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This issue in brief:

Blogonomics: The World Is Not Falling Apart

This year, SEIC unveils its blog section titled “Blogonomics.” In its inaugural feature, Jason Tay Yi Heng’s article “The World Is Not Falling Apart is a ray of sunshine amidst all the voices of economic and financial gloom.

Migrant Crisis: The Silver Lining

While the majority of opinions regarding the migrant crisis have been overwhelmingly negative, Yi Heng’s article is optimistic in suggesting that the influx of migrants may help fight another crisis Europe is facing.

Indonesia’s Tax Amnesty Dilemma

In his article, Victor discusses a particularly divisive tax bill which has gathered dissent from various sectors of the Indonesian economy. Could this be the solution for Indonesia’s tax revenue problems?

Moving From One to Two

China’s decision to end the historic One Child Policy has sparked a flurry of debate. While most agree that the policy was detrimental, there are those who believe otherwise. Join Rachel Tan as she weighs the pros and cons of doing away with the policy.

BLOGONOMICS: THE WORLD IS NOT FALLING APART

By Jason Tay Yi Heng

As you might have seen on Facebook, I was recently invited by the SMU Economic Intelligence Club to speak to some students at SMU. The topic was: The World in 2016 and what ASEAN can expect. This blogpost contains an adapted version of my speech, broken down into two parts. The first (this post) is on the global outlook and the second ([read it here](#)) is on the impact on selected ASEAN economies.

Shifting tectonics of the global economy

2016 has gotten off to a momentous start, but not of the right sort for most people. Financial markets are in a kerfuffle while doubts continue to cloud the outlook for China. Capital outflows from emerging markets have accelerated while EM currencies have also been battered. There are widespread deflationary headwinds stemming from lower oil and commodity prices, which were caused by tepid global demand. Because of the rising uncertainty and heightened volatility, forecasts of global growth have been downgraded.

However, the world is not falling apart, despite the pessimism and gloom from the naysayers. The basic picture on growth remains unchanged. Global growth is likely to accelerate on the strength of the US recovery driving similar rebounds in Japan and the Eurozone. This positive outlook for the G3 economies is likely to result in favourable spillovers to the rest of the world, including ASEAN. This is particularly pertinent when animal spirits return to businesses in the US and the capex cycle turns positive – ASEAN will feel the greatest benefits when capital expenditure in the US results in greater tech-heavy, capital-intensive exports from ASEAN.

Past recessions used to be preceded by spikes in oil prices; however, this time round when oil prices have dropped like a stone, economic agents are worried about the job losses and investment cuts. This is irrational, though understandable *prima facie*. The fall in oil prices is

a big plus for consumption levels, especially for net oil importers, like many countries in ASEAN.

China will continue to decelerate as it transitions to a higher quality and more sustainable growth trajectory. There will be episodic stresses but no epic meltdown foretold by China bears. Policy direction remains uncertain, as seen by the surprises sprung on global markets by Chinese officials and central bankers alike, and this could be the source of further instability in the Middle Kingdom. Consequently, with the close economic links between China and ASEAN, the economic slowdown in China will be a drag on global and regional growth rates.

Watch the geopolitics, too

Rising tensions on a global scale could derail growth, regardless of a country's economic fundamentals. Rising temperatures and tempers could boil over, but this is not without precedent. The increasingly belligerent North Korea with its nuclear and missile tests could really test the patient of the US; if the US deems it a viable threat to the US mainland, then the world's sole superpower could be forced to clamp down on the DPRK. In the Middle East, tensions between the Sunni and Shia factions have bubbled to the surface again, this time in the form of hostilities between Saudi Arabia and Iran. Not to mention the scourge that is ISIS. There is also disunity in the European Union: Brexit, the refugee crisis and the conditions of Greece's bailout.

Closer to home, the terrorist attack in Jakarta is an ominous portent of the terrorism spillover to Asia. ISIS proxies could instigate terror attacks in prominent locations in the region which could deflate the nascent optimism. Trouble is also brewing in the high seas. The territorial disputes in the South and East China Seas are uniting claimant nations against China. Even the US, in a bid to re-assert its once-waning influence in Asia, has waded into the fray with two Freedom of Navigation operations in recent months, to the ire of China. The incoming Democratic Progressive Party (DPP) in Taiwan – in control of both the legislature and the presidency – could complicate Cross-Straits relations with China and further turn on the heat in East Asia.

Bottom line: More positives than negatives

Global growth is likely to be fuelled by a strong performance by the G3 economies which will outweigh the drag from a slowing Chinese economy.

- **US:** Positives are reinforcing positives and feeding into a virtuous circle. The recovery is on track and the economy is slowly but surely gathering momentum. With the labour market robust and housing prices creeping upwards, wages have climbed while unemployment is near its natural floor. However, we continue to await the upturn in capex by businesses that will drive trade and growth in Asia. That said, the strength of the US Dollar could crimp export competitiveness while turmoil in the financial markets could stay the hand of the Federal Reserve in hiking interest rates in the short-term, even though markets could be caught by surprise when the US economy rebounds faster than expected, necessitating a faster-than-expected hiking trajectory.
- **Eurozone:** The Eurozone recovery remains lacklustre but seems to be picking up pace as significant monetary easing by the ECB gains traction in the real economy. The weak euro should boost exports even as inflation remains tepid. Financial fragilities continue to be present while political fractures could disrupt growth prospects. That said, the Eurozone has proven to be resilient and has seen out every crisis it has faced. With a little luck, we could see an upside surprise from the Eurozone.
- **Japan:** The weak Yen should also support trade levels and support the corporate sector while encouraging the influx of tourists. Most importantly, there is a need for the *Keidanren* (the larger businesses in Japan) to share the fruits of a weaker Yen through rising wages for employees which will in turn intensify inflationary pressures in the domestic economy. Capital spending is also increasing as economic prospects brighten. The risk of falling back into deflation, though, must be actively mitigated by aggressive policy action by the Bank of Japan. Growth in Japan might not be fast, but it will be decent.
- **China:** The world's second-largest economy is struggling to overhaul its economic fundamentals. Growth needs to transition from relying on debt-fuelled investment, export-led growth and the manufacturing sector to an economy that is focused on consumption and services while paying down debt levels. The anti-corruption drive initiated by President Xi Jinping, while necessary, is curbing growth as officials and businesses shy away from making even productive decisions, in the fear of being implicated in the harsh dragnet. China also needs to reduce its industrial overcapacity that is driving down corporate profits. The policy response needs to be coherent and coordinated to prevent more confusion and uncertainty in a nervous world. Most importantly for China, it needs to follow through on long-term supply-side reforms to ensure that growth remains sustainable in the long haul. Currency stability in the

Renminbi (i.e. no depreciation) will also boost confidence whilst curbing capital outflows.

You can read more of Jason's articles on his blog, titled "*Jason's Musings: On life, society, and the economy*" at: <https://jasontanyiheng.wordpress.com>

MIGRANT CRISIS: THE SILVER LINING

By Teo Yi Heng

The phenomenon of refugees coming into Europe is in no way recent. The Arab Spring which started in late 2010, and in particular the Syrian Civil War, truly sparked off the wave of refugees streaming into Europe. It was not until April 2015 when numerous boats of illegal immigrants capsized on their way across the Mediterranean Sea that the Migrant Crisis really came to the fore.

The numbers are staggering. In 2014, Frontex, the European Union's, border control agency, reported a total of 283,532 arrivals by land and sea, 28% of whom hailed from Syria (Frontex, 2015). In 2015, that number had ballooned to 1,000,000 arrivals, about half of whom were escaping from war torn Syria (Miles, 2015). That is about one fifth of the population of Singapore arriving in the span of just one year, many in rickety boats likely to sink in the rough seas of the Mediterranean. In fact, many did.



In response to this, the Italian government initiated Operation Mare Nostrum; a program operated by the Italian Navy to rescue migrants from capsized boats coming across the Mediterranean. While the program saved many lives, it was extremely expensive for the Italian

government which was left to fund it almost entirely themselves. (The European Union supported the program with a 1.8 million Euro grant from their External Borders Fund (European Union, 2014), but it was wholly insufficient to cover the costs of the program, estimated to be approximately 9 million Euros a month (Scherer & Polleschi, 2014).) This led to Operation Triton a program by Frontex which has been criticised for being inadequate both in terms of resources, as well as approach (BBC, 2014).

Further compounding the problem is that the inflows are not restricted to refugees, and include numerous economic migrants from places such as South Asia and the Western Balkans (Stojanovic, 2015), making it difficult for governments to determine who to give asylum protection to. This has, as expected, contributed to other problems as well, both bureaucratic and social. However, despite the myriad difficulties, the crisis also may have its benefits.

Europe, as with almost all developed economics, has an aging population. While it is in no way in as dire straits as Singapore or Japan, it is still projected to reduce growth rates, productivity and government tax revenue (Feldstein, 2006). The recent arrival of migrants, many of whom are youths of working age could be a “silver lining”. In a report by CNBC, Magdalena Andersson, the Swedish Finance Minister, said that “It's important that we see that we do have families of working age coming to the Continent which is an aging continent. Of course, it would put some strains on the public finances in the short term but in the long run this could promote growth and job creation in Europe. We truly have a demographic challenge on this continent and having asylum seekers could be a good thing. If we are able to help these people get onto the labour market and start working, it will lead to higher growth for Europe as a whole.” (Ellyatt, 2015). Christian Bodewick, a Program Lead for the World Bank, also noted in an article published by the Brookings Institute that “The real policy question for the countries of Central Europe and the Baltics today is therefore not whether to accept migrants or not, but rather how to turn the challenge of today’s refugee crisis into an opportunity.”, noting that Central Europe and the Baltics have low fertility coupled with high emigration, leading to great pressures on the funding of public services as well as the economy at large (Bodewig, 2015).



The benefits do not detract from the many problems faced by Europe with regards to dealing with this crisis. The financial burden on the government is of course a major one, especially in the short term. Matthias Lücke, Senior Researcher and Member of the Management Board for The Kiel Institute for the World Economy noted that the annual cost of accepting refugees for Germany could cost between 25 and 55 billion Euros (DW, 2015). While this sum may be manageable for a strong economy like Germany, as the case of Operation Mare Nostrum shows, the refugee crisis is already a financial burden for certain European countries. Neither does it help that the weak European economies (Italy Greece etc.) who are still reeling from the Global Financial Crisis of 2008, happen to be the frontline states in this crisis.

Perhaps the greatest challenge Europe faces is the challenge of integrating this large influx of immigrants, and to prevent them from forming ghettos and slums, isolating themselves from the larger society. The experience of France and its banlieues, where its inhabitants, mostly immigrants of Muslim origin who report to be oppressed and alienated (Packer, 2015), is one to be avoided if at all possible.

At the end of the day, as with most things, the future of the migrant crisis and its effect on Europe will be decided by numerous factors. How well will migrants and refugees integrate into European society? How will Europeans react to this new surge in refugee arrivals and will this spell trouble for Europe's mainstream parties? Will the European economy be able to support the refugees in the short term, and will the predicted long term benefits actually pan out?

But if the governing parties of Europe have any sense, they would look at the migrant crisis in its entirety and not be dictated to by their extremist rivals.

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INDONESIA'S TAX AMNESTY DILEMMA

By Victor Julistiono Barlian

In early 2015, the Indonesian Finance Minister, Bambang Brodjonegoro announced a plan for a tax amnesty bill. This bill, if successfully passed in the parliament and implemented, would allow Indonesians who park their money overseas to repatriate their assets back to the country at a lower penalty rate and be absolved of any potential criminal and financial charges.

Ever since the announcement, there have been on-going discussions regarding the tax amnesty bill. At first glance, this decision seems to be a desperate measure by the government to raise tax revenue amidst the slowdown in the economy and its prolonged failures in meeting its tax revenue target.

With a widening budget deficit, it is clear that Indonesia really needs a boost in its tax revenue to balance its growing expenditures. However, for the past seven years, Indonesia has always missed its tax revenue target. In 2015, despite exceeding Rp 1 quadrillion (USD 76 billion) for the first time in history, Indonesia's tax revenue still fell short by Rp 234 trillion (USD 18 billion) or around 18% of its target. This problem could be attributed to the challenges in tax collection and expansion of its tax base. Based on the latest data by the tax agency, out of more than 120 million workforce, only about 28 million workers have tax numbers and only half of them pay their tax regularly. On the corporate side, the situation is not better either. The latest data in 2014 shows that only 46 percent of companies with registered tax numbers pay their tax regularly. It is not surprising that Indonesia's tax ratio is among the lowest in the region at 12 percent of the GDP. Neighbouring countries like Singapore, Philippines, Malaysia, and Thailand have a tax to GDP ratio of above 14 percent.

The tax amnesty bill was proposed to solve those problems. By attracting the funds parked overseas back to Indonesia, the government hoped that the funds would stay in Indonesia for a long time and contribute to the economic development there. The draft of the bill states that the funds are required to be invested in government or state-owned company bonds for a period

of at least three years and after one year, these funds can be switched to other approved investment instruments. Although there are no official data on the amount of assets of Indonesians overseas, it is estimated the figure stands at around Rp 3 quadrillion (USD 228 billion). The Finance Ministry expects that upon its implementation, there would be additional tax revenue of at least Rp 60 trillion (USD 4 billion), which would be able to aid the ailing government budget.

The proposed tax amnesty bill is not without controversies. Since its announcement, it has garnered backlash from a number of tax experts and economists. Yustinus Prastowo, Executive Director of Center for Indonesian Taxation Analysis (CITA) cited that the policy will pose a moral hazard and could discourage compliant taxpayers to fulfil their obligation. This view concurs with a paper by Malik and Schwab (1991) that shows people tend to report less income as the probability of an amnesty rises. Furthermore, according to BNP Paribas' economist, Philip McNicholas, this policy could also be interpreted as a way to legitimizing corruption. In addition, there is also a risk that a loophole in the implementation could lead to money laundering. Notwithstanding the moral hazard of such policy, the Indonesian government are firm on their stance that "funds hidden overseas" need to return back to Indonesia and be invested in the economy, despite the dubious effectiveness of such a policy.

Up until now, the proposed tax amnesty is not conclusive as it is still being deliberated in the Indonesian House of Representatives. Most importantly, in implementing the tax amnesty, there is a need to increase future tax enforcement. Otherwise, the tax amnesty is unlikely to generate significant positive impact on tax revenues (Stella, 1991). Historical data shows that Indonesia's tax collection has been poor. Hence, there is a great need to improve the tax enforcement and collection system in Indonesia.

As the efficacy of tax amnesty is still debatable, the Indonesian government should instead focus on fixing fundamental issues that are hampering tax collection on a daily basis. Some problems are the limited number of tax officers, inefficient tax officers, poor tax administration and obsolete technology. Although solving these issues are not low hanging fruit either, fixing them would surely have a positive and longer lasting impact on the Indonesian economy.

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MOVING FROM ONE TO TWO

By Rachel Tan Yi

In October last year, the Chinese government announced that it would be putting the brakes on its one-child policy and implementing a new two child policy.ⁱ This decision came after a Community party summit at which the key leadership figures in China discussed ways and means to promote sustained growth in Chinaⁱⁱ between 2016 and 2020ⁱⁱⁱ. The Xinhua News Agency reported that this new policy aims “to improve the balanced development of population” and to mitigate the ageing population issue.^{iv}

The one-child policy was implemented in the year 1979^v amidst fears that China’s population was growing at an unsustainable rate.^{vi} To encourage families to have one child, the government invested in a propaganda campaign which featured posters and slogans including “One hope”, “One joy” and “One responsibility” in order to highlight the desirability of having a single child.^{vii} Apart from soft measures like propaganda, hard measures were also used to enforce the policy. Forced abortions were carried out from the 1980s to the early part of the 1990s, when the procedure was legal in China.^{viii} In addition, some Chinese women were forced to be sterilised^{ix} after having their first child. The authorities hired locals, usually older aged women, to identify and report females who might be hiding signs of pregnancy^x. Overall, the Chinese government believes that the one-child policy helped to reduce the total number of births by 400 million.^{xi}

The one-child policy has been subject to criticism because of its demographic effects on China. Some have likened the one-child policy to a demographic “timebomb”^{xii}, where China’s population is ageing quickly and the size of the labour force is decreasing. According to Professor Wang Feng of the Fudan University, “History will look back to see the one-child policy as one of the most glaring policy mistakes that China has made in its modern history.”^{xiii} The one child policy is believed to be a major reason for China’s current ageing population.

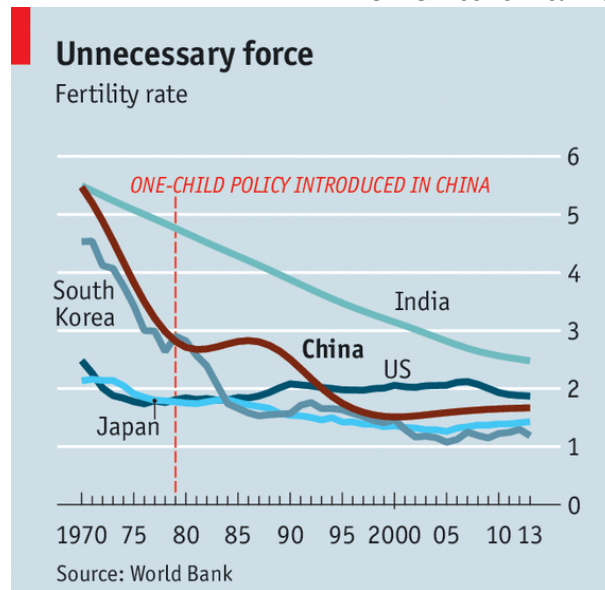


Figure 1: Drop in Childbirths Following Implementation of One-Child Policy

Source: The Economist^{xiv}

Date Accessed: 31 January 2016

China's total fertility rate dropped by almost 50% from 2006 to 2015. The number of people in China's workforce (16 to 69 years of age) fell every year from 2012, with a 3.71 million decline in 2014.^{xv} When the one-child policy came into effect, 5% of China's population were greater than or equal to 65 years of age.^{xvi} In 2015, 9% of the total population was 65 years and above, meaning that around 123 million people fell within that age range.^{xvii} China's greying population has resulted in a shrinking labour force and a rising average wage level, both of which have contributed to China's recent economic slowdown.^{xviii} Researchers predict that apart from contributing to a slowdown in the economy, China's ageing population may also place strains on the healthcare and social services system.^{xix}

Fewer children and young people

Children and young people (0-24) as a percentage of working age population (25-64)

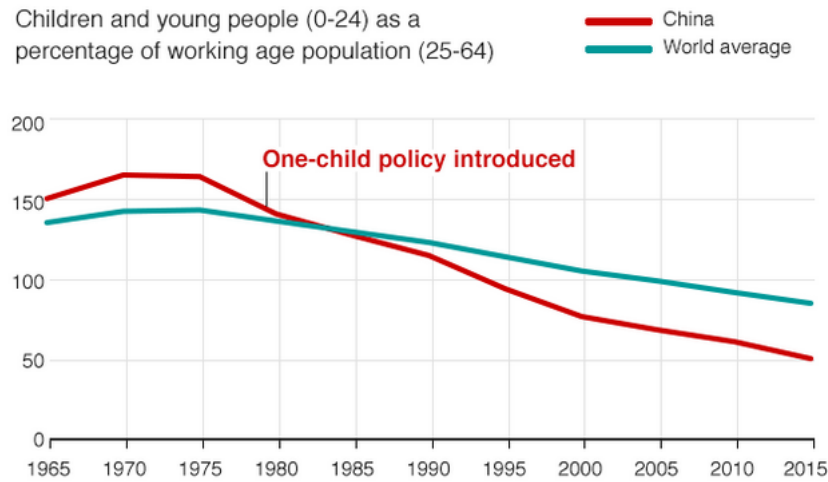


Figure 2: Children and Young People as Percentage of Working Age Population in China

Source: BBC News^{xx}

Date Accessed: 31 January 2016

Population getting older

Older people (65+) as a percentage of working age population (25-64)

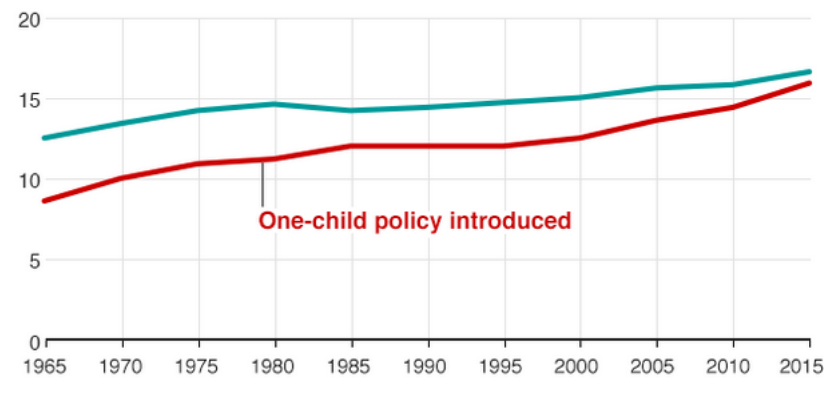


Figure 3: Older people as Percentage of Working Age Population in China

Source: BBC News^{xxi}

Date Accessed: 31 January 2016

In addition, the policy intensified China’s gender imbalance^{xxii}. Currently, China has around 106 males to every 100 females, which is one of the highest ratios in the world.^{xxiii} According to Beijing’s Family Planning Commission Minister Li Bin, this imbalance has “serious and far-reaching consequences”.^{xxiv} The Chinese government believes that the demographic imbalance is a contributing factor towards the rising divorce rate in China.^{xxv} Divorce rates in urban areas

are considerably high in China, with the most updated information suggesting that there is a higher than 30% divorce rate in Beijing and Shanghai.^{xxvi} Furthermore, the imbalance may have caused an increase in prostitution and sex-trafficking. The unavailability of women spurred an illegal business where refugees from North Korea were made to marry bachelors in the northeast part of China.^{xxvii}

Before the latest policy shift, the one-child policy had been slightly relaxed in 2013. If either husband or wife was an only child, a couple was allowed to have two children.^{xxviii} Families of an ethnic minority as well as couples living in rural areas who had a female first child were allowed to have two children as well. This relaxation contributed to the 470,000 increase in births in 2014 from the previous year.^{xxix} Yet this increase was not as high as the government had hoped for.^{xxx} This is probably one of the reasons for the introduction of the new policy.

The potential effects of the new two child policy on China's birth rate are already being discussed. Credit Suisse predicts that the new policy will result in an additional 1.2 million births in 2016 and an additional 7 million births by 2020.^{xxxi}

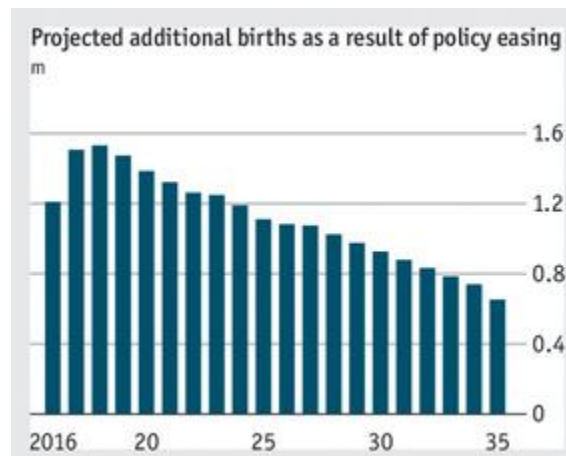


Figure 4: Projected Additional Births Following Policy Easing

Source: The Economist^{xxxii}

Date Accessed: 31 January 2016

Yet many believe that the increase in births may not be dramatic. The high cost of raising children is expected to deter urban couples from having an additional child.^{xxxiii} Chinese parents realise that bringing up more children would mean that they need to spend less on each child^{xxxiv} as quality healthcare and education are becoming increasingly expensive.^{xxxv} In

2013, Credit Suisse found that it costs around over 22,500 yuan per year to bring up a child to 18 years of age.^{xxxvi} That amount is equal to about more than 75% of an average urban dweller's yearly disposable income.^{xxxvii} This could be one of the reasons why after the 2013 policy relaxation, 88% of families which qualified to have an additional child did not take up the option.^{xxxviii} Moreover, certain couples who may have wanted more children no longer have the means to do so as they have already been sterilised.^{xxxix}

Some believe that this new policy may obstruct global sustainability. It has been projected that by 2030, the world will require an additional 30% of water, 40% of energy and 50% of food.^{xl} Presently, China is already consuming around 50% of total global production of cement, steel, aluminium and pork.^{xli} This policy change is expected to cause a rise in China's population and an increase in the demand for and consumption of global resources.

The overall impact of the two-child policy remains to be seen. Regardless of the possible effects, many believe that this is the right step towards addressing the demographic challenges which China may have to deal with in the near future. Hopefully, this will be a step towards achieving more sustainable growth for China and the world.

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