1.3	n.a.	0.0
Latin America and Caribbean	3,763	2.4	3.3	-0.1	1.2	2.9	0.5
Sub-Saharan Africa	561	2.4	1.0	-0.6	-0.9	1.7	-0.7
Developed countries ³	28,892	4.4	2.9	2.4	1.6	3.6	2.0
High-income OECD	29,578	4.4	2.9	2.4	1.5	3.6	1.9
World	5,439	3.4	2.1	1.4	0.9	2.7	1.2

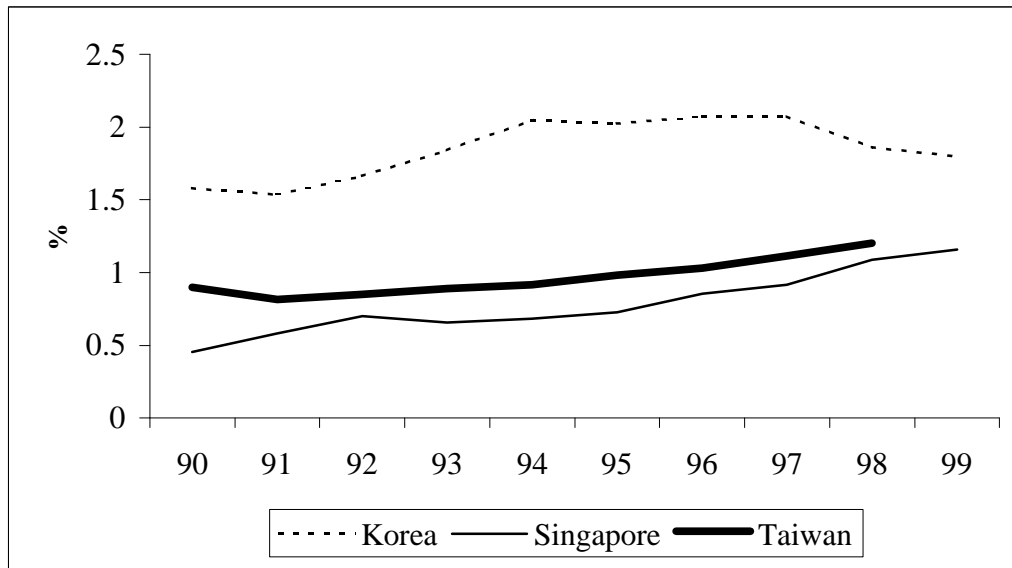
Source: Adapted from World Bank (2001)

Note: 1. Constant 1995 US\$

2. Equivalent to 'low- and middle-income economies' in the World Bank classification

3. Equivalent to 'high-income economies' in the World Bank classification

Figure 1. Trend of Private R&D Expenditure to GDP ratios in Korea, Taiwan and Singapore



Source: STEPI website, NSTB, Bureau of Statistics of Taiwan

The Role of the State in an Increasingly Borderless World

Second Prize-Winner, Open Category

By
Mr Kwek Ju-Hon
MINDEF

Summary

This essay focuses on the economic aspects of globalisation and considers their implications on state roles and capacities. A central theme running throughout is that borderlessness leads to intense competition for mobile factors of production, namely financial capital and highly skilled labour. Instead of causing a downward spiral in tax revenues (and therefore state capacities), this new competitive environment has led states to enter into a form of “policy competition”, to become a location of choice for these mobile factors.

The essay proceeds to consider the assertion that international capital markets now render states virtually powerless to make real policy choices, particularly with regard to monetary and fiscal policy. States hoping to benefit from inflows of capital are indeed forced to don the “Golden Straitjacket” of policies promoting low inflation, balanced budgets, and a well-regulated domestic banking system. While this is often portrayed as a severe curtailment of states’ discretionary power, this essay asserts that the present focus on the creation of macro-economic stability must be seen as a modern manifestation of the task of creating stable conditions of commerce and investment, a role that has always fallen on the state.

The ultra-competitive international economic environment leads to very different conclusions for the efficacy of industrial policy. The very pace of globalisation and technological change make the state more important in exercising its unique capacity to identify new developments, and facilitate *transformation* in the national economy. The key to state success is maintaining the nimbleness to constantly reinvent its roles to suit the rapidly changing global context. “New” industrial policy must include tasks of technology diffusion, coordination of innovation, and the management of trade disputes. Seen in this light, state power is not likely to be displaced in an increasingly borderless world. It is merely transformed to meet a new competitive context.

*"The nation state is about through as an economic unit"*¹

-- Charles Kindleberger, 1969

Pronouncements on the demise of the state have been in vogue for over 30 years. Yet reading contemporary literature on globalisation and international integration, one cannot help but to be struck by the newfound confidence with which the state continues to be pronounced an outdated and moribund institution. These claims have reached new heights with authors such as Kenichi Ohmae declaring that in *The (already) Borderless World*, people, firms, and market matter more, and states less.² Echoing Kindleberger's words from 30 years ago, Lester Thurow has declared that "as an externally sovereign actor, . . . (the state) . . . will become a thing of the past."³ If indeed this were the case then the simple answer to the question on the role of the state in a borderless world is that it is diminishing to the point of insignificance.

But rumours of the state's demise have been somewhat overstated. While borderlessness and the associated phenomenon of interdependence have certainly changed the context in which it operates, the modern state appears to be alive and well. This essay will consider the extent to which increasing borderlessness circumscribes the bounds of possible state action while at the same time transforming the roles of the state and creating new imperatives for policy.⁴

A Borderless World?

The last two decades have seen an accelerating growth in the volume and variety of cross border transactions in goods, services, and international financial flows. This rapid integration of the world economy has been fuelled by new technologies, the spread of information, and the growing importance of knowledge-based industries. These have drastically lowered costs of transaction, information, and mobility for a wide variety of economic actors. Interdependence has grown not just between countries, but also among groups within them.

Obviously the world is far from being completely borderless – there continues to be numerous regulatory and political limits to free flows in trade, people, and technology. It is also clear that economic integration is uneven across industries; integration of financial markets for example, leads that of all other fields. Borderlessness and interdependence also show a clear geographical bias with the developed North being far more integrated than the still developing South.⁵ But all that said, it is fairly clear that the world economy is *more* borderless and integrated than it ever was before and that the overall trend is towards more rather than less openness. Therefore the intention of this essay is not to enter into a detailed debate about the extent of global integration, but to accept its inevitability and consider its implications on state policy.

¹ Charles P. Kindleberger (1969) p. 207.

² Kenichi Ohmae (1990).

³ Lester C. Thurow (1999). p. 137.

⁴ Interdependence that is borne out of the dissipation of international borders has clear political and social implications, each of which could be the topic of a separate piece of research. This essay will focus mainly on economic aspects of integration.

⁵ Linda Weiss (1998), for example, points out that as of 1991 81% of the world stock of foreign direct investment was in high wage countries of the north. She adds that the extent of this concentration has grown by 12 points since 1967. p. 72.

International Competition: Diminishing state capacities?

We should first begin by considering the key analytical argument about the impact of openness and interconnectedness on the state capacities. The assumption is that state capacity is an inverse function of economic integration; the more open or internationalised an economy, the weaker the state's capacity to govern industrial change. The argument goes something like this: increased permeability of state borders exposes private agents and governments to greater degrees of international competition, not just in the goods market, but also in the markets for factors of production. Labour and capital – the two mobile factors of production -- will flow to countries that offer the highest rate of return.

State capacities are financed by taxation, and revenues are raised by taxes on productive factors. Since interdependence forces fierce competition among states to attract these factors, and because owners of mobile factors can vote with their feet, what results is an international "tax competition" which exerts a huge downward pressure on state revenues. Owners of capital and highly skilled professionals are free to take their resources where there they are most in demand. Economic integration allows capital and skills to migrate to low tax jurisdictions, and so the state's tax base will invariably shrink. Governments will find themselves unable to finance social programmes, safety nets or redistribution of income. Anticipating this flight of capital and skills, governments have to cut taxes and dismantle the welfare state before migration or mass capital flight gets under way.

Put simply, increasing borderlessness limits state capacities to act because it limits their ability to tax. Dani Rodrik argues that "Globalisation has made it exceedingly difficult for government to provide social insurance ... at present international economic integration is taking place against a background of receding governments and diminished social obligations. The Welfare state has been under attack for two decades."⁶

Yet as *The Economist* points out in its recent survey of globalisation, the opposite seems to be the case. In practice, governments around the world are now collecting more in taxes; not just in absolute terms, but in proportion to their economies. The US government collects some 30% of GDP in taxes, making for an average of US\$30,000 per household. Sweden, despite a much vaunted taxpayer revolt in the 1990s, taxes up to 57% of GDP, and Denmark follows closely with 53%. These are all examples of extremely open economies. Denmark's ratio of imports to national income, for example, is 33% compared to the US' 14%.⁷

How do we explain this apparent anomaly? The immediate thought is that perhaps the world is not quite as borderless as it has been made out to be, perhaps because of a good deal of stickiness in international labour and capital markets. But this is clearly not the case for capital, much of which moves seamlessly across the globe at the touch of a button.

Stickiness is actually a reality for the majority of workers, who are tied to geographical locations by national regulations. However it does not apply so much to highly paid professionals whose skills make them globally mobile, and whose incomes put them in the highest tax brackets, ensuring that they pay the bulk of national tax bills. While there is indeed some evidence to show that labour mobility has precipitated a move from direct to indirect taxation – borderlessness seems more to have affected the structure of tax code as opposed to the overall burden of taxation.

What keeps these highly mobile professionals from fleeing to low tax havens? Some point to a flaw in the fundamental assumption of the analytical argument presented above – that

⁶ Quoted in "Is Government Disappearing?", *The Economist Survey of Globalisation*, p. 2.

⁷ Figures cited in "Is Government Disappearing?", *The Economist Survey of Globalisation*, p. 1.

workers are narrow utility-maximising individuals with no ties to family place or culture, and argue that we need to take a broader view of the human condition. Borderlessness may remove the impediments to free movement, but social and cultural factors are a source of inertia. “Since people seem to choose to be tied down, indeed relish it, governments, within broad limits, can carry on taxing them regardless of globalisation.”⁸

While this perspective is certainly valid, there is another way of explaining the tax base anomaly within the framework of economic analysis. It must be noted that whether labour or capital, factors of production will flow to where they receive the highest *risk denominated rate of return*. These returns are calculated net of the price transaction (i.e. tax rates) in a particular market. So mobile factors of production will remain in higher tax jurisdictions as long as the potential for returns remains high and the risk of transacting remains low. One way of looking at this is that these locations provide “value for money” in terms of the services provided by government and the environment created for business. Factors of production will choose to remain in a high tax location if they deem that their tax dollars are being spent on enacting policies that will boost returns and lower risks. This is why capital and highly-skilled labour continue to flock to relatively high tax locations of New York, San Francisco, London, Paris rather than to the tax havens of Bermuda and the Jersey Islands. It is a matter of “policy competition” between governments as to who can provide the best environment for doing business, the most stable framework for investment, and the best place to live. Global flows of information, which are themselves a by-product of economic integration heighten such competition as they inform the owners of capital about alternatives.

The implication of this is significant – instead of just engaging in a competitive “race to the bottom” in taxes, states need to take a more holistic view of the overall package they offer to investors and highly skilled workers. Mobile capital, whether financial or intellectual, does not simply just flock to the cheapest location, but to the system that offers it the best value for money. So it is not simply the case that the state no longer has the means to play any sort of meaningful role, but that it preserves these means by showing to owners of mobile factors that it is a good value proposition. This explains why states continue to possess their capacity and what they should do to maintain it.

The End of Discretionary Power?

But even if states continue to have the means at their disposal, a further question is whether they continue to have the discretionary power to decide on policy. Globalisation theorists point out that with increased integration, the very idea of a national economy, and the capacity of governments to manage it are being undermined. Governments are moving towards greater openness in trade and investment policies, which is often represented as the emergence of a new logic of global capitalism. According to this logic, “states are now virtually powerless to make real policy choices; transnational markets have so narrowly constrained policy options that more and more states are being forced to adopt similar fiscal, economic, and social policy regimes.”⁹

Globalisation, particularly of capital markets, has made for a powerful countervailing force to the state’s discretionary power. To many, the power of the global bond market to undermine the monetary and fiscal policies of governments is all but taken for granted. All governments are impotent in the face of global finance. Thomas Friedman refers to this as the power of the “electronic herd”; perfectly mobile, it comes under no state jurisdiction. “When the herd decides to withdraw capital from a country, there is no one to complain to or to petition for

⁸ From “Is Government Disappearing?”, *The Economist Survey of Globalisation*, p. 6.

⁹ Linda Weiss (1998), p. 188.

relief. Decisions of the herd are collective ones. They are not made; they happen, and they happen because many investors individually make decisions simultaneously and on similar grounds to invest or to withdraw their funds. Do what displeases the herd, and it will trample you into the ground. Globalisation is shaped by markets, not by governments.”¹⁰

The “herd” moves vast amounts of capital in and out of countries according to their political and economic merits, and the State is powerless to challenge its will. Countries that wish to attract capital have to do what Friedman terms the “Golden Straitjacket”, a package of policies including balanced budgets, economic deregulation, openness to investment and trade, and a stable currency.¹¹ “As your country puts on the Golden Straitjacket, two things tend to happen: your economy grows and your politics shrink”.¹² In an increasingly borderless world, capital markets severely curtail a state’s freedom of manoeuvre in economic policy. This is the new context within which states are forced to operate.

Given that continued inflows of capital are a necessary ingredient for economic success, and that the tendency for capital flight is higher the higher the integration and globalisation of financial markets, a key role of the state is therefore simply about giving markets what they want. Owners of capital want a stable environment for investment, so the provision of macroeconomic stability rises to a new level of importance.

Increased inter-state competition for capital forces states and their central banks to concentrate on the goal of price stability in order to attract or avoid a drain of mobile capital. High inflation is generally perceived by markets to be a signal of bad policy and a proxy for political and economic instability. States are forced into a similar straitjacket with regard to balancing government budgets. Short-term bank debt has led many a developing country into trouble. The debt crisis, for example meant that the 1980’s were a lost decade for Latin America. The problem was one of governments borrowing heavily to finance recklessly large budget deficits. With such lessons in mind, borderless financial markets place a premium on state fiscal conservatism.

While government deficits are problematic, the case of corporate borrowers in developing countries becomes more complicated. These non-government entities occasionally borrow amounts that seem individually prudent given certain macroeconomic assumptions -- such as no devaluation of the currency -- but which become collectively unsupportable if those assumptions turn out to be wrong. This happened in East Asia in the 1990s, with the further complication that much of the borrowing was channelled through domestic banks, which meant that the ultimate borrowers were unaware of their exposure to system wide exchange rate risk. Some governments even went so far as to encourage significant amounts of foreign borrowing by firms without intermediation from domestic banks and financial institutions. This points to the importance of regulation and oversight of the banking sector.¹³

¹⁰ This characterisation of the “electronic herd” is provided by Kenneth Waltz, in his 1999 James Madison Lecture at the American Political Science Association, “Globalisation and Governance”.

¹¹ See Friedman (2000), pp. 101-111.

¹² Friedman (2000), p. 105.

¹³ Where such regulation is impossible due to immaturity of institutions, there may be some role for capital controls. Taxes or controls on short term currency inflows may well be better than the extreme alternatives of no inflows on one hand, and completely unrestricted inflows intermediated by a weakly or corruptly regulated domestic financial system.

Whither the Role of the State?

So does the emphasis on macro-economic stability mean that the state has entered a new era of powerlessness? Not so if the maintenance of macro-economic stability is seen in the larger context of fostering the *overall conditions for economic well-being*, which has always been an invariant role for all states. These conditions, essentially the infrastructure for doing business, are a function of legal security (property rights and contract enforcement), social security, economic and political stability, and are public goods that only states can provide. Macro-economic stability is key element of this infrastructure as it safeguards transactions and so creates market conditions conducive for commerce. This is a role that states have always had to play. In the context of a borderless world, the imperatives for fulfilling this role have merely intensified. States are answerable not just to their domestic business constituencies, but also to the international markets which allocate vast amounts of capital.

A borderless world with an integrated global economy intensifies the competition among states for capital. States are thoroughly engaged in the process of *locational policy competition* to show that they are the best destination for talent and financial capital. A key preoccupation of the state is simply to ensure that it remains competitive. In addition to creating market conditions that are conducive to capital, it can enact significant supply side policies to improve the quality of factors of production. For example policies that boost productivity – if public spending on education boosts productivity, investment would be drawn to countries that invest heavily in top-quality schools and universities. The same would hold if public spending on social programmes such as health and welfare raises productivity by producing a healthier and more contented workforce.

The Strong State and Industrial Policy

But surely the role of the state can and must go beyond the passive provision of the infrastructure and economic conditions that markets demand. Linda Weiss puts forward the perspective that “economic integration does not so much enfeeble the state as weaken the efficacy of *specific policy instruments*.” She notes that one result of financial liberalisation is that the instruments of fiscal and monetary policy are predetermined, leaving little room for creative adjustment. However, “the very opposite is the case with industrial policy. The very capacity for industrial policy is one that requires the state constantly to adapt its tools and tasks.”¹⁴ Borderlessness and international economic integration heighten industrial competition, and accelerate the pace of change to the industrial context. States possess unique abilities to coordinate industrial change to meet the changing context of competition.

Economic history is littered with examples of how some states are more successful than others in anticipating and responding to economic change. This is what Weiss refers to as a state’s “Transformative Capacity” -- its ability to adapt to external shocks and pressures by generating ever-new means of governing processes of industrial change. These are essentially strategies to upgrade or transform the economy – in terms of structural shifts from declining to expanding sectors, means of technological diffusion and innovation, and the creation of new industries, products and processes. While the state is not the only body that possesses this domestic adjustment capacity, it can provide a potentially more powerful locus for coordinating change. “The state’s institutions can offer the most encompassing organisational complex for overcoming a number of widely recognised obstacles to change, including problems of collective action, bounded rationality and short-term horizons as well as unprecedented time compression in technological transformation.”¹⁵

¹⁴ Linda Weiss (1998), p. 197.

¹⁵ Linda Weiss (1998), p. 6.

Most importantly among these is the fact that only the state can readily absorb and socialise the high degree of risk that is inherent in modern production technologies. State coordination is vital to induce firms to engage in activities where the risk level would be so great as to deter firms acting alone. This is particularly so where investments must be made on a large scale and where the sub-sectors are interdependent and therefore need to be created concurrently – for example the semiconductors and computer industry, or genetics and the pharmaceutical industry. An excellent example of this can be seen in the role that MITI, the Japanese Ministry for Trade and Industry, plays in promoting and diffusing technological innovation. It facilitates risk pooling arrangements, a form of “distributed cooperation”, where participant firms take responsibility for specific tasks of a larger research effort. Research is conducted independently in the firms’ own labs, but technology is exchanged through a system of shared patents. Such state sponsored cooperative arrangements allow the pooling of resources, while maintaining competition by keeping partners at an arms-length.

Weiss identifies five areas where the state’s capacity to coordinate of industrial change remains important. First, the identification of emerging areas with new product and technological potential. An example of this is the role that the MITI played in focussing Japanese firms’ attention on Robotics in the 1980s. Second, the promotion new infant industries (specifically the high tech industries of the future), present examples of which are biotechnology, micro-electronics, and materials science. Third, in maintaining a continuous long-term programme of investment and upgrading for mature industries. Fourth, in regaining critical ground lost to competitions in strategic industries (the US Department of Defence’s sponsorship of Sematech, the public private consortium for restoring semi-conductor capacity lost to Japan is a good example of this). And finally, in enacting structural adjustment policies to assist the retreat of industries that are in decline whether due to falling demand or loss of comparative advantage.¹⁶

Far from being put on the defensive by the realities of a borderless world, states have the capacity to turn increasing borderlessness into an opportunity. “Catalytic states” are ones which grab the bull of globalisation by its horns and actively encourage internationalisation strategies of corporate actors. Singapore provides an apt example of this; pre-empting the threat of cheaper labour costs to its manufacturing industry, the country’s industrial strategy has shifted from one of attracting foreign companies to one of “internationalisation” to encourage regional relocation of production networks offshore to Singapore-created investment parks. Japan and the US have enacted similar internationalisation strategies by offering a panoply of incentives to finance overseas investment and to promote technological alliances between national and foreign firms.

Beyond just positioning themselves to thrive in a borderless world, states can and are also seeking to increase their control over their external environment. This is achieved by building or strengthening power alliances, and achieving their goals by assuming a dominant role in coalitions of states, transnational institutions and private sector groups. In this light, the emergence of regional economic arrangements such as the EU, APEC, and NAFTA should be seen as gambits for augmenting rather than shedding state capacity. Active members of these groups seek power-sharing agreements which will give them scope to shape the grouping and its environment. Far from being rendered powerless by the changes wrought by globalisation and economic interdependence, “strong states tend to be midwives (even perpetrators) rather than victims of globalisation.”¹⁷

¹⁶ Weiss (1998), p. 201.

¹⁷ Linda Weiss (1998), p. 13.

Conclusion: Flexibility as the key to State Success

The increased permeability of international borders leads to a hyper competitive system in which the winners are rapidly imitated by the losers. The ubiquity of technology and the free flows of information have sped this process up immensely. In the old era, the strong ate the weak; in the new economic era, “the fast eat the slow”¹⁸. Technological innovation is rapid, and because economic conditions at home and abroad change often, states that adapt easily have considerable advantages. The policy imperatives of ensuring a nation’s economic development are fixed, but the ways of going about them are highly variable in accordance to a rapidly changing context. To be successful in a borderless world, states must be quick to pick up on these changes and adapt their tasks to them, for example by moving from export promotion and industry creation to coordination of innovation, technology diffusion, the management of trade disputes and currency realignments. Indeed the “Transformative Capacity” of the state – not just its ability to transform its industries, but also its capacity to remain nimble and transform *itself* is a key to success in the world economy. “Change is hardly novel to the state: it is the very essence of the modern state, by virtue of the fact that it is embedded in a dynamic economic and inter-state system.”¹⁹

In a borderless world, the state maintains the means to enact policy, but because of the extreme mobility of productive factors, is forced into a straitjacket of conservative macro-economic policy to produce the conditions demanded by their owners. While this might at first seem like a severe curtailment of the discretionary power of the state, it must be seen in the contemporary context of creating the conditions of commerce, a task that has always fallen on the state. The imperatives for state action are similar, but the pressures are greater as it comes under scrutiny not just by its own internal actors, but by participants in international markets.

The ultra-competitive, rapidly changing globalised environment leads to a different conclusion for industrial policy. Here the very pace of globalisation makes the state more important in exercising its unique capacity to facilitate transformation in the national economy. The key to state success is the ability to be nimble and constantly reinvent its roles to suit the rapidly changing global context.

Seen in this light, state power is not likely be displaced in an increasingly borderless world. If anything it will become more salient.

¹⁸ Klaus Schwab quoted in Thomas Friedman (1999), p. 213.

¹⁹ Linda Weiss (1998) p. 195.

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The Role of the State in an Increasingly Borderless World

Third Prize-Winner, Open Category

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Summary

Economic globalization, or the rapid recent growth in international trade and capital flows, creates both exciting opportunities and serious challenges for national economies and the world economy. At the same time, globalization entails far-reaching repercussions for individuals and firms as well as the state or the government.

In this paper, we examine the relationship between globalization and the state. An especially notable loss of the state's power in the face of globalization is its reduced ability to collect taxes due to more internationally mobile capital and labor. However, this overlooks the possibility that low tax countries may have low quality of public services, making them less attractive for capital and labor.

The East Asian Miracle emphatically showed that whether a country can take advantage of the enormous opportunities inherent in international trade and capital flows depends to a large part on the quality of government policies. Globalization raises the reward for sound policy as well as the penalty for unsound policy. As such, policy quality becomes more relevant than ever in a borderless world economy.

The Asian currency crisis illustrated the importance of sound policy in minimizing the potential risks from globalization. Globalization is not inherently destabilizing or harmful. Instead, it is often inappropriate policy that turns globalization into a destructive force. A key role for the government in connection with reducing the risks and adjustment costs is to facilitate the re-allocation of resources between sectors.

The competitive pressures unleashed by globalization are not only relevant for firms and workers; they are equally relevant for governments as well. A borderless global economy with internationally mobile capital and labor exposes the state to the discipline of competition from other states. Globalization thus encourages governments to pursue good policies, and refrain from bad ones.

1. Introduction

Globalization, or the integration of the countries of the world into a single homogeneous community, is taking place across a broad spectrum of human activities. Globalization is an irresistible and relentless phenomenon touching and reshaping almost all aspects of our everyday lives. In the political arena, for example, multiparty democracy and ideological pluralism are gaining a foothold and establishing themselves in many countries that used to have more authoritarian political systems. Likewise, we find ourselves exposed to foreign culture to the extent that listening to foreign music or watching foreign movies or dining out at restaurants serving foreign cuisine has become second nature to most of us, as has visiting foreign countries or seeing foreign visitors wandering around our streets. In fact, with globalization proceeding full steam ahead, the distinction between foreign and homemade becomes less meaningful by the day.

In this essay, we look at one component of globalization, namely economic globalization, which refers to the rapid recent growth of international trade in goods and services, as well as international flows of capital and to a lesser extent, labor. Economic globalization, or global economic integration, thus implies the progressive removal of barriers to the movement of goods and services, capital, and labor across countries. That is to say, economic globalization denotes the process whereby the national economies of the world are moving toward a single economy with unfettered movement of goods and productive factors. While we still have long way to go to achieve a truly borderless global economy, the acceleration of international trade and capital flows in the postwar era suggests a clear movement toward rather than away from that kind of an economy. Economic globalization entails far-reaching repercussions for individuals and firms as well as the state.

Our focus here is on the impact of economic globalization on the role of the state or the government. Although the private sector tends to determine the allocation of resources in market economies, the state continues to play a significant economic role in those economies. Although the extent to which the state intervenes in the economy varies substantially from country to country, the invisible hand of market forces has yet to completely displace the more visible hand of the state even in the most laissez faire economies.

As we will see below, economic globalization has significant implications for the role of the state. Economic globalization creates both exciting opportunities and serious challenges for national economies. While globalization weakens the government in some respects, the government and its policies help determine a national economy's ability to maximize its returns and minimize its risks from globalization. Put differently, the impact of globalization on a country's firms and individuals depends critically on how their government responds to globalization.

2. Economic Globalization, Factor Mobility, and The Disappearing State

An especially notable loss of the government's power in the face of globalization concerns taxes. Although the state can borrow or resort to inflation as a means of financing itself in the short run, taxes are its primary source of resources in the long run. As such, any reduction in the state's ability to collect taxes from firms and individuals translates directly into a general loss of its ability to produce services. According to conventional wisdom, economic globalization renders the state less powerful at best and irrelevant at worst by limiting the state's ability to collect taxes and thus finance its activities.

The intuition is quite straightforward. As indicated earlier, economic globalization does not only entail greater cross-border flows of goods and services, but factors of production such as capital and labor as well. Greater mobility of productive factors does not bode well for the future of taxes and by implication, the state, since capital and labor will gravitate toward national

economies that offer the lowest tax rates. There is mounting concern that factor mobility may even spark off a race to the bottom as governments fall over each other in cutting taxes in a competitive bid to attract and retain companies and workers. The growth of electronic commerce and the difficulty associated with taxing on-line sales further compounds the problem that globalization creates for the taxman.

There is at least some validity to such concerns since *ceteris paribus* firms and individuals find low-tax countries more attractive than high-tax countries, especially now that it is easier and less costly to relocate. However, while plausible in theory, casual observation suggests that they are considerably overblown. For one thing, although globalization in the sense of rapidly growing international trade and capital flows has been going on since the dawn of the postwar era, the government's share in national output has not fallen in most countries. If anything, the share has been large and growing, especially in developed countries. Furthermore, tax rates are one and only one consideration, albeit a major one, for companies and workers in deciding where to locate.

A related point is that tax rates and public services are not independent of each other. It is not too meaningful to talk about tax rates as being high or low without any reference to the quantity and quality of services produced by the government. To illustrate, facing a choice between a country with high tax rates but high-quality public transportation, education and health, and another country with low tax rates but low-quality public transportation, education and health, a perfectly rational company or individual may opt for the former. High tax rates are not a problem *per se*. They become a problem if and only if the government fails to give the citizens their money's worth for their tax payments. Therefore, globalization renders the government's efficiency all the more important, possibly setting off a benign international race for better and more affordable public services.

This suggests that globalization may strengthen the rationale for outsourcing or contracting out those services that the private sector is more efficient at producing than the government. The transfer of economic activities from the government to the private sector sometimes involves privatization or outright sales of state assets to the private sector. For example, while many governments are still involved in the energy and telecommunications sectors, there is no obvious reason why the government would do a better job of producing energy and telecommunications services than the private sector. On the other hand, there have been many real-world instances of botched privatizations that have produced neither lower prices nor higher quality. Whether privatization works or not in practice depends on how well the government implements it, for example in terms of regulating the privatized industry so as to promote competition, investment, and innovation.

Interestingly, in some cases economic globalization can loosen the resource constraints facing governments instead of tightening them. To illustrate, governments in many poor countries depend on financial assistance from rich country governments and multilateral financial institutions for their budgetary requirements. More significantly, in this age of massive international capital flows, the governments of rich countries and poor countries alike can and do borrow from foreign sources to finance their budget deficits. For instance, the United States government relied heavily on the willingness of Japanese investors to buy up its securities during the 1980s. However, a government's ability to borrow abroad is subject to strict market discipline. In any case, the positive impact of globalization on access to foreign capital is scant consolation for governments worried about its negative implications for taxes, its main long-term source of income.

As pointed out earlier, the demise of taxes and states are greatly exaggerated. What we cannot overemphasize under economic globalization is the need for greater commitment to efficiency on the part of the government. Whether the government itself produces a service or transfers production to the private sector is not nearly as important as the quality and

affordability of the service. That is to say, the reliability and cost of, say, energy or telecommunications, matters much more to individuals and firms than who produces them. Therefore, confronted with footloose capital and labor, the government should pay more attention to customer satisfaction than ever before, both when it is itself the producer as well as when it is in a position to influence the producer.

3. The Promise of Economic Globalization and the State

A quick glance at a globe reveals that economies that are least integrated into the world economy, such as Cuba, North Korea or much of sub-Saharan Africa, are also among the world's poorest. On the other hand, the star performers of the world economy in recent decades, most notably many East Asian economies, have been precisely those economies whose economic transactions with other economies have grown the most rapidly. While globalization clearly entails undesirable consequences, on balance it is all but impossible to downplay its immense benefits for the world economy as well as individual national economies.

Nowhere are such benefits more noticeable than in East Asia in the postwar era. So much so that their meteoric economic rise has been dubbed the East Asian Miracle. Regardless of where one stands in the debate between proponents of market-led development and state-led development, it is only fair to acknowledge that the state played an instrumental role in enabling East Asian economies to take full advantage of the opportunities presented by globalization, in particular, access to foreign markets as well foreign capital and technology. While the degree of state intervention in the economy varied from country to country, throughout the region the state provided macroeconomic stability conducive to saving and investment, liberalized their foreign trade regimes in order to promote exports, and interfered less with the price mechanism relative to other developing countries.

Not surprisingly, those policies have helped to mobilize both domestic and foreign investment, especially in export-oriented manufacturing industries, and transformed the region into dynamic, high-growth economies. The region's success in economic globalization, evident in its large and growing share of global trade and inward FDI, has driven the region's overall economic success. And, this is the crucial point here, the region's success in economic globalization owes a great deal to the generally sound economic policies of the region's states.

We can expect technological progress and multilateral trade liberalization, and the proliferation of regional trade agreements to further bring down barriers to international trade in the 21st century. At the same time, technology and liberalizing policies are also reducing the importance of borders in capital flows. Therefore, there is every reason to believe that the opportunities from globalization, in particular using exports as an engine of growth and foreign capital to finance productive investment opportunities, will continue to grow. But, as before, whether a country can grab those opportunities depends to a large part on the quality of the state's policies.

Consider a country that does not produce rubber, but is potentially good at making car tires, in fact so good as to be a world-beater. Now suppose that the country fails to make any car tires due to prohibitively high tariffs against rubber imports. The cost those tariffs impose on this country rises with globalization since the progressive removal of trade barriers expands the opportunities for exporting car tires. Similarly, globalization raises the benefits from reducing the same tariffs. Simply put, globalization raises the penalty for unsound economic policy and raises the reward for sound economic policy.

It is probably much more meaningful to talk about whether globalization renders policy, rather than the state, irrelevant. Our discussion so far yields an unambiguous answer – under globalization, the quality of policy becomes more relevant than ever. This is not to say that government policy alone is the determinant of how well a country copes with globalization – far

from it. However, given the capabilities of the country's individuals and companies, it is a critical factor at the margin. And, in a world of globalization and factor mobility, a razor-thin margin can make a world of difference.

The progressive removal of barriers to the movement of goods and services, capital, and labor associated with globalization necessarily implies greater competition among firms and individuals. What is less obvious but equally significant is that the removal of barriers entails greater competition among states to attract and retain firms and individuals. Globalization weakens the state's ability to get away with bad policies by limiting the state's monopoly over domestic capital and labor. The loss of policy autonomy often cited as a consequence of globalization pertains much more to bad policy rather than policy per se. Borders no longer protect policymakers from the consequences of their actions. The discipline of international competition can conceivably promote a race to the top among governments for sounder policy.

4. The Challenge of Economic Globalization and the State

If globalization were all gain and no pain, we would not see such vociferous opposition to it from so many different quarters around the world. In particular, economic globalization seems to be a favored target of violent anti-globalization protesters, whose exploits grab all the headlines during meetings of institutions that have come to symbolize growing international economic integration, such as the WTO, IMF or World Bank. Globalization is clearly not everybody's cup of tea. As hinted earlier, globalization not only presents vast opportunities for improving human welfare but also throws up all-too-real challenges as well.

Ironically, those same East Asian economies that so vividly illustrated the tremendous promise inherent in globalization gave the opponents of globalization their most damning evidence of globalization's dangers. The Asian currency crisis that hit many of the Miracle countries like a tidal wave in 1997-1998 plunged the whole region into unprecedented financial, economic and social turmoil. Despite the region's subsequent recovery, the unexpectedness and severity of the crisis still serves as a powerful reminder about the two-faced nature of globalization. To many observers, the helpless vulnerability of the affected countries in the face of massive reversal of capital flows revealed the benefits of globalization to be a tantalizing but ultimately empty illusion.

Upon closer scrutiny, the Asian crisis illustrates not so much the risks of globalization as the importance of sound policy in minimizing those risks. A combination of heavy-handed state intervention and weak prudential regulation left the region saddled with financial systems that did a poor job of allocating resources to their most productive uses. East Asian governments' propensity to use their country's financial systems, especially banks, as tools for channeling resources toward favored firms and industries inevitably stunted the development of sound and efficient banks. Opening up the capital account, as East Asian countries did, under such circumstances virtually guarantees a sharp deterioration in the quality of investment, as indeed happened. What the Asian crisis tells us, then, is not that globalization is inherently destabilizing or harmful, but that bad policy can easily shatter its promise.

The Asian crisis arose from the failure of government policy in yet another dimension. The other side of pre-crisis over-borrowing by East Asia's private sector was over-lending by rich country banks. Simply put, lured by high returns, the banks failed to do their homework in evaluating the potential risks involved in lending to the region. Of course, the responsibility for encouraging banks and other financial institutions to manage their risks sensibly falls ultimately on the state. Therefore, unsound policy in the form of weak prudential regulation in both the borrowing countries and lending countries was a major contributing factor in the Asian crisis.

At a broader level, it is worth noting that the essence of globalization is greater competition. As a country becomes more integrated into the international trading system, for

example, its firms enjoy more opportunities abroad but at the same time, face more competition at home. Just as rapid technological progress calls for a smooth reallocation of resources within the economy, so do the daunting competitive pressures unleashed by globalization. Which means that the state should promote flexible output and factor markets to facilitate this critical reallocation. To illustrate, in countries experiencing a hollowing out of their manufacturing sector, deregulating and liberalizing the markets for services as well as the labor market will promote the expansion of service industries, which tend to be labor-intensive, and re-deployment of displaced manufacturing workers into those industries.

In some cases, a more direct and active role for the state may be justified. For example, the market may fail to provide enough training for workers laid off due to cheaper imports or the private sector may lack financial resources or scale to make investments in potentially profitable but risky new industries. What matters for a country's competitiveness is that the reallocation of resources be quick and effective. If government intervention in any shape or capacity facilitates rather than hinders this critical movement of capital and labor, it is to be welcomed, not condemned on the basis of some presumed impotence of the state in a borderless global economy. The state can thus help the economy better adjust to globalization by directly and indirectly strengthening the economy's resilience in terms of uncovering new areas of comparative advantage and re-allocating resources toward them.

Globalization, like free trade, inflicts high costs on some firms and workers even though it generally benefits the economy as a whole. In this connection, an often ignored but necessary role of the state is to champion the cause of globalization to the public. The losses from globalization tend to be immediate and concentrated while the gains are distant and dispersed. It is only natural for a worker whose job has been exported overseas or a farmer whose livelihood has been destroyed by cheaper imports to be angry. The dislocations from globalization are real, especially to its short-run victims. In addition to policies that effectively facilitate adjustment and reallocation, what is required is a more compassionate state. This probably requires building a stronger social safety net and paying more attention to income inequality.

5. Concluding Thoughts

Economic globalization, or the breakdown of barriers to cross-border movements of goods and services, capital and labor, has already delivered sizable benefits to the world economy. To cite just one example, the flow of capital from capital-abundant rich countries to capital-poor countries enable firms in the latter to undertake productive investments while providing a higher rate of rate of return to savers in the former. However, the distribution of globalization's fruits has been quite uneven across countries as well as within countries, and this goes a long way toward explaining widespread hostility toward globalization.

As we noted earlier, the demise of the state under globalization is greatly exaggerated. In one sense, the state matters even more in a borderless world economy. To be more specific, globalization magnifies the penalties for bad policies and the rewards for good ones because the consequences of policies no longer stop at the borders. Overvalued exchange rates not only keep away foreign investors, they also drive domestic capital abroad. Reducing red tape and corruption unleashes domestic enterprise, and at the same time brings in foreign capital and know-how.

Interestingly, globalization has not perceptibly altered the definition of good policies. For example, some say that globalization forces governments to provide a well-rounded, world-class quality of life so as to attract top talent from abroad. But aren't governments supposed to try to provide the best possible living and working environment for their citizens in the first place, globalization or not? The only difference is that success attracts skilled foreigners in addition to making citizens happy. And, failure not only makes for unhappy citizens, but citizens who

emigrate, especially among the more able and thus more mobile.

This brings us back to an important point mentioned earlier, that the essence of globalization is greater competition. The discipline of greater competition due to globalization is not only relevant for firms and workers; it is equally relevant for governments. That is to say, just as globalization promotes competition among the world's firms and workers whose national borders offer them much less protection than before, so it is with the world's governments. The yardstick for measuring the quality of a government and its policies is no longer limited to the quality of other domestic political parties and their alternative policies. Rather, that yardstick is increasingly the quality of governments and policies in other countries. Under globalization, capital and labor can and do vote with their feet.

In short, the state is alive and well in our increasingly borderless world, especially in the sense that the quality of its policies play a big role in determining the impact of that world on national welfare. At the same time, that world serves as a powerful force for positive changes in the quality of the state's actions. Which gives us strong grounds for optimism about the future of both the state and globalization. The optimistic scenario is one of mutual feedback between globalization and policy quality leading to states that continuously improve their policies and a globalization process that brings about ever-bigger benefits for the world.

The Role of the State in an Increasingly Borderless World

First Prize-Winner, Students Category

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Summary

Governments have always played a dominant role in the development of a country's economy. However, as the world increasingly comes to resemble a single integrated market, with paradigms that are markedly different from what has come to be known as the Old Economy, the manner and level of government involvement needs to be re-evaluated. This essay first of all outlines the parameters of the new global economy, how these differ from the old economic model and the potential benefits and setbacks in embracing the new model. It would look at how this would affect policymakers as they seek to harness the global economy while safeguarding their constituents from its worst excesses. It examines the necessary creation of new roles, the redefinition of old roles, the decentralisation of decision-making power to market agencies, and the problems countries will face in creating a globalised, knowledge-based economy. Changes to social structures and priorities will also be explored. Finally it stresses the necessity of international co-operation and consensus building in order for the fruits of globalisation to be more equitably distributed.

Introduction

The collapse of Communism and its advocacy of central planning in the preceding decade has been seen by many as the final triumph of capitalism. At the same time, developments in Information and Communications Technology have reached critical levels, enabling information to be processed and transmitted at a low cost on a large scale, with profound effects on lifestyles and businesses. In the following years, the world has come to resemble an integrated market, presenting us with an array of challenges. Chief among these is the necessary re-evaluation of the role of the government.

Globalisation: Definition and Parameters

Globalisation is an integration of people, cultures and countries everywhere. Economically, it represents the breakdown of traditional economic barriers—quantitative controls, tariffs and national monopolies. People, capital, goods and ideas have greater mobility than ever before.

The ICT revolution has catalysed this process. The Internet connects everyone with access to a PC and a modem, essentially creating a global marketplace. Its ubiquity has accelerated the process of knowledge diffusion, fuelling technological progress and enabling its fruits to be enjoyed globally and almost immediately. The lowered cost of knowledge has moved markets closer to the ideal model of perfect competition. Electronic mail, cell phone technology and other communications breakthroughs have enabled firms to expand their operations globally, where previously costly and inefficient communications processes limited command and co-ordination links between headquarters and branches. The advent of multinational corporations with interests spanning the globe has made the reversion to isolationism extremely costly. ICT offers governments an unprecedented opportunity to streamline bureaucracies, to eliminate red tape, and to better understand the circumstances of their countries and constituents.

Expectations of the quality of governance will rise. With a better understanding of global situations at the grassroots level, there will be an inevitable comparison between local and foreign conditions. Price and wage differentials will become immediately obvious. Governments who cannot meet citizens' aspirations will find themselves looking at an exodus of talent from their countries, or facing social unrest.

The economics of growth have been altered. Technology has improved the efficiency of agriculture and manufacturing. However, as markets for primary and low-end secondary products become fully exploited, this would also mean that these sectors would be shedding employees.¹ In the global economy, the greatest profit is derived from knowledge—knowledge of consumers' needs, of how to fulfil those needs, and fulfilling them better and more cheaply than your competitors.

Globalisation is more than an economic phenomenon. The shrinking of the world has magnified problems like environmental degradation and the rich-poor divide. Countries face ever-increasing intrusions on sovereignty, either through the expanded areas of jurisdiction of international bodies like the World Trade Organisation or the surrender of prerogatives to associations like the European Union. The ability of governments to influence the operation of

¹ This is true even for tertiary sector products. In an article from its August 10th issue this year, commenting on the lacklustre performance of AOL Time Warner (*New boss, same problems*), *The Economist* quoted Peter Kriesky of Kriesky Media Consultancy as saying, "When your market has begun to mature (referring to AOL's one-size-fits-all dialup service), you need to segment the market and develop a family of must-have services targeted to different customer groups."

economies is also diminished by the increased clout of MNCs, whose interests are not aligned with any particular state.

The New Role of the State

Among all the uncertainties of the new economic paradigm, the permanence of economic needs remains constant. This must be the utmost consideration as policymakers seek to meet the challenges of globalisation. Policymakers should not be encumbered by expectations placed on them to conform to a set of “acceptable” policies, and should continue to be guided by realpolitik dictates in policy formulation.

Countries should integrate with the world market in a manner and extent that is compatible with their state of development. There is no shame in erecting trade barriers when an economy is mostly made up of fledging industries. There is no sense in investing vast sums on so-called New Economy projects when a country lacks the requisite human and physical capital, and when a country’s comparative advantages obviously lie in other areas, like Malaysia and that country’s sputtering Multimedia Super Corridor. This is not to deny the many advantages of globalisation, but to make a case for understanding both these advantages and a country’s economic disposition, and for flexibility in the pace and manner of integration. Governments should retain powers of safeguard, to be able to intervene swiftly and effectively in event of market failures. Dr. Mahathir’s unorthodox response to the threat of a capital exodus—currency controls—has arguably saved Malaysia’s fledging financial markets and its economy from being laid waste by Mr. Soros and his associates.

Governments are instituted to insure the well being of the governed, of which economic welfare is only a part. Although developments, discussed below, may have diminished the conflict of interest between profit and social priorities, it is still hard to balance the two, and governments must remain committed to finding an optimal combination.

Legislation and Regulation

Capitalist economies are founded on the rule of law and the enforceability of contracts. Regulation has always been a key function of government. In the past, enforcement was easily undertaken—good and services traded were clearly defined, the opportunities for fraud and malpractice were foreseeable. However, the goods and services traded today are not as tangible, and the complexity of market operations lends itself to abuse, like the analysts in America who wilfully led their clients to invest in failing stocks. This situation exists in part due to an asymmetry of knowledge. Information is cheap and widely available, but not all people can make sense out of it—it will take even experts many months to unravel the accounting antics of Enron. It is often in the interest of knowledgeable parties to withhold this knowledge, because an edge in knowledge often translates into profit. Recently a letter was written to *The Straits Times* protesting the disclosure of customer databases by Singapore Power to third parties for commercial purposes, a grave violation of consumer privacy. Internet phenomena like mp3.com compromise the integrity of trademarks and copyrights.

A reform of old regulatory regimes is in order. However, in their anxiety to punish, governments may run a risk of over-regulation. Already there are concerns that the legislation and lawsuits slapped on post-Enron capital markets is suppressing one of America’s greatest competitive advantages. Applied carefully, regulation prevents malpractice. Applied excessively, it stifles business sentiments. Perhaps governments should keep in mind that the erosion of confidence generated by their own folly is the greatest punishment that errant businesses can receive. Governments should outlaw specific detrimental practices and not institute well meaning blanket legislation that burdens commerce with arbitrary restrictions. They should also understand that market developments often outpace policy formulation, and that a constant review and renewal of legislation is necessary for its relevance.

As consumers become better educated and in a better position to make informed decisions, governments should encourage them to rely less on state protection but to exercise the old market maxim of *caveat emptor*—buyer beware. As voluntary and informed participants in a legal, buyer-willing-seller-willing transaction, buyers can and should be expected to be fully cognisant of the risks involved in their purchases.

Besides the need to safeguard consumers' interests, there is also a need to provide a legal framework for the development of New Economy businesses. The validity of electronic contracts and mechanisms for their enforceability has not been addressed by many legislatures, despite the increased popularity of electronic commerce. The authenticity of contracting parties often cannot be verified. Countries who fail to clarify the legal positions of new businesses that fall outside of conventional definitions will be left out in the exploitation of new niches.

The Enron and WorldCom accounting scandals provide ample evidence of the fallibility of even the most transparent and vigilant regulators in the world. The changing world will continually test the integrity and adaptability of established institutions. Corruption and abuse continue to be rampant in countries like China, where civil servants are underpaid and government watchdogs are either toothless or themselves partners in crime. Governments must exercise zero tolerance of corruption and incompetence, and uphold transparency and legality. Only then can investor and consumer confidence be sustained.

Economic Role

As mentioned earlier, the dominant source of growth in the global economy will come from the ability to innovate, to create niche markets and enrich existing ones. The challenges for economic policy in the global economy would be to ensure a smooth transition from an agricultural and manufacturing centred model to a knowledge-based economy, to secure investment and to ensure flexibility and resilience in the face of increased volatility.

Even with the best of economic and political climates, the creation of a knowledge-based economy will be fraught with difficulties. A developing country's education policy is usually oriented towards producing engineers, technicians and other production line related expertise. A dearth of managerial and operational expertise is likely to limit competitiveness. Developing economies are characterised by a predominance of large firms reaping significant economies of scale, with a negligible Small and Medium Enterprise presence. Firms like South Korea's *chaebols* and Japanese conglomerates are notoriously inert and reliant on "winning formulas" concocted decades ago. Protected by pork barrel politics and domestic barriers to entry, these firms have no incentive to spearhead the innovation that is crucial to a knowledge-intensive economy. The exploration of niches is a long and not necessarily fruitful process, as the bursting of the dotcom bubble evidenced. While a country seeks to define its areas of competitive advantages, structural and frictional unemployment can derail progress.

The government's role as investor-in-chief remains important. As in the Old Economy, governments are more able to undertake riskier, costlier ventures where returns are not immediate—the Singapore government has invested upwards of US\$700 million into developing a biotechnology sector² as our competitive edge in manufacturing is whittled away by Chinese competition. In the absence of protective barriers, government investment has become a formidable tool to ensure domestic competitiveness against international corporations. The onus is on countries with large public sectors to ensure that those companies are subjected to market rigours, that management is competent, and that continual processes of consolidation

² Asia Private Equity Review, June 2000

and rationalisation are in place. Businesses not relevant to strategic needs or the development of domestic niches and competitiveness should be privatised.

Knowledge has replaced mass production as the basis of wealth creation. Governments have to pay especial attention to how innovation happens, and make sure it does. One way to do this is through patent policy. If firms can expect to profit from a legalised monopoly of breakthrough technology or through licensing their innovations, then they are more likely to come up with new ideas. Countries where intellectual property rights are poorly enforced, like China, are unlikely to attract knowledge-driven, high value-added industries. On the other hand, the dissemination of new technology benefits society at large, contributes to economic and non-economic welfare and inspires further innovation. Governments must reconcile the conflict of interest between facilitating innovation and spreading its benefits.

Tied to the need to innovate is the need to create a comprehensive and dynamic education system. Demanding East Asian education systems have churned out thousands of technicians that helped their countries complete their industrialisation drive and surge ahead of resource-rich but human capital-poor countries like Brazil. Now the challenge for these countries is to encourage entrepreneurial spirit and innovation in risk adverse populations. A greater emphasis on social sciences and the humanities would provide a more diverse talent pool. Employers should recognise that sending employees for skills upgrading would bear dividends and be given incentives for doing so. The workforce should understand that upgrading increases its employability in the face of the ever-diminishing shelf lives of skills and products. Education systems should take note of the diffusion of knowledge between once-demarcated disciplines—Wall Street financiers employ physicists to conjure up the financial instruments and investment strategies that has made New York a world financial hub.

The greatest dynamism in the global economy will come from small firms, with their greater sensitivity to market fluctuations. Having no market muscle they are reliant on anticipating future demand, and in areas like software development they often lead larger firms in fulfilling specialised needs. With their informal work cultures they are more flexible than their larger counterparts and are often the first to rebound from recession. Governments should recognise the role small firms play in identifying demand patterns, eroding monopolistic dominance, and galvanising large firms to undertake their own R&D to catch up. Stringent bankruptcy laws should be eased to reduce the cost of failure. Banks should be encouraged to extend credit to small businesses without the ability to provide collateral. Given their comparatively small turnover, governments lose little in taxing them lightly. Complicated bureaucratic processes should be streamlined—perhaps rules of thumb like not more than three forms to start a company can be adopted. In their efforts to promote homegrown companies with international stature governments must bear in mind that providing opportunities for SMEs to flourish makes for more balanced growth and greater overall resilience.

Governments should realise, in their efforts to make countries more attractive to investors, that they should not only be concerned with the sheer volume of investment but also the nature of investment. As barriers to the movement of capital are removed, countries should not be surprised that they are losing cost advantages driven investment to markets like China, which received US\$40 billion in foreign direct investment in 2000³ alone. Rather, governments should be concerned about the amount of investment received in a country's areas of competitive advantages. This would be a crucial indicator of a country's ability to differentiate itself. Silicon Valley, the cradle of the information technology revolution, received US\$21 billion in venture capital investment in 2000, despite sky-high operational costs. Even after the demise

³ Newsweek, September 3, 2001 *The Spread of China Inc.*

of the dotcom bubble, investors still ploughed in US\$6 billion, hoping to be in position to ride the next boom⁴.

As barriers to mobility break down, as employment becomes international in nature, the exodus or the influx of talent has become a top policy concern. On the surface the scramble for foreign talent seems like a zero sum game. Yet governments cannot take any significant, explicit action to insure countries against a brain drain. Perhaps a new perspective on this thorny issue is in order. People are attracted to opportunity. When a country is not receiving its fair share of talented immigrants, it needs to ask itself: do its people lack opportunity at home? Many Japanese find this to be the case. However, even net exporters of talent need not be dismayed—foreign enclaves of your own people are beachheads for further investment and expansion in that country. The Jewish and Indian diasporas are examples of communities that remain strongly attached to their homeland after generations in a foreign land.

Social Policy

The effects of globalisation are not restricted to the economy. As businesses and society gear up to meet the challenges of a fast-paced world, traditional values and lifestyles come under siege. Negative externalities generated by industries are felt more acutely as population densities soar. There is no simple approach to the complex challenges posed to society by globalisation.

Social structures and priorities are undergoing a transformation. The nuclear family's cohesiveness has been eroded by the high incidence of two working parents. Income gulfs have widened, sometimes coinciding with racial divides. Instead of a hierarchy based on caste or race, a social order founded on merit is emerging. An increasing competitive and commercialised society is in danger of leaving behind the disadvantaged and forgetting such intangibles like the arts and graciousness. Governments can increase job security and benefits for part-time workers, who are often parents who work and take care of their families, or giving grants to budding artists. Subsidising basic education, healthcare, and housing, levels the playing field and ensures an equality of opportunity. Most importantly, governments will send a strong signal that a nation is defined more by these intangibles than by its economic prowess.

The global reach of businesses has exacerbated the problems they generate. Encouraging consumer activism can complement the regulatory function of government in combating these problems. By working with interest groups, and through the ubiquitous mass media, governments can benchmark firms according to compliance with labour statutes, levels of pollutant emissions, efficient energy usage and raise awareness of the relevance of these indicators. Consumers can then actively discriminate between firms that adopt best practices and those that do not. There is therefore a dual pressure from regulatory bodies and market forces that would compel firms to update their production processes to adhere to environmental and social standards. Governments need to stress that the goals of profitability and social responsibility are not exclusive—efficiency boosts profits, investment in education and respect for labour rights boosts productivity and motivation, environmental responsibility enhances public image. In combating old problems like unemployment, governments must mix compassion and discipline—retraining criteria must go hand in hand with providing unemployment benefits. As fish become more elusive, people must be taught how to fish.

International Relations

The world has become so organically linked that countries ignore their neighbours' woes at their own peril. The EU's new eastern frontier is threatened by crime and poverty in Ukraine, Belarus and Moldova. September 11 showed how threats to our common security, working

⁴ BBC, January 25, 2002 *Hope lives on in Silicon Valley*

through increasingly porous societies, have also become globalised. In 1999 official development assistance to developing countries stood at US\$5.6 billion, a paltry 0.24% of the net GDP of the principal donors⁵. Developed countries need to be more generous in forgiving debt, transferring know-how and removing barriers to Third World exports. Consensus and co-operation between nations, along with the integrative effects of globalisation, will lay the foundation for a more equitable world, principled and prosperous, free from want and fear.

Conclusion

It would seem, therefore, that the explicit and implied responsibilities of governments have not diminished in a globalised world. Rather, they have changed in nature, from economic direction to regulator, from leader to partner. Governments must embrace their new roles with vigour and alacrity, for although it cannot be said if things would get better if we change, we must change if things are to get better.

⁵ World Trade Organisation, Economic Research and Analysis Division—*Globalisation Statistics 2001*

The Role of the State in an Increasingly Borderless World

Second Prize-Winner, Students Category

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Summary

This paper highlights issues which states face in this era of globalisation, and explores policies that governments can take to overcome them.

In an interconnected world, states are more interdependent, with the integration of factor flows, product and financial markets in the global marketplace. This poses certain challenges: increased foreign competition hastens the destruction of inefficient industries, causing greater unemployment; the liberalisation of capital markets and the resultant volatility in global short-term capital flows potentially destabilises countries. The increased mobility of people and capital results in greater competition for both FDI and labour. Globalisation extends the influence of the new knowledge-based economy, putting emphasis on technological creation as a medium for growth. The over-concentration of trade and investment in certain regions leaves countries more vulnerable to economic contagion. Finally, globalisation creates the impetus for international cooperation to solve problems relating to the world economy.

States can respond in several ways. Domestically, labour mobility and productivity can be enhanced with a greater emphasis on human capital development. Indigenous innovation should be promoted with greater government expenditure on R&D, a rethink of current institutions and policies, and the cultivation of 'technopreneurs'. Local firms can be persuaded to diversify into untapped overseas markets for investment and export growth. There must be a cultivation of ties between the state and her growing overseas citizenry. Financial institutions should be strengthened to guard against excessive capital flows. Improvements to infrastructure and reducing business costs can foster an attractive investment climate for foreign investors. Internationally, states will require greater diplomatic dexterity in cooperating to draw up the framework for international trade and finance, and ensure free trade.

In conclusion, globalisation is a double-edged sword, and by remaining relevant in the world economy, states can turn apparent challenges into opportunities for growth.

Introduction

We are all living in an interconnected world. The 'global village', once a concept confined to the realm of science fiction, has with technology become a reality. In such an environment, engagement with the international community is no longer an option, for it is now imperative for states to remain relevant to changing global trends. This phenomenon has become known as globalisation, and in the past few decades, it has transformed the worldwide economic landscape, with the promotion of free trade, deregulation and the privatisation of nationalised industries. Globalisation has spurred the growth of new industries in areas such as Information Technology (IT), leading to the coining of the term "Knowledge-Based Economy" to describe the future trends in economic development. But globalisation has also exacerbated existing problems within and among countries, and created new ones. For example, the divide between rich and poor nations has widened, and the income gap within most countries has also increased. Economic contagion has become a feature of the past decade, with the financial crises affecting Mexico, Brazil, Argentina and Thailand spilling over to neighbouring countries and destabilising entire regions. All this has been attributed to the force of globalisation.

In this essay, I will discuss the challenges posed by globalisation, and the various policy implications this has on government policy-making.

Defining Globalisation

Globalisation refers to the integration of factor flows, product and financial markets into the global marketplace. Nation-states have become more interdependent, politically as well as economically. This interdependence has grown dramatically in the past few decades, affecting the ability of governments to respond to economic issues, and altering the tools available to them to do so.

Globalisation works on several levels: first, transport and communications have improved, with a corresponding fall in costs, with the growth in air transportation and the IT revolution. Second, international trade and capital flows have increased as trade barriers fall and governments reduce restrictions on the flow of capital abroad. Between 1970 and 1997, over 102 countries removed foreign exchange controls.¹ Third, giant multinational corporations (MNCs), of the likes of Sony and Glaxo Wellcome, continue to expand into overseas markets, resulting in a great deal of foreign direct investments (FDI) flowing into countries. On a global scale, FDI inflows from 1991 to 2000 actually jumped six-fold from US\$202 billion to US\$1270 billion!² Lastly, consumer tastes in various products, from soft drinks to fashion, have become more similar, as a result of the interaction of different cultures around the world.

Challenges in a Increasingly Borderless World

As a result of globalisation, physical barriers that divide countries become less significant, and people and capital are able to pass through national borders with much greater ease than in the past. The world becomes more interlinked, with factor flows, product and financial markets integrated into the global economy. The challenges posed by globalisation are listed below. They concern the fundamental structure of the economy, and must be met with by effective government policies.

i. Increased competition from other countries in international trade will accelerate the destruction of inefficient firms and industries, as they are unable to compete in the new global marketplace of many different competitors. This will destroy secure jobs for a great many employees, and cause large-scale unemployment. Long-term structural unemployment may increase with the greater rate of structure upheaval in the economy. In the meantime, the

¹ Sloman (2002)

² UNCTAD Online Handbook of Statistics, stats.unctad.org

beneficiaries of globalisation will see their incomes rise dramatically. The widened income gap requires government intervention, in the form of a “helping hand”.

ii. With the liberalisation of capital markets, the growth of the financial and banking sector tends to outpace the growth of the real economy, as seen in many developing economies. However, there is often a lack of adequate safeguards to ensure good corporate governance, as well as the political resolve to enforce the rules. The premature lifting of capital controls has resulted in large short-term capital flows between nations. This may lead to instability in a country should there be a mass-migration of short-term funds out of the economy. Crises will ensue, as can be seen from the experiences of the Asian and Latin American economies in the nineties.

iii. The increased mobility of both capital and people in a global economy means countries must step up their efforts to attract and retain them, resulting in greater international competition for foreign direct investment (FDI) and skilled labour. Migration policies among countries are sifting towards barring the entry of unskilled labour while accepting highly-skilled manpower. The ability and temptation for talented individuals to migrate overseas will require states to come up with policies that prevent a brain-drain in the workforce.

iv. The IT revolution, riding on the back of globalisation, is transforming the economies of many developed and developing countries, including those in East Asia. The new economy requires countries to attain a high level of technology so as to tap the new markets that IT opens up. Countries must shift their emphasis from focusing on capital accumulation to increasing their investments in research and development (R&D), while equipping workers with the necessary skills for such an economy. With the IT age, a new engine of growth, ‘technopreneurs’, or technology entrepreneurs, has also risen into prominence.

v. Nation-states realise that they are no longer fully in control of their domestic market. Trade and investment linkages expose countries to economic contagion. Globalisation has created greater interdependence between countries, encouraging governments to work together, on both a regional and a global level.

Domestic Policy Implications

Globalisation and the new economic environment it creates require governments to review existing domestic policies on labour, science and technology, citizenship, banking, trade and finance. The following addresses the changes that will have to be made in these policy areas, with reference to East Asia and the Singapore economy, in greater detail.

I) Improving Labour Mobility and Productivity

Unemployment that results from structural changes in the economy is a key feature of globalisation. Structural unemployment stems from workers not having the required skills to undertake new jobs that are created by the knowledge-based economy. This is particularly so if workers are less educated, as they will be less occupationally mobile. To tackle this, workers must be retrained to be able to cope with new technology and machinery. Training programmes and facilities can be provided, together with government incentives for workers to retrain. Retraining also serves as a useful measure to reduce wage inequity by closing the skills divide that separate the lower and higher income groups. In Singapore, where 62.1% of the workforce has secondary education and below³, this is covered by schemes such as the Skills Redevelopment Programme. The lack of job insurance in most East Asian economies tends to further persuade workers to take up new skills.

³ Annual Manpower Statistics 2002, Ministry of Manpower

Strong trade unions can also bring about unemployment by keeping wages at artificially high levels. This discourages firms from employing more people. Moreover, wage increments that exceed productivity gains result in higher costs to the firms and reduce its competitiveness. Trade unions also hamper a country's restructuring efforts by resisting layoffs. The solution is for states to diminish the power of trade unions, either via legislation or state-sanctioned arbitration. States should make it easier for firms to hire and fire, and reduce wage rigidities in the labour market.

Governments should also view the development of human capital as a competitive strategy to attract foreign investments and boost productivity. To start with, the education system should be revamped to discourage rote learning, emphasize creativity and research, and create enterprising, visionary leaders. Education must keep pace with rapidly changing technology and teaching methodology. Indeed, the modern theory of human capital development is not simply about increasing the time one spends being educated, but increasingly, also about improving the quality of the education one receives.

Likewise, states ought to reduce their reliance on foreign unskilled workers, and step up efforts to attract highly-skilled people from abroad. States that give firms easy access to foreign unskilled labour will impede the industries' restructuring process and depress local wages, while lowering the skill profile of the workforce. This will lead to long-term inefficiency and a loss of competitiveness in these industries. Highly-skilled foreign labour, on the other hand, can share their expertise with the local workforce, leading to technology transfer. Skilled labour is often in shortage, resulting in structural bottlenecks that limit industry growth. The influx of such individuals can help to resolve such bottlenecks, raise productivity levels and increase employment opportunities for the economy as a whole. In Singapore, such 'foreign talent' are attracted via a change in immigration policy, encouraging them to settle here permanently, and low income taxes. Construction firms are also discouraged from employing unskilled foreign labour as they incur higher levy payments.

Developing and increasing the pool of human capital will thus enable states to increase their productivity and international competitiveness, while reducing unemployment. In addition, a more mobile labour market can contribute to the diffusion of know-how through the workforce.

II) Encouraging R&D and Technopreneurship

Technology is the driving force behind the new knowledge-based economy created by globalisation. However, many countries, in particular Singapore, tend to be over-dependent on technological transfer from foreign MNCs based in the country. Hence, there is a dearth of indigenous research and development (R&D), which requires states to implement a national science and technology policy to promote it.

Such a policy would, first and foremost, necessitate that the state increases government investment in R&D activities to levels comparable with advanced industrialised countries. Industrialised countries like the US and Japan spend 2.84 and 3.06 percent of their GDP on R&D, while Singapore and Taiwan pale in comparison, with a R&D/GDP ratio of 1.84 and 1.98 percent respectively⁴.

Further, states will have to focus on basic research, and not just applied research to gain a more lasting competitive advantage in the market. Emphasis will have to be placed on creating break-through technologies and anticipating future problems of industries. Producing many copycat technopreneurial start-ups based on existing technology often points to a lack of technological depth, and these may be easily overtaken by foreign competition. On the other

⁴ National R&D Survey of Singapore, 1999, NSTB (2000)

hand, places like Silicon Valley and Israel, with their strong focus on basic research, are able to produce cutting-edge technology consistently that are more resistant to foreign competition.

Encouraging local entrepreneurship should be central to a government's science and technology policy, in order to develop a solid local technological base to break into the large and sophisticated markets of industrialised countries, such as the US and the EU. In this respect, the presence of venture capital funds is imperative in financing technopreneurial start-ups, since other financial institutions will be unwilling to fund such high-risk activities. Countries should also reduce the amount of red tape regarding the operation of such start-ups. In Singapore, a US\$1 billion technopreneurship fund has been set up, which together with new bankruptcy laws and taxation rules, seeks to attract more local technopreneurs to set up shop. In addition, up-and-coming economies such as China are vying for a share of the global manufacturing pie. To maintain competitiveness, states must produce more value-added goods and services, and shift away from low-end manufacturing. This shift up the production ladder can only be accomplished by investing in technology.

Ultimately, institutional changes must occur for an indigenous science and technology policy to be effective. There must be a realignment of current institutions and policies to fit with the new science and technology. The education system must focus more on the elements of risk-taking and creativity to nurture more entrepreneurs, for example. Institutional innovations that have succeeded in other countries, such as the R&D consortium model in Taiwan and the "Incubator Management Company" model in Israel, should also be adapted to facilitate institutional change.

III) Diversification of Export Markets and Overseas Investments

Globalisation has spurred the regionalisation process, whereby neighbouring countries come together to increase trade and firms expand into overseas markets. However, this may lead to an over-concentration of investments and export earnings in a particular region, and any instability there will have serious repercussions on the well-being of the state economy. The Asian financial crisis in 1997 showed how countries in the region, heavily dependent on each other for trade and investment, were all badly affected by the economic contagion that emanated from the financial collapse of the Thai economy. This underscores the need for countries in the region to look beyond their immediate surroundings in search of new export and investment markets.

To decrease the state's dependence on her neighbours, governments can persuade local firms to 'internationalise' and take full advantage of the new markets opened up by globalisation, by pushing beyond national and regional boundaries to tap the bigger world market for export and investment. The benefits to firms, after all, are numerous, they can achieve higher efficiency (via lower labour costs etc.) and greater economies of scale, exploit superior foreign technology and ultimately lower product costs and get higher returns on their investment. To this end, the state can offer financial incentives to firms that invest in non-traditional markets like Latin America and Eastern Europe, or even shoulder some of the risk of venturing overseas, as the EDB is doing in Singapore by offering to share some 70% of the risks in overseas ventures involving firms.

IV) Maintaining Links with a Global Citizenry

With greater international flow of labour and the migration of people between countries, more and more people will be living outside their countries of birth. Many developing nations, such as India and the Philippines, now depend on their diaspora for remittances to support their economy. States will have to adapt to this development by adopting a more flexible attitude towards citizenship, and cultivating closer ties with their overseas citizenry.

States may allow for a more accommodating policy of dual citizenship. This can sustain the bonds between a country and her diaspora, and enables migrants to feel equally attached to both their country of origin and their adopted home. Steps may also be taken so that nationals working overseas maintain links with their mother country. Embassies and consulates can facilitate the setting up of clubs to foster greater interaction among the expatriate community and their relatives back home. The building of schools overseas allows expatriate children to be educated in line with the domestic education system. Singapore has an organisation known as the Singapore International Foundation, which through its vast network of publications and activities, enable overseas Singaporeans to remain informed about domestic developments. Furthermore, states should provide opportunities for overseas citizens to return home and work, so as to prevent a brain-drain of talent overseas. Specialists and professionals, in particular, bring back from abroad precious experiences and skills when they return to take up jobs in their home country.

V) Strengthening of Financial Institution

The financial crises around the world in the last decade exposed a serious flaw in many of the crisis-hit countries – a weak banking and financial sector. While most advanced Asian economies already have strong banking regulations, there is still a need to ensure banks are more transparent in their operations, improve their accounting standards and maintain sufficient solvency. There should also be regulations in place to reduce short-term borrowing by local banks in order to prevent future liquidity crises.

Due to the volatile nature of foreign short-term capital, states may prefer to put in place certain capital controls to stabilise capital flows in and out of a country and curb speculation. In this respect, Singapore has a long-standing policy of disallowing bank lending in local currency to foreigners. Also, to avoid the over-reliance on overseas funds to finance local investments, countries can develop long-term bond markets. In this way, domestic savings can be channelled into local instead of overseas investments, and the risks of sudden short-term capital outflows destabilising the economy.

VI) Maintaining an Attractive and Stable Investment Climate

The rise of China as an economic power on the world stage with its entry into the WTO, together with the increased mobility of capital, signals a more competitive global environment for foreign direct investment (FDI). States have to meet this challenge by investing in infrastructure and enacting measures that reduce the costs of doing business, so as to make themselves more attractive for foreign investors. Corporate tax cuts are a popular means to lure foreign companies to set up here, but the government will undoubtedly suffer a reduction in its revenue. Revenue collection thus has to come from other sources, such as indirect taxes on consumers and greater cost reclamation from the provision of public services. This can, however, make income more inequitable, and creates a dilemma for most governments that choose to reduce the amount of direct taxation on companies by levying an indirect tax on households.

The growth spurt in many countries brought about by globalisation has also led to increases in the price of non-traded goods and services. Left unchecked, the rise in prices can result in exports losing price competitiveness, and lead to the formation of speculative 'bubbles' in certain assets, such as property, encouraging capital inflows. The inevitable bursting of such bubbles, when foreign investors realise their folly and pull out, can be disastrous. Hence, the solution is for states to increase productivity in the non-traded goods and services sector in order to control the rise in prices, and monitor the growth of any speculative 'bubbles'.

External Policy Implications

The growing interdependence of world economies and the increased volatility arising from globalisation tends to encourage states to seek greater cooperation with each other in dealing with international economic issues. Such cooperation can exist in the form of coordination of economic policies among nations to stabilise the international business cycle and prevent worldwide recessions, and the strengthening of international lending agencies to circumvent the financial crises that have arisen in the past decade. This section deals with how countries can cooperate with each other to reduce the perils of globalisation.

Greater trade among nations creates the impetus for states to come together to create rules, such as those pertaining to intellectual property rights protection, and resolve disputes in international trade. This was the reason behind the creation of the WTO. Countries should also join hands in promoting free trade for mutual benefit, either by signing free-trade agreements or by becoming members of regional trade bodies such as APEC, ASEAN and NAFTA. In this way, more markets can be freed up for foreign competition, allowing all parties involved to gain. The removal of the remaining barriers to free trade is especially important to developing agricultural economies in bridging the rich-poor country divide, as their produce is still prevented from entering the European and American markets by extensive protectionistic policies that shield EU and US farmers from competition.

World financial bodies like the IMF and the World Bank enable states to work out a principal framework of regulations that can be internationally implemented to smooth out problems with international finance. Global issues that require inter-governmental cooperation include: the need for an international lender of last resort to solve sovereign liquidity problems; and reducing the volatility of international capital flows, perhaps via the imposition of an international Tobin tax⁵ on foreign exchange transactions.

However, seeking international cooperation is not so straightforward in practice when states have conflicting goals and policy objectives. Then, they are likely to see each other as competitors, rather than collaborators. The challenge is to seek out common ground, and this will require greater diplomatic dexterity, especially with the growing complexity of issues and the increasing number of parties involved. In this respect, problems may be easier solved with domestic policies than with international relations, since with the latter it is harder to reach mutual consensus. Furthermore, states that become members of regional and world groupings may have to give up some sovereignty and the ability to make certain individual economic decisions, since such decisions must be taken in consultation with other countries, as can be noted from the process of economic integration within the European Union.

Concluding Remarks

This essay has examined the ways in which governments can better plug into the world economy, by considering how the various issues that come with globalisation, including greater competition, the importance of technology and human capital, increased mobility of factor flows, and the strength of financial institutions can affect states. The different policies, both domestic and international, which states can employ has also been discussed.

In the final analysis, globalisation is an unstoppable force that is transforming patterns of trade and investment between countries. It generates pressure for governments to pursue sound and effective financial policies. Globalisation indeed poses new challenges to governments of individual states, but is a double-edged sword, and by adopting measures to cope with the new realities brought about by the phenomenon, states can turn these challenges into opportunities for growth instead.

⁵ Tobin tax – A tax on foreign exchange transactions originally proposed by Yale Professor and Nobel laureate James Tobin, to control capital flows and provide a useful source of revenue.

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The Role of the State in an Increasingly Borderless World

Third Prize-Winner, Students Category

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Summary

The breaking down of longstanding traditional barriers in mindsets as well as physical barriers has brought upon us the new challenges of the increasingly borderless world. In this new environment the role of the state must adapt suitably to changes, preserving both the balances of the old as well as paving new inroads to tackle the new challenges of the future. Only by embracing these changes and responding to the challenges will the nation continue to prosper. My essay looks at the traditional roles of the state in regulating the economy so as to form a basis of evaluation of old policies in comparison with the new present day environment. It then seeks to isolate the fundamentals of the old that are still nevertheless pertinent in our modern day context. The importance of guidelines and regulation in business practices are a case in point to improving welfare of the country's residents. Building upon these past strengths and learning from past failures, my essay seeks to show how we can hence adapt to the new world through government policies which emphasize the role and importance of free trade that benefits our country in this increasingly globalised environment. Next, the essay examines the key role of innovation and change in order to progress. The role of the state, with regards to sacred cows and promoting enterprise is discussed. Fundamental structural changes in the industry which are to be implemented by the state are addressed. This essay argues for economic integration as a means to achieve the ends of economic growth in the face of increasing competition. Finally, this essay concludes by cautioning against destabilizing the balance between the need for allowing economic freedom while guarding against the dangers that arise from the lack of regulation.

Introduction

The last decade of development has seen a pronounced shift in the focus of the global economy. The new world has seen the breaking down of many long-standing traditional barriers. A wealth of opportunities have arisen. The catchphrase 'New Economy' stresses the importance of knowledge, talent and entrepreneurial spirit in the globalised arena. Countries not embracing change are left behind.

In this setting of rapidly changing global outlooks, the role of the state has come under increasing scrutiny. Traditionally entrusted with the task of safeguarding interests and social welfare, government policy is gradually evolving in order to better face the mounting challenges of the very immediate future. To meet these trials, the state should seek to capitalize on the benefits while minimizing on the harmful influences of globalization.

Traditionally, state objectives in implementing public policy have been due to the following. The main priority of any government is the improvement of the standard of living and welfare of residents in the country. To accomplish this, government policy seeks primarily to achieve socio-economic stability. This is managed by ensuring that firstly, price fluctuations in the marketplace are at a minimum. Controlling inflation is also another priority in order to be able to reduce economic uncertainty. Balance of payments and foreign exchange are also regulated to protect the domestic economy from the rigour of international market pressure and to minimize reliance on foreign economies. In addition, public policy has to address the failure of market forces to allocate resources efficiently. Public goods, like national defence, have to be provided for the people. Consumption of socially desirable merit goods, like health care have to be encouraged through subsidies. Socially detrimental consumption, like smoking, have to be deterred. Social welfare demands the equity of income distribution through the use of policies such as progressive taxation. Unemployment rates have to be kept low to minimize social discontent. And lastly, economic growth remains a fundamental priority of any government, in order that the nation may progress.

However, it is perhaps fitting that at the turn of the millennium, we should seriously seek to reevaluate the tools of our government agenda in facing the new challenges of an increasingly borderless world. Globalization links the world. In the past decade, economic integration has occurred at an unprecedented level. Today, Europe stands united, utilizing a common currency within a common market. The North American Free Trade Agreement (NAFTA) forms a trade bloc involving the most powerful economy in the world. The entrance of China into the World Trade Organization this year, and the re-emergence of many of the East Asian 'tiger economies' after the Asian Financial Crisis, has attracted trillions of dollars in trade and investment into the high growth potential region. Increasingly, multinational organizations grow in wealth and power. Worth billions, firms like Cisco, Sun Microsystems and Vodafone are able to attract top talent via offering top wages. Mergers and acquisitions lead to the rapid buildup of lucrative international market share. Armed with expertise and capital, these firms are able to infiltrate worldwide domestic markets, intensifying competition against local firms. Local firms and ill-equipped economies may become marginalized by increasing levels of international competition. The threat is ever present. Thus, the state must strive to do its part in ensuring the continued prosperity of the country in an increasingly borderless world.

Importance of fundamentals

Yet, even as we seek to reinvent ourselves to succeed in this more open and brutally competitive environment, we must take care to preserve several fundamental aspects of our existing government policy. Even as new objectives strive to claim consideration as priorities in our nation's planning, several of our 'old economy' principles should remain as they will continue to serve us well in the future.

One such objective that should continue to be a priority of state policy is the continued development of infrastructure within the country. As globalization leads to the opening up of domestic industries to intensified foreign competition, firms must seek to provide higher levels of service in order to attract and retain clients. The role of good infrastructure in aiding these firms has not diminished, but instead only grown in importance, providing an essential platform from which local firms are able to compete more successfully. An illustration of the benefits of good infrastructure in aiding a firm to succeed in the global economy can be found in PSA Corporation. One of the primary reasons why PSA Corporation is able to out-compete its competitors in the provision of global transshipment services, is due to its effective integration of physical and electronic resources, to provide unparalleled levels of service to its clients. In the new economy, firms should seek to achieve such seamless operation. All aspects of PSA's operations are totally managed by its CITOS computer network, enabling over 200 containers to be first unloaded from a single vessel in under an hour, while simultaneously assigning trucks to transport these containers to warehousing facilities, allowing the shipper to achieve a turnaround time of less than a day. Good infrastructure makes this possible. Investment into infrastructure should continue even in times of economic downturn. Government expenditure to build a good transportation and logistics network, develop information technology linkages, as well as liberalization of related industries to promote efficient, low cost provision of utilities will reap exponential returns in allowing local industries to achieve higher levels of operational efficiency to outcompete its foreign rivals and succeed in a fast paced global economy.

In addition, while political and social stability were considered to be the prerequisites for growth in the yesteryear, they cannot yet be overemphasized as we move forward towards an increasingly borderless future. As more multinational corporations seek to invest in opportunities overseas, one of the main deciding criteria would be how conducive the political climate would be towards business operations. High-technology capital and expertise are especially essential in expanding industries with greater dynamic potential. A case in point would be the emphasis by our country on the sectors of electronics and biotechnology. Capturing potential multi-billion dollar investments required for their startup boost a country's growth substantially. State policy should seek to encourage precious investment through the use of incentives such as tax relief, and schemes that seek to provide attractive measures, such as good infrastructure, provision of a firm support base of related industries and government grants for startups and innovation in related fields. However, governments should not fail to neglect the socio-economic aspect of the borderless world. Issues of welfare and stability should not be compromised, especially in the face of increasing vulnerabilities such as civil tensions from widening income disparity or spread of crime and undesirable lifestyles. Women in El Salvador are paid just 84 cents for every \$194 jacket they sew, or 0.4% of the selling price. The role of the government, is thus not only to attract foreign investment into the country, but also to safeguard the welfare of domestic workers. Economic development at the expense of worker exploitation and human rights is not an attractive prospect.

The basic role of government intervention should seek to correct market failure as well as to provide an adequate legal platform for the industry to operate upon. Today, more than ever, the government needs to clamp down harshly on corruption and business malpractices such as can be seen from the impacts of recent accounting sagas like the Arthur Anderson and Enron saga. Trust is a fragile thing, the loss of which can lead to even multi-billion dollar firms like Worldcom collapsing overnight. Government regulation cannot be overemphasized with regards to fundamentals such as transparency of accounts. Global firms come to possess increasingly unrestricted power which spread across national demarcations in a borderless society. Their actions result in global repercussions. When Arthur Andersen was declared bankrupt, thousands of employees from worldwide branches were laid off and billions of dollars of deals were lost globally. State watchdogs need to regulate firms to a certain degree in order to ensure proper business proceedings. A harsh hand needs to be dealt by today's state institutions to maintain the mechanisms of the market

As state policy strives to carry us into the uncertain world of the future, it is also essential that we learn from and avoid repeating the mistakes of the past. While it is important that state policy should target high growth rates, caution should yet be judiciously exercised in not allowing the country to succumb to hype and 'bubble building', such as illustrated by the internet bubble of the 90s, as these are just time bombs waiting to explode. For example, an important aspect of state policy should continue to be the need for sound monetary policy. Lessons can be learnt from the hyperinflations of South American countries like Brazil and Argentina. In a borderless world of more trade linkages, sound management of a country's exchange rate policy is necessary as currencies become increasingly vulnerable to international fluctuations. If states are too enthusiastic in credit creation as a means to fund the new fast pace of growth, they could find themselves neck deep in debts and inflation, which would literally ground the economy to a halt. Thus, it is important in this new environment that caution continue to be exercised.

Adapting to the new world

Yet as we shift towards an age of reduced information and mobility costs, arguably, the core challenge of the state is for it to remain adaptable in the face of mounting challenges. In a world of shortening business cycles, rigid traditional models no longer offer all-encompassing solutions. Successful government intervention in a borderless world should be one that integrates flexibility, together with a philosophy of pragmatism.

Globalization is an irresistible force. The consumer is spoilt for choice by products flooding in from international markets. The recent entrance of China into the World Trade Organization is perhaps globalization's final triumph. Most countries today enjoy the benefits of free trade as well as face the pressures of increased competition. Globalization leads to increased prosperity for the nation. The role of the state is thus to embrace this new wave.

How can the state seek to facilitate the forces of globalization? One such method is in the area of free trade. Free trade implies greater efficiency, and provides many benefits in a borderless world, such as trade creation, where nations exporting according to their comparative advantages without any trade barriers are able to achieve a higher standard of living from increased output. The breaking down of traditional protectionist tariff barriers between nations help countries immensely in the face of intensifying global competition. For example, Singapore has recently negotiated a number of Free Trade Agreements (FTA) with various countries. This has given local firms an edge in competition over their rivals. Yenom Label Materials, a local producer of industrial-strength stickers saw sales to New Zealand jump nearly 80% after the announcement of the ANZSCEP FTA. Clearly, the benefits of trade liberalization cannot be denied.

Success in a free world has never depended so much on attracting investment. The role of the state is thus in working closely with international and multilateral organizations such as the World Trade Organization (WTO), ASEAN, APEC and ASEM, as well as seeking out bilateral agreements such as FTAs in order to facilitate the entry of global firms for the benefit of domestic markets. Free trade acts symbiotically with the forces of globalization. Open markets often reap the benefits of economic growth from capital and technological inflows. The government can thus work towards this objective via implementing a competitive corporate system of taxation, where firms are subject to ample tax deductibles and find sufficient incentive from remitted profits to continually enhance their operations while establishing a long term stake in the country's development.

A Pro-Innovation Environment

Innovation is the buzzword of the new global economy. Technological progress occurs at a breakneck pace. Moore's law states that the number of transistors on an integrated circuit

doubles every eighteen months. To lag behind the pace of innovation is to become obsolete. In order to remain competitive in an increasingly borderless world, it is imperative for the economy to remain receptive to new ideas and techniques.

What are the implications and how can the state accomplish this? In August 2001, business guru Michael Porter spoke at a New Economy Conference in Singapore about the importance of re-examining sacred cows, such as the role of manufacturing (in particular electronics) in our nation's economy. Similarly, the state must constantly seek to reevaluate the workings of its own economy. In today's world, the old adage of 'if it's not broken, why fix it' can no longer apply. Information transfer occurs at such a rate that often, better positioned competitors are always rapidly seeking to surpass you. While it is important to strive towards the higher service industry sectors, the state must also constantly be on the lookout for new niches of comparative advantage so as to plan for future sustainable growth. One such niche at present is the next push into biotechnological industries. Reinvention, or as so aptly stated, new ways of milking sacred cows, are also important. The state can play a huge role in promoting innovation. For example, expenses on research and development can be made tax deductible. Infrastructure for new niche industries can be developed.

However, perhaps most importantly, the state must seek to cultivate a conducive environment for innovation. Entrepreneurship and risk-taking, constantly looking for new methods to reap even greater gains, are key to success in this world. Industry pioneers must not fear failure. Creativity should be encouraged.

In this regard, the state can play its part by enforcing intellectual property rights to encourage innovation. Also, by investing in education, potential talents for research can be nurtured. Finally, aid in the form of interest free loans, and tax incentives for start up firms can be provided, to help build up a culture of entrepreneurship. These measures would go a long way in pre-disposing the economy towards innovation and preparing the country for the challenges of globalization.

Starting from the Basics

As of present, the most firms in underdeveloped countries are incapable of meeting giants in the cut-throat games of global competition. This may not be due in any part of physical constraints of population or resources. Scandinavian countries are existing proof. Despite their physical limitations, they have produced many of the globe's well recognized industry leaders, such as Nokia, Saab, Ikea. Rather, these domestic firms often merely require time for which to build up their firm size to a critical mass. Once they are able to acquire sufficient expertise and reap adequate economies of scale, they can then proceed to become successful global players. The role of the state in an increasingly borderless world is to thus ensure that their domestic players succeed on a global stage. Yet protectionism may not necessarily serve the best interests of domestic firms. Global competition, despite its unforgiving nature is the best means to spur a firm to efficiency. Rather than allowing domestic industries to consist of overwhelmingly inefficient firms which drag the economy down rather than pull it forward, the state should aim for rapid integration of domestic firms with the global market competition.

Government policies in an open world should seek to accelerate the integration of local industries into several dominant players for the world market. Despite recent concerns over the merger and acquisitions hype in the United States and Europe, they remain a viable means by which economies of scale can be rapidly achieved. Government policy can be formulated to aid domestic integration, such as via the relaxing of relevant regulation. While the state continues to play an important role in monopoly regulation, domestic monopolies are by themselves constrained internationally by the law of contestable markets. In a global economy, size matters. The big fish usually wins.

Moreover, in line with economic integration, the state can also facilitate the forces of globalization by implementing an open policy towards foreign talent. The role of foreign expertise in bringing firms to the next level of global competition cannot be understated. Simply put, it would be unwise to limit one's outlook to a smaller domestic population, where, with the eroding of global barriers, a much wider market of top talent lie at a country's disposal. One important measure for the state to make is the establishment of merit based wage scales and higher corporate rewards, in a bid not only to attract, but also to retain the very best talent to ensure economic success.

Conclusion – The new wave

In the face of increasing globalization, the main challenge is in accommodating the two pronged objectives of the government. On one hand, traditional enforcement of state regulation is important. Recent cases of accounting scandals, arising due to the lack of corporate governance illustrate this fact. The state needs to play a bigger role in enforcing regulation and firm transparency in order to safeguard the economy. Revolutionary fields with great economic potential, life sciences and stem cell research in particular, may lead to unethical practices which could be exploited for profit. To this end, state regulation is a must.

At the same time, the balance should not be neglected. An oppressive system of laws and restrictions would not successfully fulfill the twin goals of safeguarding as well as nurturing the economy. Policy must not inhibit innovation and entrepreneurship, because ultimately, these are the driving factors in achieving the primary aim of economic growth. Greater global cooperation in free trade and increased domestic incentives in industry would go a long way.

The increasingly borderless world harnesses the power of innovation, talent as well as the spirit of unrestricted enterprise. By balancing these energies with that of adequate, but not overbearing regulation, the country can then reap the benefits without succumbing to the pitfalls of globalization. Policies promoting innovation, free trade, economic integration as well as constructive government intervention should be strongly advocated. Only then, by riding the new wave, can success be achieved.

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