The Iskandar Development Region and Singapore

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5
chapter

This chapter argues that both Singapore and Malaysia potentially could enjoy considerable synergies if the Iskandar Development Region (IDR) would become integrated more seamlessly with the Singapore economy through the freer movement of people, goods, and capital. However, political barriers do present a major challenge to realizing these synergies. The fact that Singapore and the IDR are in different political jurisdictions is further complicated by several political difficulties related to the legacy of Singapore's bitter separation from Malaysia in 1965, ethnic tensions, the affirmative action program pursued by Malaysia, and the presence of vested interests.

This chapter is structured as follows. It begins by sketching the key factors determining the relationship between Singapore and Malaysia and then assesses their current economic relationship as well as Singapore's current ties with the IDR. This is followed by an assessment of the key features of the two countries' economic development that will influence the manner in which they could collaborate on the IDR, an analysis of the impact of political differences on their economic relationship, and a discussion of the various channels through which synergies could be realized for Singapore's economy through greater collaboration with the IDR. The chapter concludes with an assessment of the way forward. The relation between the focus of this chapter and the *World Development Report 2009* is presented in box 5.1.

Background

The IDR was formally launched by Malaysian Prime Minister Abdullah Ahmad Badawi in November 2006.[1] The Malaysian government had earlier appointed Khazanah Malaysia, its holding company for a large number of state-owned companies, to take the lead in developing the IDR. Given that the IDR is fairly well developed, with significant industrial, logistical, tourist, and business centers, the aim of the initiative is to take the IDR to an even higher level of development so that it becomes "a strong, sustainable conurbation of international standing" (see Khazanah Malaysia 2006). By 2030, the region is projected to have a per capita income equal to that of a developed country.

Encompassing an area of 2,216 square kilometers, the IDR is located in the southern part of Malaysia's Johor state, just across the narrow Johor strait that separates Singapore from Malaysia. It already has an international airport, a successful port that has drawn some shipping lines away from Singapore, good road and rail links to other parts of Malaysia as well as Singapore, townships, tourist resorts that attract visitors from Singapore, and a population of 1.4 million. The area embraces a large manufacturing hub that is globally competitive and has benefited from the relocation of manufacturing production from Singapore.

Key factors driving the relationship between the two regions

This section sketches the current state of the economic relationship between Singapore and the IDR and identifies key features of the Singapore and Malaysian economies that affect their relationship.

Current economic ties

With only a 1-kilometer-wide strait dividing Singapore and Malaysia and a long history of close economic integration, the movement of goods, people, and capital between Singapore and Malaysia and between Singapore and the IDR is quite substantial.

In terms of trade, Malaysian goods comprise 15 percent of all imports into Singapore, and Singapore exports 13 percent of its exports to Malaysia. The top-traded items include electrical and electronic products and refined petroleum products. The former reflects the existence of production networks of major electronics firms with collaborating facilities in both Singapore and the IDR. Many goods are shipped to southern Malaysia from the outside world through Singapore's port, generating substantial traffic in goods between Singapore and the IDR. Similarly, many goods manufactured in the IDR are shipped through Singapore's port.

Table 5.1 shows Malaysia's position as a destination for outward investment from Singapore. Although an important destination, Malaysia has received a declining share of Singapore's investment since the Asian financial crisis. China now receives the lion's share of Singapore's outward direct investments, and Singapore has started investing in India, which had not attracted much Singapore investment in the past. Other emerging markets like Vietnam have also seen Singapore investments more than double in the past few years. Malaysia now has to compete with newly industrialized countries like China and India for its share of Singapore direct investment.

Singapore companies, especially the smaller ones, see Malaysia and, in particular, Johor as the natural place to relocate production when costs rise in Singapore. An example is the shift of Super Foods, a maker of instant coffee and foodstuffs, from its base in Singapore to Pasir Gudang in southeast Johor, just across the water from Singapore. The plant currently employs 150 workers. Naigai Nitto, a Japanese company with headquarters in Singapore, also runs several

BOX 5.1 ***Density, distance, and division: Singapore and Johor***

This chapter is written in the spirit of the *World Development Report (WDR) 2009*, which focuses on density, distance, and division:

- *Rising density.* Rapid urbanization is increasing the density of urban agglomerations. More and more activity is being concentrated in increasingly denser cities. Singapore is rapidly emerging as a global center of commerce, attracting clusters of economic activity that are densely located within its limited territory.
- *Falling distance.* The concentration of economic mass in urban agglomerations reduces the distance between economic producers, now concentrated more proximately to each other in cities. The flow of goods, services, equity capital, direct investment, and technology is higher the shorter the distance between two centers of economic activity.
- *Persisting divisions.* The number of borders between countries has increased threefold since 1950. Until Singapore gained independence in 1965, Singapore and Malaysia operated mostly as a single economic entity. Before 1965, other than customs checks (Singapore was a free port), there were no barriers between the two territories.

Divisions are preventing the two countries from fully extracting the benefits of the growing density of economic clusters in Singapore. The challenge for Singapore and Malaysia is to capture the benefits of proximity, thereby reducing international fragmentation and increasing regional concentration. Our main policy recommendation is for both countries to seek ways to eliminate the barrier of distance.

The discussion of Singapore and Malaysia relates to the following issues raised in the WDR:

- *Scale economies.* Increased integration of economic activities between Singapore and Johor would yield dividends from agglomeration and large-scale economies, which Singapore has not been able to exploit fully due to its small size.
- *Factor mobility.* A key route to achieving factor mobility is to achieve freer flow and mobility of skills, knowledge and ideas, labor, and capital.
- *"Bridge" the distance gap.* Facilitating the convergence of the markets would reduce transportation costs and directly enhance trade between the two countries.

Table 5.1 Share of Singapore foreign direct investment in Asia, by country, select years, 1996–2005
percent

Recipient	1996	2001	2005
ASEAN	32.3	19.8	23.8
Malaysia	17.3	8.4	8.6
Hong Kong, China	12.0	8.6	6.6
Indonesia	7.0	4.2	7.5
Philippines	1.8	2.1	1.9
Thailand	2.8	3.4	4.1
India	0.5	0.6	1.0
China	11.5	11.8	13.8

Source: Singapore Department of Statistics.
a. Year-end stock for all sectors.

of its logistics and warehousing operations near Tanjung Pelepas in the IDR.

The close ties are also evident in the number of commuters who cross the border daily. An estimated 205,000 Malaysians work in Singapore, of which 60 percent commute in and out through the checkpoints every day. Most of the commuters are engaged in the electronics and electrical industry. Almost 60 percent of these commuters are Johor born. Most of the workers who traverse the border daily are part of the unskilled or semiskilled workforce, drawn by wages in Singapore, which can be between two and three times the wages they would receive in Johor. This is one of the reasons why Johor's unemployment rate is low. Conversely, about 130,000 Singaporeans visit Malaysia every day for both tourism and work.[2]

A Comparison between Singapore and Malaysia (IDR)

Table 5.2 outlines some of the key features differentiating Singapore from the IDR (or Malaysia where data for the IDR are not available). This brief analysis and accompanying tables seek to highlight some of the key features of the relationship between Singapore and the IDR.

First, there are strong complementarities. Singapore is rich, well developed, and well regulated, and its educational system produces a relatively highly skilled labor force that is increasingly first world in terms of capacity. However, it is beginning to encounter constraints in terms of land and labor, and it needs to do more to unleash entrepreneurial energies. Singapore is ranked one of the most competitive economies in the world, whereas Malaysia has seen its competitiveness rankings fall over the years; they are now substantially lower than Singapore's except in business process outsourcing, where the A T Kearney Index ranks Malaysia third in the world and Singapore eleventh. The IDR is well endowed with land, unlike Singapore, where only 15 percent of the territory is developed. Although its population

Table 5.2 Comparison of Singapore and the IDR

Indicator	Singapore	Iskandar Development Region, Malaysia
Area (square kilometers)	692.7	2,216.3
Population[a]	4.5 million	1.353 million
GDP	US$136.9 billion	US$20.0 billion
Population density (people per square kilometer)	6,376	631.8
GDP per square kilometer	US$197.6 million	US$9.0 million
GDP per capita[b]	US$30,422	US$14,790
Main constraints		
Land	Geological and political limits of land reclamation are being reached; 30 square kilometers were reclaimed in past 40 years.	Only 15 percent of land in the IDR is under development, leaving considerable land available for economic development purposes.
Labor	Against a current population of 4.5 million, Singapore has a "planning parameter" of 6.5 million by a notional year X, representing the maximum population that its officials believe Singapore can accommodate.	Population density is low, and many Malaysians from other parts of the country migrate to the IDR for work. There is ample flexibility to expand and enough room to accommodate inward migration from other parts of Malaysia to raise IDR's population and work force, as needed.
Education	Singapore's education system is highly ranked globally: for example, the National University of Singapore is ranked 33rd in the world.[c]	Malaysia's education system has been criticized. Two of its universities used to be ranked among the top 200 global universities, but no longer enjoy this ranking.
Main strengths and weaknesses		
General competitiveness	Singapore is ranked among the world's top in general competitiveness surveys.	Malaysia is ranked well behind Singapore in general competitiveness surveys.
Logistics	Singapore is ranked first in the World Bank Logistics Performance Index.	Malaysia is relatively well ranked, at 27 in the same survey, just behind Republic of Korea and Spain, but still far behind Singapore.
Ease of doing business	Singapore ranks first in World Bank rankings.	Malaysia is relatively well ranked at 24, which puts it behind only Hong Kong, China; and Thailand in East Asia.
Governance	Singapore is above the 90th percentile in all key areas except voice and accountability.	Malaysia is relatively highly ranked (80th percentile) for government effectiveness but ranks poorly in other areas.

(*continued*)

Table 5.2 Comparison of Singapore and the IDR (*continued*)

Indicator	Singapore	Iskandar Development Region, Malaysia
Affirmative action polices	Singapore has adopted a system of meritocracy. No policies favor any particular ethnic group over others, although some modest programs have assisted the Malays as the indigenous population.	Malaysia's affirmative action program, generally known as the New Economic Policy (NEP), gives preferential treatment to Bumiputeras, the indigenous people of Malaysia. The NEP affects the allocation of jobs, scholarships, places in tertiary educational institutes, housing, business licenses, and so on. This can be a disincentive for businesses, including domestic and foreign investors, as it raises their costs and reduces their flexibility. The government has conceded that such NEP requirements will be relaxed for foreign companies in the IDR, but it is not clear how well this will be implemented.
Labor costs in manufacturing[d]	US$2,360 per month	US$414 per month. Although the IDR is not as cheap as India, Indonesia, or many parts of China, its proximity and familiarity to Singapore companies more than make up for its higher costs.
Demographics[e]	Singapore is rapidly aging, from 31st in the world in median age in 2005 to the 4th oldest population in 2050.	Malaysia has a youthful population.
Income inequality[f]	The Gini coefficient rose from 0.44 in 2000 to 0.47 in 2006.	Malaysia had a higher Gini coefficient of 0.49 in 2005.
Entrepreneurial capacity	Despite considerable deregulation in recent years, entrepreneurs consider Singapore's tightly controlled society and regulatory regime as constraints.	Malaysia's corporate sector continues to demonstrate substantial verve and vitality.
Infrastructure	Excellent	Excellent
Tourism	Singapore is aiming for higher-spending tourists. Its main attractions are traditional tourist products such as a zoo and bird park, but these are well managed and innovatively designed. There is no beach resort of any global standard. Activities requiring large expanses of nature are limited.	Substantial tourist potential exists, with large tracts of nature such as one of the world's most extensive mangrove forests, beaches, and historical sites.

Source: Collated by Centennial Group from official data.

a. July 2007 estimate for Singapore and 2005 estimate for the IDR.

b. Singapore: 2006 GDP divided by December 2006 US$ per S$ rate; for IDR, 2005 estimate.

c. The *Times of London*, Higher Education Supplement, November 8, 2007. Its previous rank was 19.

d. From International Labour Organisation's LABORSTA Web site: 2006 data for Singapore and 2001 for Malaysia.

e. From United National database.

f. From Department of Statistics, Singapore and Malaysia, respectively.

is small, there is a large, growing, and still-youthful population in the rest of peninsular Malaysia that can be tapped by businesses operating in the IDR should the need arise. The mobility of labor across the peninsula is sufficiently fluid given that workers from all over Malaysia already work in the Johor's industrial estates as well as in Singapore.

Second, there are some competitive elements in the economic relationship between the two territories. The ports clearly compete, as seen in the growth of the IDR's Port of Tanjong Pelepas after a successful effort to lure two large shipping customers away from the Port of Singapore. Competition is also evident in related logistics businesses, such as recent efforts to set up bunkering facilities.

Key features of Singapore's economy

The Singapore economy has gathered substantial momentum in recent years after a period of sharply fluctuating GDP growth in 1998–2003, a period marked by painful domestic restructuring and significant external shocks (recession in the United States, including a downturn in technology demand in 2001–02, and the outbreak of severe acute respiratory syndrome [SARS], in 2003). More recently, the economy has been growing rapidly, by 8.8 percent in 2004, 6.6 percent in 2005, 7.9 percent in 2006, and around 7.5 percent in 2007, according to preliminary estimates.

Some characteristics of Singapore's growth carry important implications for the relationship with Malaysia and the IDR.

First, Singapore is in a new phase of growth in which it is reaping the benefits of the economic restructuring, deregulation, and policy changes carried out in 1996–2004. Its economy is drawing in substantially more foreign professionals, workers, and investors than before. New engines of growth have emerged (high-value manufacturing, such as pharmaceuticals, petrochemicals, and electronic components, as well as new financial services, such as wealth management and hedge funds). Long-stagnant activities, such as construction, are growing strongly again.

As a result, Singapore's gross domestic product (GDP) growth averaged close to 8 percent in 2004–07, above the 3–4 percent level that the Singapore government estimates is its long-term potential growth rate. Consequently, capacity is becoming constrained: unemployment fell to a decade low of 1.7 percent in the third quarter of 2007, causing wages to accelerate. Rents for homes and offices are soaring, in many cases doubling or even tripling over year-earlier levels. Road congestion has worsened significantly as well. It is becoming increasingly difficult for incoming expatriate families to secure places in international schools for their children.

Third, a key plank in Singapore's growth strategy is to build itself up as a global city, one that aspires to be more than just a regional hub for Southeast Asia. Rather, Singapore ambitiously seeks to transform itself into a city, like London or New York, capable of being a hub for global financial market activities and business operations.

Fourth, the composition and distribution of Singapore's growth remains uneven and may be getting more so. The poorer segments of the population are not enjoying the benefits of growth and bore a disproportionate share of the burden of economic adjustment during the economic restructuring in the early 2000s. The bottom quintile of the income distribution experienced a fall in real income in 2000–05, with the bottom 50 percent seeing a substantial deceleration (see Chan 2007). Data from the Department of Statistics show that locally owned companies underperform foreign-owned companies in terms of profitability. This is creating political pressures that are likely to persuade policy makers eventually to refine Singapore's growth strategy to achieve a more balanced and equitable growth. This chapter argues that improved access to the IDR for poorer Singaporeans and less profitable Singapore companies would allow both groups to improve their relative position as a result of lower costs of living and business operations in the IDR.

Fifth, Singapore is aging rapidly. The proportion of the population above 65 years of age rose from 3.4 percent in 1970 to 4.9 percent in 1980, 6 percent in 1990, 7.2 percent in 2000, and 8.5 percent in 2006. This reduced the old-age support ratio from 17 workers per elderly in 1970 to 8.5 in 2006.

These features of Singapore's economy raise important questions for its relationship with the IDR. Can Singapore become a global city without expanding its relationship with the IDR?

Key features of the Malaysian economy

Unlike Singapore, which has overcome a period of slower growth, Malaysia has not yet regained the vigor it lost after the Asian financial crisis (see table 5.3). The Philippines, in contrast, grew 7.5 percent in the first half of 2007, substantially exceeding the growth of Malaysia. Some trends in Malaysia's growth experience stand out.

A good part of the deceleration in growth post-crisis is due to a sharp fall in the ratio of investment to GDP, from above 40 percent in the years just prior to the crisis to 20.9 percent in 2006. This is despite fairly strong public sector investment spending, showing that the fall has been primarily due to desultory private investment.

Malaysia's competitiveness has taken a hit as measured by general competitiveness indexes such as those constructed by the World Economic Forum and the Institute for Management Development. This suggests that Malaysia has not adjusted to the much more competitive global economy that has emerged as China, India, and others such as Vietnam have liberalized and reformed their economies.

More recently, Malaysian export growth has been weak, mainly due to the slowdown in demand for the technology-related products in which it specializes. Yet the other technology-dependent economies such as Korea, the Philippines, and Singapore have had different experiences. Singapore has found new manufacturing activities that have been able to offset the technology slowdown, while the Philippines has found sources of growth outside manufacturing.

However, Malaysia has made some progress in developing a competitive position in exportable services. It has been consistently ranked by A T Kearney as third in the world after India and China as a location for business process outsourcing. Malaysia's exports of educational and medical services have also been rising. Malaysia continues to grow as a tourist destination. In all of these areas—education, medical services, and tourism—Singapore struggles to attract customers who are highly price sensitive, giving lower-cost Malaysia the edge among this group of customers. However, Singapore's more rigorous educational and medical standards and regulations, coupled with its investment in cutting-edge equipment and its success in assembling a critical mass of specialists who have rare skills in these activities, gives it the edge in providing higher-priced medical and educational services. Thus while Singapore and Malaysia (IDR) may well compete with one another in the areas of educational and medical space, they are complementary in a larger sense.

Within Malaysia, Johor is a major pole of economic growth and has a manufacturing and services economy that is globally competitive in key areas. Johor has enjoyed better flows of foreign direct investment (FDI) than any other state in Malaysia for the last three years. Foreign investments approved in Johor rose sharply from RM 1.4 billion in 2002 to RM 5.9 billion in 2005. In the field of education, Johor has some key universities, including the Universiti Teknologi Malaysia.

Malaysian policy makers realize that they need to create new strategies to reignite Malaysia's economic dynamism. To this end, they have been reforming the economy. Capital controls have been eased substantially. Government-linked companies have been restructured to raise efficiency. Significant efforts have been made to improve the delivery of public services. Most recently, the government has implemented the policy of setting up economic growth corridors, of which the IDR is just one. Two others have been announced, with another two to follow.

Table 5.3 Economic growth before and after the Asian financial crisis, by country, 1991–2006
percent a year

Country	Precrisis average, 1991–96	Postcrisis average, 2005–06
China	11.9	10.6
Indonesia	7.3	5.6
Japan	1.7	2.0
Korea, Rep. of	7.7	4.6
Malaysia	9.6	5.5
Philippines	2.8	5.2
Singapore	8.7	7.2
Thailand	8.2	4.8

Source: Collated by Centennial Group using CEIC database.

Potential synergies between Singapore and the IDR

In this section, we identify areas where Singapore's economy could enjoy synergies from greater economic integration between Singapore and the IDR. Synergies are defined here as the achievement of greater welfare for each country individually as a result of cooperation than they would enjoy if they did not cooperate. The combination of the two territories creates more welfare in total than the individual sum of the welfare of each country prior to cooperation.

We see several channels through which synergies could be realized if Singapore and the IDR were to cooperate more together.

- *Rational use of resources*. Reallocation of scarce resources such as land and labor to higher-value uses would create higher economic output.
- *The benefits of scale and diversity.* The size of the combined Singapore and IDR economies would be substantially larger (table 5.1), allowing more scope for businesses and consumers to exploit economies of scale and other benefits of scale.
- *Leveraging off each other's competitive advantages.* There are important differences in competitiveness between Singapore and the IDR (Malaysia). Each territory could leverage off the relative

advantage of the other. For instance, the IDR could benefit from being associated with Singapore's higher rankings in governance and ease of doing business.

- *Dynamic benefits of competition.* Increased interaction would bring about more opportunities for competition, stimulating efforts to overcome performance gaps and leading to improvements in the lagging territory.

Reallocating land alone would yield significant net gains to Singapore: moving some activities from Singapore to the IDR would allow this land to be used for even higher-value activities, resulting in a net addition to GDP.

Reallocation of land and labor to higher-value uses

Several aspects of the successful reallocation of resources would make sense for both Singapore and the IDR. First, whole business or industrial sectors could be moved from Singapore to the IDR, if doing so were mutually beneficial. In the past, for instance, Singapore has made policy changes that resulted in the elimination of entire sectors. For example, the removal of tariffs in the early 1970s led to the movement of automobile assembly out of Singapore, and the 1980s environmental decision to end support for pig farming resulted in the movement of activity to neighboring countries.

Second, the more labor- or land-intensive operations of a particular activity could be moved to the IDR from Singapore, leaving high-productivity work that is done more profitably in Singapore. For example, a watch manufacturing plant could shift to the IDR the manufacture of low-cost watches that do not need a high level of skilled labor or precision engineering capital equipment, enabling it to concentrate its scarce factory space and expensive workers in Singapore on higher-value watches or watch components. There are a number of important issues to consider here.

First, Singapore's economic planners are determined that manufacturing should remain a key segment of Singapore's economy. Singapore will therefore not follow Hong Kong, China's, example: manufacturing in Hong Kong shrunk in the 1980s, and Hong Kong became a mostly services-producing economy. By providing the right incentives and economic fundamentals, Singapore continues to attract highly capital-intensive and technologically intensive manufacturing, as seen in the surge to a record high S$20 billion in net investments in manufacturing in 2007. Many of the new manufacturing investments in Singapore relate to capital-intensive activities such as petrochemicals or pharmaceuticals (capital intensive as well as requiring a regime that protects intellectual property) or in cutting-edge alternative energy (such as solar cells). However, to accommodate these new industries without straining the capacity of industrial zones in Singapore, lower value added manufacturing activity needs to be relocated out of Singapore.

Second, Malaysia itself has become a labor importer and is not a labor-surplus economy, so it might be said that relocation of labor-intensive activities from Singapore to Malaysia does not make sense. But Malaysia has maintained relatively liberal immigration policies, allowing about 2 million foreign workers (mainly Indonesians) to work in Malaysia. Moreover, Malaysia does not need to offer Singapore companies Chinese-level or Indian-level labor costs: so long as Malaysian labor costs are substantially below Singapore's, the greater familiarity that its business environment offers to Singapore companies (given historical, linguistic, and cultural legacies) will make relocation to Malaysia or the IDR a viable proposition for many Singapore businesses.

Third, the relocation would not be of existing activities but of future ones. For example, some of the growth in aviation, educational, and other activities needed to service Singapore's ambitious growth in the future could be located in the IDR.

For the IDR, with 85 percent of its area undeveloped, including 58 percent of land now devoted to agriculture, land is not a binding constraint, and the case for relocating activities to it is relatively straightforward. Relocation of activities could be accommodated and would be beneficial so long as the value created from relocation exceeds the value of agricultural and other rural activities that are replaced. For

Table 5.4 Benefits of relocating and undertaking complementary activities

Activity	Potential for relocation	Benefits
Manufacturing	Substantial manufacturing activity has already shifted from Singapore to districts such as Johor Baru, Pasir Gudang, Kulai, and Senai in the IDR in the past 20 years. In many cases, the same manufacturer has plants in both the IDR and Singapore, each focusing on a different component or finished good. As land, labor, and other costs continue to rise in Singapore, manufacturing activity will probably continue to relocate to the IDR. The policy incentives and infrastructure exist to support such relocation.	Year-to-date 2007 alone has seen S$20 billion of new manufacturing projects committed to Singapore, against an average in past years of less than S$10 billion. Most of this is in very capital- and skill-intensive areas (petrochemicals, alternative energy technologies, high-end electronics). This will raise input costs, making lower value added per worker in manufacturing activities less viable in Singapore. Shifting such activities to the IDR would be best for Singapore: being close to Singapore would mean that such activities would continue to use Singapore-based financial, transportation, and logistics services, while releasing resources for the higher-end activities entering Singapore.
Port	Five port terminals occupy 6 square kilometers of land, 0.8 percent of total land in Singapore. Three of these directly abut the central business district, where very high-value financial and business services are constrained by lack of office space.	Releasing the land from use by the port to use by finance business activities would result in a net addition to GDP. Road congestion would improve considerably, as container lorries would not compete with other users for scarce road space. Singapore's marine services sector (specialized legal, logistics, finance for shipping) is already well developed and has critical mass. Like London, the reduction of actual port activities in Singapore will probably not result in such activities moving out of Singapore.
Airport	The airport occupies 13 square kilometers of land. A third terminal will bring capacity to 70 million passengers a year, sufficient to accommodate growth well into the next 20 years. Sufficient land has been reclaimed for a third runway and a fourth terminal: hence the land constraint is not as binding as in ports.	Benefit comes not from relocating aviation services from Singapore to the IDR but rather from complementing the primary airport in Singapore with a secondary airport in the IDR connected directly to Changi. This would allow Singapore as a metropolis to have the number of airports that successful global cities have.
Tertiary educational and research institutions	Singapore has three full-fledged universities with several campuses for other tertiary activities (such as business schools and research institutes). As the economy climbs the value added ladder and is pressed to generate its own innovations and intellectual capital, the need for more tertiary institutions will grow substantially. Already, a fourth university is planned, even as the new third university is ramping up in Singapore.	The IDR plans to devote large areas to educational institutions and is wooing universities to locate campuses there. Provided the immigration and transportation issues can be eased, locating some of Singapore's future tertiary institutions in the IDR could benefit both territories.
Warehousing	Warehouses currently occupy about 6.1 square kilometers of land in Singapore.	If port activities shift out of Singapore, a good part of such land will be released to other, potentially higher-value uses.
Tourism	Singapore's problem has been the declining duration of average tourist stay and slow increases in average expenditure per tourist as well as an insufficient number of repeat visits by tourists. An inadequate range of visitor attractions and high costs probably account for this.	IDR and Singapore can complement one another: (a) Singapore's airport connectivity brings in large numbers of tourists, which IDR can leverage; (b) IDR is developing theme parks, mangrove nature reserves, and other attractions that can offer tourists in Singapore wider choices; (c) IDR offers cheaper accommodations for cost-conscious tourists.
Back-office support services	To be viable, such support services need office space (land) and relatively lower-paid staff. Neither are Singapore's strengths. As wages and rentals rise in Singapore, activities that can be shifted profitably out of Singapore could include all types of simple transactions processing, basic bookkeeping and accounting, customer service or call centers, draftsmanship for architectural firms, and so forth.	Malaysia has been consistently ranked third worldwide in business process outsourcing according to A T Kearney. Skilled workers are available in Malaysia who can relocate to the IDR.

Source: Estimates by Centennial Group.

Singapore, the analysis is more complex. Table 5.4 assesses the potential benefits to Singapore of relocating activity to the IDR.

This analysis supports the case for substantial benefits from relocating present or future activities from Singapore to the IDR. The net benefits would be considerable:

- Singapore as well as the IDR would realize a one-off gain in GDP, as land and labor are released to higher-value activities. This would apply mostly to manufacturing, port, warehousing, and backroom support services;
- Greater competitiveness and business flexibility would come as Singapore businesses are able to provide a range of products and services profitably, the production of which can be located in

Singapore or the IDR, depending on where it is more profitable;

- If additional land and labor from the IDR were available, these constraints would ease to some extent in Singapore and relieve cost pressures there. It would effectively push out the production possibility frontier, enabling Singapore to make a credible bid to become a global city of the standing of London or New York. Without the IDR, Singapore would not have the advantage of a secondary airport or the space to build tertiary educational institutions capable of supporting its growth.

The benefits of scale and diversity

If there were no political barriers between Singapore and the IDR, a larger joint economy would offer several benefits to economic agents.

First, with a larger land area, larger population, larger market, and larger economy, there would be more economies of scale or, at least, the promise of a rapidly growing economy that would offer considerably greater economies of scale. This could attract manufacturers or service producers who desire a home market of a certain minimum size and who might otherwise decide to locate operations elsewhere.

Second, a larger joint economy with a more diverse mix of skills, types of companies, types of business activities, and a greater variety of business locations (some cheap, some expensive) could accommodate the diversity of talents, business activities, consumer preferences, and skill sets that make for a successful urban conurbation of global scale.

Third, Singapore's small and medium enterprises (SMEs) could operate in the lower-cost IDR. Otherwise, rising costs in Singapore would squeeze them out.

Similarly, Singaporeans at the bottom end of the income distribution could benefit if they had the option of living in the IDR and commuting to Singapore, in the same way that lower-paid workers in Manhattan live outside the city and commute to work each day. This would also apply to Singaporean retirees who are living on fixed pensions or are relying on a limited amount of retirement savings: the lower costs of living in the IDR would enable them to stretch out their retirement funds for much longer than if they were living in Singapore. This is particularly pertinent given the rising concerns over the adequacy of retirement financing in Singapore. At a broader level, seamless movement of people between the two territories would enhance standards of living by giving greater choices to consumers, who can weigh the advantages of living in Singapore, such as proximity to workplace and more-developed physical, regulatory, and cultural infrastructure, to the advantages of living in the IDR, such as cheaper living costs, open spaces, and less congestion.

Leveraging off each other's competitive advantages

Table 5.5 expands on some of the factors differentiating Singapore from the IDR, focusing specifically on various indicators of competitiveness. Although no separate measure of competitiveness is available for the IDR, Malaysia's competitive positioning will probably reflect the IDR's position in most instances.

The wider the differences in competitive advantage between the two territories, the more likely it is that synergies will be released were they to collaborate more effectively. Singapore is better governed, a place where it is easier to do business, and more efficient in logistics. Malaysia and the IDR offer one of the world's best places for business process outsourcing and an environment that is much more supportive of entrepreneurship than Singapore. If Singapore and the IDR could be connected more seamlessly, each territory could leverage off the other's strengths and reap more benefits.

Increased competition: costs and benefits

There is a fear on both sides that there will be competition as well as complementarities in the relationship between Singapore and the IDR. This may be true, but there are two arguments against this. First, the likely complementarities far exceed the areas where there might be competition. Second, and more important, competition need not be a negative. A real case study is of the impact of Port of Tanjung Pelepas (PTP) on Singapore. The opening of PTP did lure two of the Port of Singapore's largest customers. It also resulted in a loss of pricing power for the Port of Singapore. However, the net effect is what is important. PTP's emergence forced the Port of Singapore to restructure to reduce costs, improve efficiency, and be more sensitive to customer needs. The overall impact was that both PTP and the Port of Singapore grew in revenues and profitability.

Similarly, there probably will be further dynamic effects of competition should there be greater economic integration between the two territories.

Table 5.5 Competitiveness indicators for Malaysia and Singapore

Name of index or rank	Malaysia	Singapore
World Economic Forum Global Competitiveness	21	7
Institute for Management Development World Competitiveness	23	2
A T Kearney Globalization Index (2006)	19	1
A T Kearney FDI Confidence Index (2005)	—	18
AT Kearney Global Services Index	3	11
World Bank Governance Indicators (percentile rank, 2006)		
Political stability	58.7	94.7
Government effectiveness	80.6	99.5
Regulatory quality	69.8	99.5
Control of corruption	68.0	98.1
World Bank Logistics Performance Index	27	1
World Bank Doing Business Indicators	24	1
Transparency International Corruption Perceptions Index	43	4
Global Entrepreneurship Monitor Report 2006		
Percentage of population involved in early-stage entrepreneurial activity	11.1	4.9
Percentage of population who are established business owners	7.3	3.4

Sources: Collated by Centennial Group from World Economic Forum; Institute for Management Development; A T Kearney; World Bank; Transparency International; and Global Entrepreneurship Monitor Web sites.
— Not available.

The way forward

In this section, we look at what prerequisites have to be in place for a more integrated Singapore-IDR region to form and succeed. We also assess the political obstacles that make successful collaboration difficult to achieve.

Economic and other prerequisites for synergies to be released

Increased collaboration can be structured in a number of ways: from a collection of sector-specific collaborations to complete economic integration in which political boundaries are irrelevant. However this collaboration is structured, effective economic collaboration or integration between Singapore and the IDR can only happen if a number of conditions are in place. Four areas of weakness seriously compromise the ability to expand collaboration between the two territories.

Lack of seamless connectivity for people and goods. However Singapore and the IDR collaborate, realizing materially important benefits that come from significant reallocation of activities between the two territories requires a fairly seamless flow of goods and people between and within the two territories. In concrete terms, this means improvements in the following key areas.

First, transportation is inadequate. Currently, there are only two access routes by road and one by rail, with the rail service too limited and infrequent to be of significance. There is no mass transit link that would allow large numbers of people to move between the two territories at low cost and with high frequency of services. Consequently, there is substantial congestion, with delays of up to an hour or more at peak periods for the causeway route. This is enough to deter the reallocation of many activities from Singapore to the IDR. Multiple routes of access involving several modes of transportation are needed. Another land link to supplement the two existing land routes would help. Extending Singapore's mass transit railway into the IDR would improve the ease of access considerably.

Second, border controls for immigration, customs, and security checks are time-consuming enough to deter the free flow of people and goods. Passports are required, and forms have to be filled in and checked by immigration officers. Except for a limited number of individuals who have work permits or student passes, there are no quick and easy immigration checks with special passes or smart cards. Security checks on the Singapore side are intrusive and time-consuming.

Third, taxes and related barriers need to be removed. Malaysia imposes special taxes on vehicles transporting cargo into Singapore from Malaysia, to encourage use of its own ports and airports. Similarly, Singapore imposes restrictions involving timings, entry fees, and daily charges on Malaysian vehicles entering Singapore as part of its policy of restraining the use of motor vehicles to reduce congestion.

Need to improve law and order. Rising crime in Johor has claimed victims among both Johor residents and travelers from Singapore. Some well-reported cases of gruesome murders, violent robberies, and car thefts have alarmed Singaporeans, who have become accustomed to a very low level of crime. The law-and-order situation could deter Singaporeans and others from visiting the IDR region if current trends continue. There is also the perception among Singaporeans that petty corruption (such as officials requiring incentive payments for government services) is common in the IDR.

Policy regime: security of investments and savings. Both Singapore and Malaysia have generally been investor-friendly jurisdictions where the rule of law operates and where both domestic and foreign investors conduct business with legal protections that are effective. However, Singaporean investors remember the Malaysian treatment of the CLOB over-the-counter market for Malaysian shares that operated in Singapore and how these shares were sequestered for a number of years after Malaysia imposed capital controls in September 1998. These shares were only released to Singaporean investors several years later and only after the payment of costly fees to an intermediary company set up by Malaysia. This history deters many Singaporeans from wholeheartedly investing in Malaysia. For their part, Malaysians were upset by the seemingly arbitrary decision of Singapore not to allow Malaysians from west Malaysia who worked in Singapore to take out their contributions to the Central Provident Fund when they left Singapore, unlike the treatment accorded to other foreigners and Malaysians from east Malaysia.

Policy regime: visas for foreign professional workers. Singapore and Malaysia have taken different approaches to the treatment of foreign professionals. Singapore has liberalized its policies even further, wooing global talent aggressively and offering liberal entry to such talent. Malaysia has been very open to receiving workers for jobs that Malaysians no longer want to do, such as construction work, domestic help, plantation work, and low-end factory work. But its approach to foreign professionals has been mixed. In some cases, Malaysian officials have articulated their willingness to allow the entry of foreign talent in areas such as information technology (IT) as part of its ambition to excel as an IT hub. However, in practice, actually securing visas for such and related professionals has been difficult. Moreover, the mood seems to have soured in recent months, with officials now discouraging the inflow of semiprofessional workers, such as trained hotel staff. For the IDR to really take off, a more pragmatic approach to foreign professionals may be necessary.

What are the obstacles?

Improved political relations between Singapore and Malaysia are a sine qua non for effective collaboration. Without a clear demonstration that a new regime of political relations exists between the two countries, investors and businesses will not have the confidence that a deterioration in political relations would not result in problems for business or discriminatory policies that would harm the value of their investments. This is where the obstacles are serious enough to raise questions about whether the full synergies between Singapore and the IDR can ever be obtained.

A troubled historical legacy. Economic cooperation between Singapore and Malaysia takes place in the context of a relationship molded by a troubled political and historical legacy. Singapore is a small island off the southernmost tip of Malaysia and was considered for long periods of its early history to be part of the kingdoms and sultanates that controlled southern Malaysia. In the years before it was occupied by the British in 1819, Singapore was seen as belonging to the Johor-Riau-Lingga Sultanate, which was split as a result of the interventions of the British and Dutch colonial powers that then dominated the region. For the better part of its modern history since its refounding in 1819 by the British as a major port and regional center, Singapore's economy has been materially integrated with what is now Malaysia. Even after Singapore separated from Malaysia in August 1965, there was a short period until 1967 when the economies remained highly integrated, with the free flow of labor and capital between the two countries and companies incorporated in one territory functioning in the other without too much trouble. It was only after 1967 that the Singapore and Malaysian economies went their separate ways: economic policies diverged, the commonly owned airline was split into two national airlines in 1972, and the currency union ended in 1973.

There are several important reasons why political factors might hold back economic ties between Singapore and the IDR.

Ethnic relations. Ethnic differences unfortunately affect the relationship between the two countries. Singapore is a majority Chinese country, where the Chinese are about 76 percent of the population, the Malays are about 15 percent, and the Indians are around 6 percent. Malaysia is the reverse: Malays and other indigenous groups make up more than 60 percent, while the Chinese proportion is now around 25 percent, and the Indians account for about 10 percent.

Singapore left the Federation of Malaysia in August 1965 mainly as a result of ethnic tensions between the Malays who were the majority in peninsular Malaysia and the Chinese who were the majority in Singapore. Two major race riots erupted in Singapore in 1964 in which many were killed. A bout of racial violence in Malaysia in 1969 in which hundreds died added to the bitter legacy.

Following separation, various bilateral issues became sore points in the relationship and remain today, sometimes decades after they first emerged as problems, attesting to the difficulty involved in settling differences quickly. Issues included the price of water supplied to Singapore under what many Malaysians deemed to be a one-sided agreement, the release of provident fund savings due to Malaysians working in Singapore, disputed ownership of a rocky outcrop, and the location of customs, immigration, and quarantine facilities for rail travel between Singapore and Malaysia.

Divergent economic policies. Although both Malaysia and Singapore are highly open economies that have been friendly to foreign investors and foreign trade, there are some differences in economic policies.

The first difference is the pursuit of ethnic-based economic policies in Malaysia. After the racial convulsions of 1969, Malaysia followed a policy (NEP) of affirmative action favoring the indigenous communities of Malaysia, such as the Malays and the various east Malaysian ethnic groups, a policy that many Chinese and Indian Malaysians felt discriminated against them. Singapore sought to pursue a policy of meritocracy, but in the early years of rapid growth, its own Malay community felt marginalized. These experiences helped to nurture resentments on both sides against each other. Because the NEP imposed ownership and other restrictions on businesses operating in Malaysia, it affected the way largely Chinese-owned Singapore investments operated in Malaysia.

Second, following Singapore's separation, Malaysian policy makers noticed that substantial economic benefits accrued to Singapore from its economic ties with Malaysia: Singapore's port and airport handled a considerable proportion of goods and people being carried in and out of Malaysia, for instance. In many cases, Malaysia followed a nationalist policy of developing its own ports and airports to rival those of Singapore, using taxes and other economic interventions to reduce Singapore's role in the Malaysian economy. For example, a levy was introduced in the 1980s on lorries carrying Malaysian-made goods for export through Singapore port to divert goods to the port that Malaysia had developed in one part of the IDR (Pasir Gudang Port).

Many of these problems were specific to Johor, where the IDR is located. For instance, the agreement on the supply of water by Johor to Singapore is seen by Johor as particularly unfair to it, as it gives Singapore exclusive use of Johor's main water source up to a certain level of demand and at a price that is not indexed to inflation and has limited scope for adjustment. The issue of sovereignty over Singapore is also particularly felt in Johor, where many people feel that Johor was somehow cheated out of its historic ownership of Singapore by the British colonialists as well as by the federal government, which agreed to the separation of Singapore from Malaysia in 1965. These issues cloud relations with Singapore. This means that simple issues of bilateral economic interaction become easily politicized and thus difficult to resolve.

Conclusion: can these obstacles be overcome?

Ultimately, policy makers have to ask themselves whether they can achieve their ambitious goals without finding ways to overcome these political obstacles. Can Singapore achieve its aim of becoming a global city on the scale of London or New York without the IDR? And can the IDR be the strong, sustainable metropolis of global significance it aims to be without substantial integration with Singapore? The answers in both cases are clear: neither side can achieve its aims without the other. Thus they will have to sink their political differences or abandon their ambitions and settle for a much more mediocre set of goals.

Notes

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1. Originally known as the South Johor Economic Region, it was renamed the Iskandar Development Region in November 2006 in honor of Sultan Mahmud Iskandar, sultan of Johor, the state in which the IDR is located.

2. Data on the movement of people between Singapore and the IDR were given in a speech by Malaysia's International Trade and Industry Minister Rafidah Aziz, which was reported in *Singapore Business Times*, August 29, 2007.

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