The economic consequences of separation

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The loss of the common market

Separation ended the hope on which the industrial strategy of 1959 had rested. Singapore lost the prospect of a common market of about 12 million people, on which its planners had counted since 1959. In practice the loss was smaller than the figure suggests, because the common market had never been implemented. Goh Keng Swee concluded already during merger that its benefits were less substantial than he had once believed.[1]

Lee illustrated the imbalance on the day of separation. Dunlop tyres made in Petaling Jaya entered Singapore free of duty, while Bridgestone tyres made in Jurong faced a quota in the Federation. In purchasing power, he argued, Singapore represented about 40 per cent of the combined market against 60 per cent for the peninsula, although its population was only a quarter.[2] He drew the conclusion that any future economic cooperation would require a quid pro quo.

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The dependence on Malaya was nevertheless real, as Lee showed in the same conference. He estimated that about 24 per cent of Singapore's trade was with Malaya and a further 4 to 5 per cent with Sabah and Sarawak, while its water came from Johore. He also noted that the British bases cost about $400 million a year, while Singapore's annual budget was only about $120 million.[3] These figures defined the economic problem of the new state: it needed its neighbours for trade and water and could not pay for its own defence.

Growth, trade and unemployment

The official national accounts show the shocks of those years clearly. In chained 2015 dollars, real GDP fell from $10,463.5 million in 1963 to $10,138.8 million in 1964, a contraction of about 3.1 per cent. It recovered to $10,933.1 million in 1965 and $12,046.1 million in 1966, growth of about 7.8 and 10.2 per cent.[4] Older estimates put the fall of 1964 at about 4 per cent, a difference that probably reflects later revisions of the national accounts.[5]

The composition of the decline shows where Confrontation struck. Wholesale and retail trade, the sector of the entrepôt merchants, fell from an output of $2,006.6 million in 1963 to $1,595.2 million in 1964, a fall of about one fifth. Manufacturing rose in the same year from $1,365.3 million to $1,407.7 million, and finance and insurance from $234.2 million to $253.9 million. Total merchandise trade fell from about $7.75 billion in 1963 to about $6.25 billion in 1964, a decline attributed to the suspension of trade with Indonesia.[6]

Between 1960 and 1965 real GDP grew at an annual compound rate of 5.7 per cent according to the government's own historical account. Some 21,000 jobs were created in manufacturing during merger. Unemployment nevertheless remained in double digits, a figure that worried a government facing a fast-growing labour force. The population had reached 1,886,900 by 1965. Separation thus came at a moment when the economy had begun to recover from Confrontation, while the labour market still could not absorb the young population.[7]

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Fiscal sovereignty

Separation restored to Singapore the whole of its tax base. The contribution of 40 per cent of national taxes to the federal government ended with the rescission of Annex J. The government could also undo the federal taxes it had opposed. Lee announced on 9 August 1965 that the turnover tax would be revoked forthwith and that the payroll tax would be replaced, if at all, by a contribution for an unemployment insurance scheme.[8]

Fiscal sovereignty carried new burdens, since Singapore now had to finance its own defence and foreign service, the costs of which Lee had described with the figures for the British bases. It also gained full control over tax incentives. Pioneer status, which federal authorities had granted so sparingly, became an instrument of the Singapore government alone. Chapter III of this part shows how the EDB used it to attract foreign manufacturers, while Chapter IV shows how the same freedom made possible the tax concession of 1968 that created the Asian Dollar Market.

Monetary sovereignty

The most lasting financial consequence of separation concerned money. Singapore and Malaysia still shared the Malaya and British Borneo dollar, issued by a common currency board and pegged to sterling at two shillings and four pence. After separation the planned Malaysian currency would have been foreign money in Singapore. Singapore's Minister for Finance, Lim Kim San, therefore proposed a common currency as early as October 1965 and wrote to Tan Siew Sin on 8 November 1965 suggesting either a currency board or a joint central bank.[9]

The negotiations turned on the ownership of reserves. Bank Negara Malaysia rejected a currency board as anachronistic and proposed that Singapore's reserves be held in separate accounts. The draft agreement would have left Singapore without indisputable ownership and control of them. On 4 August 1966 Lim wrote that Singapore "would never place its reserves in trust with an agency under the control of a foreign government". On 17 August 1966 the two governments announced that they would have separate currencies from 12 June 1967.[10]

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On that date the currency union came to an end, as Malaysia, Singapore and Brunei began to issue their own currencies. A Currency Interchangeability Agreement kept the three currencies interchangeable at par until Malaysia opted out with effect from 8 May 1973. Brunei and Singapore have maintained interchangeability to this day. Singapore chose to keep a currency board, whose history Chapter V of this part traces together with the founding of the Monetary Authority of Singapore. The insistence on owning its reserves outright became the starting point of the reserve management examined in Chapter I of Part D.[11]

From hinterland to world

The deeper consequence of separation was strategic. Since the nineteenth century Singapore had lived as the port of a hinterland, first the archipelago and then British Malaya. Merger had been an attempt to secure that hinterland through a federal constitution. Its failure forced the government to look beyond the region for markets, capital and technology.

Lee stated the principle on the day of independence: Singapore ought to trade "with every country in the world that is prepared to leave us alone to be ourselves".[12] The industrial strategy changed accordingly. Factories would now produce for export, financed by foreign direct investment and supported by the state. The financial sector followed the same logic. A market for offshore dollars in the Asian time zone, created in 1968 and examined in Chapter IV of this part, needed no hinterland at all. It needed a stable currency, a reliable legal system and a government willing to give tax incentives. Each of these Singapore now controlled alone.

Notes

1. SG101 (Government of Singapore), "1959–1965: Early Economic Strategies" (accessed November 2026): merger was expected to create a combined market of about 12 million people. SG101, "1959–1965: Early Economic Strategies" (accessed November 2026): the benefits of the common market "were not as substantial as he once believed", describing Goh Keng Swee's conclusion. ↩

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2. Lee Kuan Yew, press conference of 9 August 1965, pp. 13–14: “Dunlop tyres from Petaling Jaya come to Singapore free”; “Bridgestone tyres made in Jurong can’t go to the Federation because I think there’s a quota restriction”; in purchasing power “we are 40 per cent, they are 60 per cent”. ↩

3. Lee Kuan Yew, press conference of 9 August 1965, pp. 2–3: “Our water supply comes from Johore. Our trade … I think about 24 per cent – with Malaya, and about 4 to 5 per cent with Sabah and Sarawak”; bases “comes to about $400 million a year, and Singapore’s annual budget is only about $120 million”. ↩

4. Singapore Department of Statistics, Table Builder, “Gross Domestic Product In Chained (2015) Dollars, By Industry (SSIC 2020), Annual” (table M015721, accessed November 2026): GDP of $10,463.5 million (1963), $10,138.8 million (1964), $10,933.1 million (1965) and $12,046.1 million (1966); growth rates calculated by the author. ↩

5. Alvin Tan, “Konfrontasi”, *BiblioAsia*, January–March 2024, citing Cheng Siok Hwa: “GDP fell by 4 percent” in 1964, with recovery in 1965. ↩

6. Singapore Department of Statistics, table M015721 (accessed November 2026), chained 2015 dollars: wholesale and retail trade $2,006.6 million (1963), $1,595.2 million (1964), $1,649.0 million (1965); manufacturing $1,019.3 million (1960), $1,365.3 million (1963), $1,407.7 million (1964), $1,573.6 million (1965); finance and insurance $234.2 million (1963), $253.9 million (1964), $279.1 million (1965). Wikipedia, “Singapore in Malaysia” (accessed November 2026): overall trade decreased from “$7.7535” (1963) to “$6.2498” (1964), attributed to the suspension of Indonesian trade (the article’s unit notation is defective; the order of magnitude is billions of dollars); Singapore Department of Statistics, table M451001 (“Merchandise Trade By Commodity Section, (At Current Prices), Monthly”, accessed November 2026): total merchandise trade for the twelve months of 1964 adds up to $6,255.1 million; the table notes that data before 2003 exclude trade with Indonesia, which had been suspended in 1964. ↩

7. SG101, “1959–1965: Early Economic Strategies” (sg101.gov.sg/economy/surviving-our-independence/1959-1965, accessed November 2026): real GDP

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grew at an annual compound rate of 5.7 per cent from 1960 to 1965; some 21,000 manufacturing jobs were created; "the unemployment percentage still hovered in the double digits". Singapore Department of Statistics, table M810001 (accessed November 2026): total population 1,886,900 in 1965. ↩

8. Lee Kuan Yew, press conference of 9 August 1965, p. 5: "It is the intention of the Singapore Government to revoke the turnover tax forthwith. And, the payroll tax I think will be revoked as payroll tax", possibly replaced by a contribution "for an unemployment insurance scheme". ↩

9. GIC, *Bold Vision*, chapter 2, "Second Separation" (accessed November 2026): the Malayan dollar was issued by the Board of Commissioners of Currency of Malaya and British Borneo and "pegged to sterling at the rate of two shillings and four pence"; the 1960 Currency Agreement allowed either government to give "an 18-month notice to leave the currency board". GIC, *Bold Vision*, chapter 2 (accessed November 2026): Lim Kim San raised a common currency "as early as October 1965, just two months after separation"; on 8 November 1965 he wrote to Tan Siew Sin proposing a currency board or a joint central bank. ↩

10. GIC, *Bold Vision*, chapter 2 (accessed November 2026): Bank Negara regarded a currency board as "anachronistic"; formal negotiations from 10 June 1966; Singapore "was not guaranteed indisputable ownership and control of its reserves"; Lim's letter of 4 August 1966. GIC, *Bold Vision*, chapter 2 (accessed November 2026): on 17 August 1966 both governments announced that Singapore and Malaysia "would have separate currencies from 12 June 1967". ↩

11. Wikipedia, "Malaya and British Borneo dollar" (accessed November 2026): "On 12 June 1967, the currency union came to an end"; the Malaya and British Borneo dollar ceased to be legal tender on 16 January 1969. GIC, *Bold Vision*, chapter 2 (accessed November 2026): the currencies were "fully interchangeable at par value, in all three countries"; "The agreement lasted till 8 May 1973, when the Malaysian government opted out of it"; Brunei and Singapore keep it "till this day". ↩

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12. Lee Kuan Yew, press conference of 9 August 1965, p. 6: “we ought to trade with every country in the world that is prepared to leave us alone to be ourselves”. ↩

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