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PERSPECTIVE

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Singapore-Malaysia Economic Relations: Deep Interdependence

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EXECUTIVE SUMMARY

- The economic linkages between Singapore and Malaysia are longstanding, far-reaching, spanning trade in goods and services, as well as foreign direct investment (FDI) and movement of people.

- Each are the other's second most important trading partner, in both cases surpassed only by China and outranking traditional commercial allies such as the United States and Japan.

- Rather than solely trading finished items with each other, the bulk of the trade in goods between Malaysia and Singapore consists of very specific components and parts of electronic microcircuits and consumer electronics, specialized machinery, and plastics. Due to this, the two nations are closely integrated into regional and global production networks, an intertwining process that began during Malaysian Prime Minister Mahathir Mohamad's first tenure.

- Although starting from a lower base than goods, trade in services – including logistics, telecommunications, and financial activities – is increasing steadily between the two countries and is in Singapore's favour.

- In terms of foreign direct investment (FDI), the European Union and the United States are the most important investors into Singapore. For Malaysia, the most important investors are the EU, followed by Singapore and then China.

- People-to-people movements between the two countries are also substantial, with Singapore constituting Malaysia's largest source of visitors. Conversely, available data indicates that Malaysia provides the city-state with a sizeable number of workers – many of whom are skilled.

- Due to their depth, reach, and complexity, the economic ties between Singapore and Malaysia are resistant to short-term changes in policy.

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INTRODUCTION

Malaysia's new government swept into power on May 9 last year. While greater clarity regarding bilateral relations between Singapore and Malaysia was expected as the transitional period ended, this appears not to have been the case. Indeed, the past few months have been characterized by uncertainty on a number of established issues between the two countries as well as several new ones.

Part of the reason for this is that the Pakatan Harapan government faces important domestic challenges, including financial legacies inherited from the previous administration. At present, the Malaysian government owes more than RM 1 trillion in direct debt, contingent liabilities, and lease payments.[1] Furthermore, a number of very large government-linked entities such as Tabung Haji and FELDA Global Ventures are struggling with toxic assets.[2] And, the new administration eliminated the reviled GST to replace it with the Sales and Service Tax which – while in line with pre-election pledges – has entailed a reduction in government revenue.

In a bid to improve its fiscal health, the PH government has scrutinized large-scale infrastructure projects. A number of them, most notably the East Coast Rail Link and several KL-based public transport initiatives have been scrapped or put on hold. Of most direct relevance to the city-state, following a request by Malaysia, construction on the KL-Singapore High Speed Rail project will be deferred until 2020 and come on line 5 years later than initially planned.[3] The drive for cost rationalization may also affect the much-awaited Rapid Transit System (RTS), linking Singapore and Johor Bahru. While the PH administration has reiterated its intention to proceed with the link – slated to ferry 10,000 passengers per hour in each direction – there has been little information forthcoming as to when construction will start.[4]

In addition, a number of older issues between the two countries have resurfaced, including: the price of water supplied by Malaysia to Singapore; whether the Causeway should be replaced by a 'crooked bridge' that would allow ships and water to flow beneath it; and whether the governments of both countries should invest in a Third Link connecting Singapore's eastern portion to Johor.[5] In October, two new issues unexpectedly emerged, namely: the management of airspace over southern Johor Bahru, which is currently handled by Singapore; and the precise delimitation of the maritime border between the two nations in the Strait of Johor.[6]

What makes the handling of these issues more complex is that there are now a greater number of 'moving parts' to factor in. The new Malaysian coalition is comprised of different parties with distinct perspectives. Furthermore, the cabinet is a mixture of known personalities such as Prime Minister Mahathir Mohamad and Home Minister Muhyiddin Yassin, as well as less-familiar decision-makers. Also, not to be forgotten are the crop of new state governments, which are still in the process of finding their feet. The Johor state government has been at the forefront of some of these issues, including the nature and placing of the hypothetical Third Link.[7]

Consequently, how bilateral relations evolve in the months ahead and what issues become salient will be pivotal for both countries. However, rather than dealing with these questions directly, this Perspective will frame them by analysing how and to what extent the economies of Malaysia and Singapore are intertwined. This will be done through examining data on the flow of goods, services, investment, and people between Singapore and Malaysia over the past three decades and, where relevant, comparing them with key economic partners.

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TRADE IN GOODS

Given Malaysia and Singapore's shared history, family connections, and cultural affinity, the depth and breadth of economic ties between the two countries are often taken for granted. However, the nature of bilateral economic ties and their complexity are more recent than commonly thought.

Following separation in 1965, the economies of the two countries initially grew apart due to their different economic models. Singapore sought to industrialize through attracting foreign direct investment and manufacturing for export.[8] While Malaysia also sought to do this, it simultaneously pursued import substitution industrialization and increased tariff and non-tariff barriers to promote local production.[9] The country also invested substantial resources in developing its domestic port sector, in order to capture a portion of its products that were being shipped through Singapore.[10]

During the 1980s, Malaysia and Singapore became more integrated as their economic models converged. In the wake of a recession in the mid-1980s, Malaysia moved to liberalize its investment regulations and boost its manufacturing sector to generate jobs and foreign exchange.[11] In addition, Southeast Asia benefitted from a wave of investment from Japanese and European manufacturers, seeking to lower their production costs. Regional and then global production networks proliferated between Singapore and manufacturing centres in Malaysia such as Penang, Kuala Lumpur, and Johor Bahru.[12]

From the mid-1980s, work on economic issues between the two countries began to progress, with cooperation between the Malaysian Industrial Development Authority (MIDA) and Singapore's Economic Development Board to foster tourism and cross-border production. In addition, the two countries started negotiations on a range of issues such as water provision, ferry services and the sale of land to foreign investors that provided a good context for deepening business links.[13]

Consequently, economic exchanges between Singapore and Malaysia grew in breadth and scope over the next three decades. Table 1 sets out trade in goods between Singapore and a range of key commercial partners from 1981 to 2017, with the tenures of Malaysia's previous prime ministers identified.[14]

Several key trends stand out. First, over this period, the United States and Japan have gone from being Singapore's most important trading partners to fourth and fifth respectively. Conversely, the importance of China has increased in relative terms from fifth in the 1980s to first following the turn of the century. Malaysia, for its part, has become an increasingly important trade partner, rising from third to second place over this time period. Indeed, the most important change took place in the second decade of Mahathir Mohamad's first administration, when trade tripled from approximately USD10 bn p.a. in the 1980s to more than USD36 bn p.a. in the 1990s.

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Table 1: Singapore's total trade with key partners (in USD mn)[15]

	Mahathir I	Mahathir II	Badawi	Najib
	1981 - 1991	1992 - 2002	2003 - 2008	2009 - 2017
Malaysia	10,121 #3	36,877 #2	62,187 #2	79,229 #2
China + Hong Kong	5,294 #5	21,394 #5	73,755 #1	128,417 #1
USA	12,521 #1	37,995 #1	51,583 #4	58,179 #4
EU	9,206 #4	30,916 #3	55,671 #3	74,069 #3
Japan	10,521 #2	28,094 #4	33,483 #5	37,781 #5

Sources: CEIC Database, World Bank, IMF

Table 2 sets out the trade in goods between Malaysia and its most important commercial partners. The overall trends closely track those seen in Singapore. Over the period under study, Japan and the United States declined in relative importance from being the most important trading partners to being the least in the group. Conversely, China has risen from fifth position to become Malaysia's most important trading partner. Singapore, for its part, has been a key trading partner throughout the past 35 years, either in third position or – as in the 1980s and again from 2009 to the present – in second position.[16]

Table 2: Malaysia's total trade with key partners (in USD mn)[17]

	Mahathir I	Mahathir II	Badawi	Najib
	1981 - 1991	1992 - 2002	2003 - 2008	2009 - 2017
Singapore	6,578 #2	23,070 #3	36,982 #3	50,570 #2
China + Hong Kong	1,540 #5	10,051 #5	37,237 #2	69,918 #1
USA	5,936 #3	26,220 #1	41,155 #1	33,099 #5
EU	5,635 #4	19,710 #4	34,833 #4	39,598 #3
Japan	7,843 #1	24,387 #2	32,114 #5	38,510 #4

Sources: CEIC Database, World Bank, IMF

Singapore exports an exceptionally diversified range of goods to Malaysia, which include everything from electronic micro-circuits to liquor, and from watches to glue. However, three groups of products stand out, which collectively account for almost 60 per cent of the total. They are: refined petroleum and related by-products; integrated electronic microcircuits and components of electrical and electronic consumer goods; and chemical products and polymers (Table 3).

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Table 3: Singapore – Top 10 Exports to Malaysia (2016)

Exports	%
Refined Petroleum	28%
Integrated Circuits	16%
Semiconductor Devices	3.9%
Office Machine Parts	2.2%
Low-Voltage Protection Equipment	1.8%
Ethylene Polymers	1.8%
Gold	1.8%
Computers	1.6%
Industrial Printers	1.1%
Electric Motors	1.1%

Table 4: Singapore – Top 10 Imports from Malaysia (2016)

Imports	%
Integrated Circuits	22%
Refined Petroleum	17%
Semiconductor Devices	4.5%
Office Machine Parts	2.7%
Industrial Printers	2.4%
Jewellery	2.2%
Machinery with Individual Functions	1.8%
Computers	1.8%
Blank Audio Media	1.8%
Telephones	1.5%

Source: Observatory of Economic Complexity

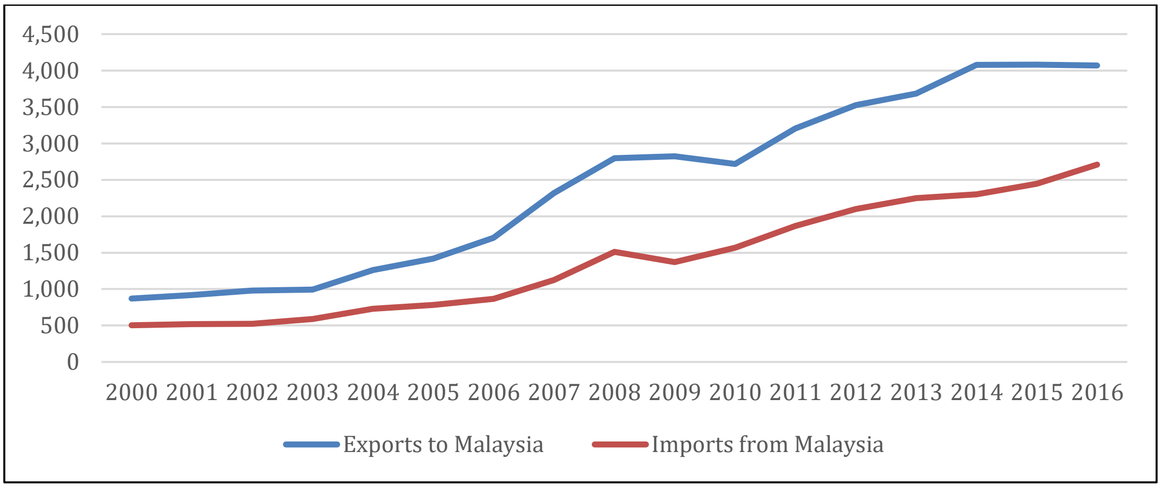
Looking at Singapore's imports from Malaysia yields a very similar picture. A wide range of goods are sourced from across the border, yet three specific product groups stand out, namely: integrated microcircuits and associated parts and components; refined petroleum; and electronic consumer articles (Table 4). The trade between the two countries is essentially part of regional production networks in electrical and electronics goods.

TRADE IN SERVICES

Relative to trade in goods, the trade in services between the two countries is at a much lower level. By way of example, in 2016 Singapore exported around USD18 bn in goods to Malaysia in 2016, but only sold USD4 bn of services. Nonetheless, the latest figures paint an encouraging picture, with flows between the two countries increasing progressively since 2000 (Figure 1). In addition, it is likely that much of the trade in services is not captured due to data difficulties.

Between 2000 and 2016, Singapore increased the value of its services exports to Malaysia four fold. This includes telecommunications, insurance, finance, logistics, maintenance and repair tasks, and construction. For instance, Singapore's United Overseas Bank (UOB), which was incorporated as UOB Malaysia in 1993, has the largest branch network of any foreign bank operating in Malaysia. Similarly, Malaysia is a key market for Singapore's Oversea-Chinese Banking Corporation (OCBC) Bank. In fact, the bank's insurance subsidiary, Great Eastern Holdings, is also the oldest and most established life insurance group in Singapore and Malaysia.

Figure 1: Singapore Services Sector Trade with Malaysia (in USD mn)



Sources: CEIC Database, Singapore's Department of Statistics

Food and beverages are another important component of trade in services, and include well-known local brands such as The Wellbeing Group (TWG), Old Chang Kee, and the BreadTalk Group (including its food court chain, Food Republic), which have a strong presence in Malaysia. In the hospitality sector too, Singapore's Banyan Tree Holdings inaugurated its first luxury hotel in Kuala Lumpur in June 2018.

An equally promising trend is also observed in the value of service imports from Malaysia to Singapore, which has increased from USD500 mn in 2000 to USD2.7 bn in 2016. Malaysia's most valuable bank brand, Malayan Banking Bhd (Maybank) has been operating in Singapore for almost six decades, and was identified as a systemically important bank in 2015 due to its credit rating.[18] In the retail sector, Malaysia's home-grown fashion brands like Bonia and British India have proved to be strong players in Singapore as well, as suggested by their growing number of outlets throughout the country. Similarly, Malaysia's hypermarket store, Giant, has emerged as the leading mass market retailer of everyday items in the city-state.

TRENDS IN FOREIGN DIRECT INVESTMENT

While Singapore has experienced a structural shift in its trading patterns away from Europe, the US, and Japan towards China, this has not occurred with FDI. The European Union has consistently remained the city-state's largest investor, injecting some USD250 billion into the economy in 2016. The United States is not far behind, investing USD200 billion the same year. While historically very significant, Japan's investments in Singapore have plateaued and now are similar to those of China, which has increased of late. Malaysian investment into Singapore has hovered around USD25 bn p.a. since 2012 (Figure 2), making it the Republic's eleventh largest source of FDI.

While not overly large, there have been some noticeable investments by Malaysian firms into Singaporean companies, such as Khazanah-owned CIMB's purchase of GK Goh Holdings in 2005, the Axiata Group's investment in MobileOne (M1) Singapore in 2004,

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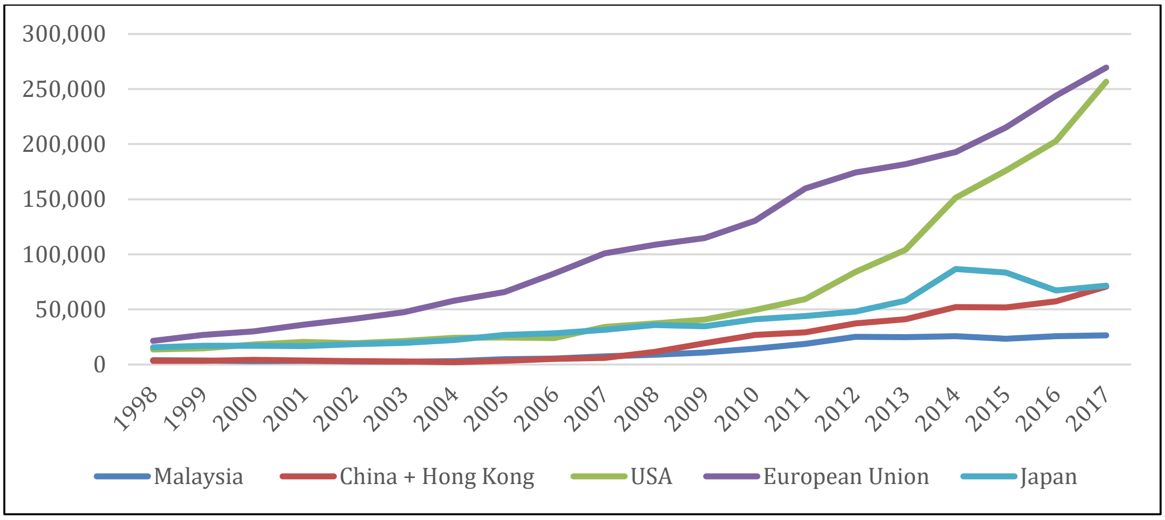
Khazanah's takeover of Integrated Health Care Holdings (IHH) in 2010, and its two joint development projects with Temasek Holdings in 2017 – Marina One and DUO.

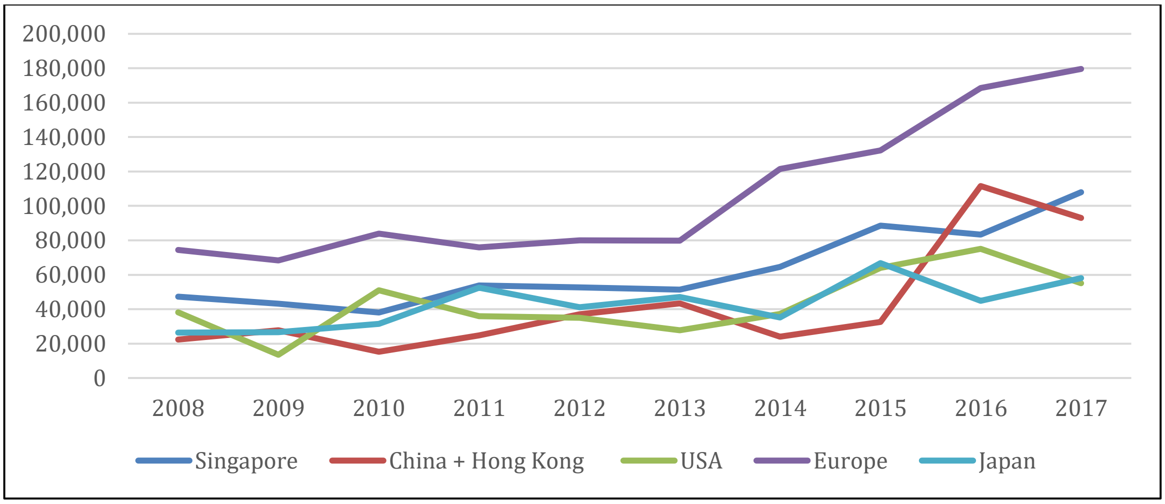
Figure 2: Singapore's FDI Sources (in USD mn)



Sources: CEIC Database, Singapore's Department of Statistics

Trends in Singapore's FDI to Malaysia are rather different. As with Singapore, the EU is the largest source of investment, and flows of FDI are rising. However, the city-state is the second-most important source of investment for Malaysia. Since 2006, Singapore has injected nearly USD4.4 bn into Iskandar Malaysia. In March 2016, InnoVen, a UOB-Temasek joint venture infused almost USD5 mn in Malaysia-based KFit Holdings, an e-commerce health and fitness company. In November 2017, Temasek-owned Heliconia Capital Management acquired a stake in Health Management International, a major private healthcare player in Malaysia. As with the EU, flows of investment from the city-state have been rising steadily. China has emerged as an important source of FDI. However, the levels have been rather more volatile, increasing from a low base in 2015 to almost USD120 bn in 2016, before falling substantially in 2017 (Figure 3).

Figure 3: Malaysia's FDI Sources (in USD mn)



Sources: CEIC Database, Bank Negara Malaysia

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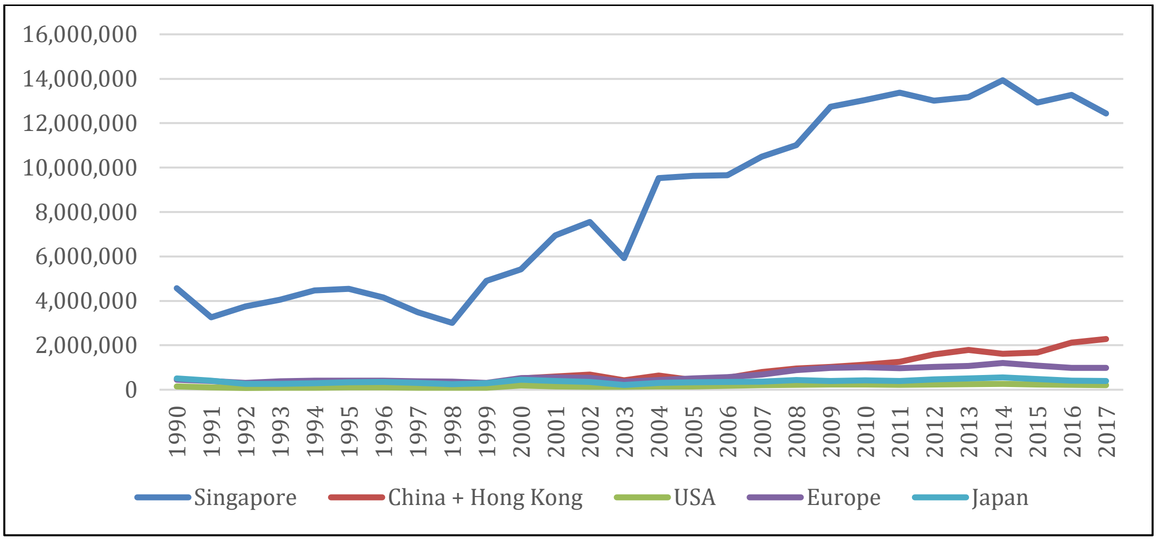
MOVEMENT OF PEOPLE

Given the shared history, cultural ties and geographical adjacency of Malaysia and Singapore, it is no surprise that movement of people between both countries remains significant. In 1980, Singapore was home to 120,104 Malaysians. This figure has steadily increased and by 2010, three decades later, the Malaysian diaspora in Singapore had reached 385,979.[19]

Singapore has gained from Malaysian talent employed across a vast array of sectors in the country. In 2013, a total 308,834 high-skilled Malaysians had moved overseas, with 47.2 per cent of these going to Singapore.[20]

The close proximity between the neighbouring countries also provides ample opportunities to reap benefits from tourism. In 2017, Malaysia recorded close to 12.4 million tourist arrivals from Singapore, making the city-state by far the largest source of visitor arrivals (Figure 4). While visitors from Singapore may stay shorter periods of time than visitors from other countries, it is notable that the city-state accounts for substantially more than the combined arrivals from China, Hong Kong, Japan, US and all of Europe.

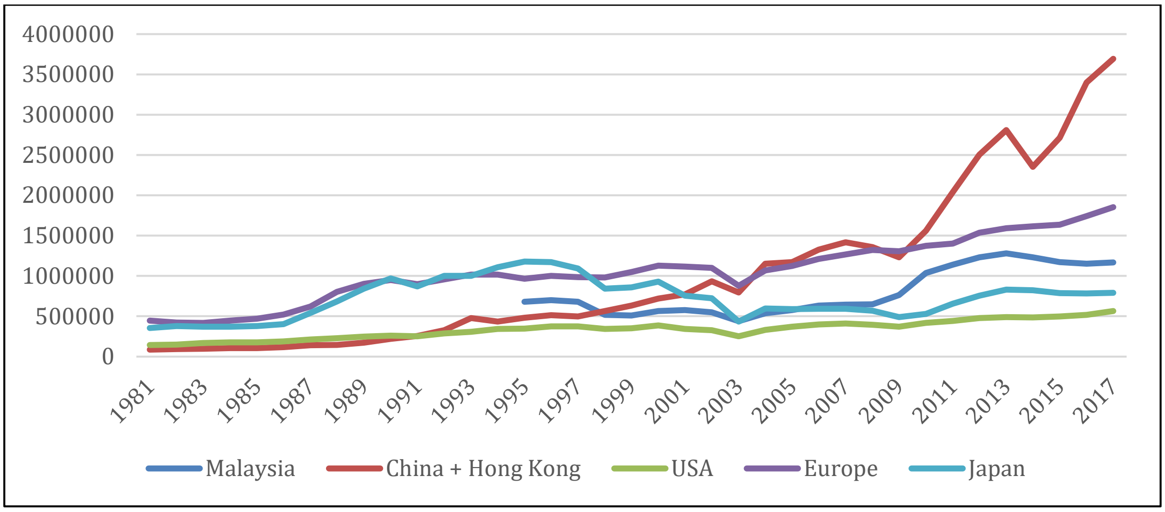
Figure 4: Tourist Arrivals in Malaysia



Sources: CEIC Database, Singapore Tourism Board, Tourism Malaysia

The flow of tourist arrivals to Singapore is structured somewhat differently. Tourists from China and Hong Kong constitute the largest source of visitors, reaching some 3.5 million arrivals in 2017. Visitors from Europe account for the second largest source to the country, and Malaysia the third-largest source with 1.16 million arrivals from the country in 2017 (Figure 5).

Figure 5: Tourist Arrivals in Singapore



Sources: CEIC Database, Singapore Tourism Board

CONCLUSION

Singapore and Malaysia have become increasingly intertwined economically. Despite their proximity, however, many of these links are relatively recent. Indeed, ties between the two countries really deepened and became more complex in the 1980s, during the first tenure of Malaysia's Mahathir Mohamad. These links span trade in goods, services, flows of investment, and short and long-term movement of people.

Contrary to the image that most Singaporeans have of trade between the two countries consisting of fresh vegetables, fruit, food items, and clothing, the bulk of trade between these two countries consists of highly specialized inputs and components that are shipped back and forth between the two locations before being exported to markets further afield. These deep economic linkages have remained while both Malaysia and Singapore's trade patterns have gravitated away from established US, Japanese, and European markets towards China.

Although starting from a lower base, trade in services between the two countries is developing consistently and rapidly. Beyond the familiar food and beverage sector, this includes key economic sectors such as finance, logistics, and healthcare.

Trends in FDI are somewhat different, as both Malaysia and Singapore still receive the largest part of their investment from traditional sources such as Europe and the US. In addition, Singapore is the second largest source of FDI for Malaysia.

As is to be expected, Singapore and Malaysia are also closely linked through people-to-people flows. The city-state is the largest source for its northern neighbour's tourist flows, and Malaysia is a key supplier of Singapore's skilled workforce.

Building upon their geographical and social cultural proximity, complementary factor endowments, and familiar regulatory environments, the ties between Singapore and Malaysia have grown in breadth and depth over the past three decades. Ties of this quality take time to cultivate but, while they are resistant to short-term changes in policy, should not be taken for granted.

[1] 2019 Budget Speech by YB Tuan Lim Guan Eng, 2 November 2018.
[2] *The Straits Times*, "Malaysian govt throws financial lifeline to haj fund", 12 December 2018.
[3] *Marketline*, "Singapore defers HRS project until 2020 as Malaysia cites high costs", 7 September 2018.
[4] *The Straits Times*, "Singapore, Malaysia look forward to bringing RTS link to fruition: Ministry of Transport", 23 August 2018.
[5] Arlina Arshad, "Do Singapore and Johor need a Third Link?", *The Straits Times*, 28 October 2018; Sebastian Liu, "Deep Waters, Close Quarters: Malaysia and Singapore's Cross-Strait Disputes", *The Diplomat*, 20 December 2018.
[6] Karamjit Kaur, "New landing system doesn't impose new height restrictions: Experts", *The Straits Times*, 13 December 2018; *The Straits Times*, "Key questions on settling maritime disputes", 14 December 2018.
[7] Ben Tan, "Johor's New Crossing to Singapore Nothing to do with Causeway, State Official Clarifies", *Malay Mail*, 20 November 2018.
[8] Toh Mun Heng, "The Development of Singapore's Electronics Sector" in *Architects of Growth?* Edited by Francis E. Hutchinson, Singapore: ISEAS, 2014.
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[10] Fong Chan Onn, "Johore Port: its Role in the Growth of South Peninsular Malaysia", *The Developing Economies*, 1984.
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[12] Rasiah R, "Expansion and Slowdown in Southeast Asian Electronics Manufacturing", *Journal of the Asia-Pacific Economy*, 14(2) 2009: 123-137.
[13] Ooi K.G. "Politics Divided: Singapore-Malaysia Relations", in *Across the Causeway: a multidimensional study of Malaysia-Singapore relations*, edited by T. Shiraishi, Singapore: ISEAS, 2009.
[14] The most recent data available is for Q1 of 2018, which pre-dates Pakatan Harapan's victory in May of this year.
[15] Yearly average for the given period.
[16] In theory, the level of trade, measured as exports plus imports, between Singapore and Malaysia should be the same in the two tables. However, they are measured differently in the two countries, with Singapore classifying re-exports as exports, and Malaysia excluding them.
[17] Yearly average for the given period.
[18] "Maybank retains Malaysia top bank brand spot." In *The New Straits Times*, 19 July, 2018 https://www.nst.com.my/business/2018/07/392364/maybank-retains-malaysia-top-bank-brand-spot (accessed 7 January 2019).
[19] United Nations Population Department (UNPD) International Migration Database
[20] Mok Opalyn. "Malaysia's returning expert programme driving out more talent, economist says". In *Malay Mail*, 22 June 2014 < https://www.malaymail.com/s/691899/malaysias-returning-expert-programme-driving-out-more-talent-economist-says#sthash.5zTHG6Vj.dpuf> (accessed 5 January 2019).

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