

# **Rethinking Singapore's Social Safety Nets**

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## **Introduction**

Singapore's social security system is based on the principle of self reliance where the first line of support is the individual and his family, failing which community help and government assistance would provide targeted help for the needy. There are four pillars in Singapore's social security system, viz.:

- The Central Provident Fund (CPF) which enforces individual savings for retirement.
- Public housing which provides subsidised housing for the majority of Singaporeans.
- Healthcare to meet basic healthcare needs and access to hospitalisation.
- The Workfare Income Supplement Scheme (WIS), which is a wage supplement to encourage employment and increase retirement savings of older, low-wage workers.

The objective of this presentation is to examine the challenges faced in the Singapore labour market in the context of an aging population and increased economic volatility and uncertainty. This will be followed by recommendations in the areas of implementing minimum wages and enhancing our social safety nets as a buffer against economic volatility.

## **Current Realities of the Singapore Labour Market**

Singapore's labour market has seen increased volatility and uncertainty, as evidenced by the four recessions in the past 12 years. There has also been increased fragmentation and vulnerability of jobs from offshoring and skill-biased technological change. Demographically, Singapore has one of the fastest ageing populations in the world. In addition, it has high inflows of low-skilled foreign labour, with significant dampening pressures on wages at the low end.

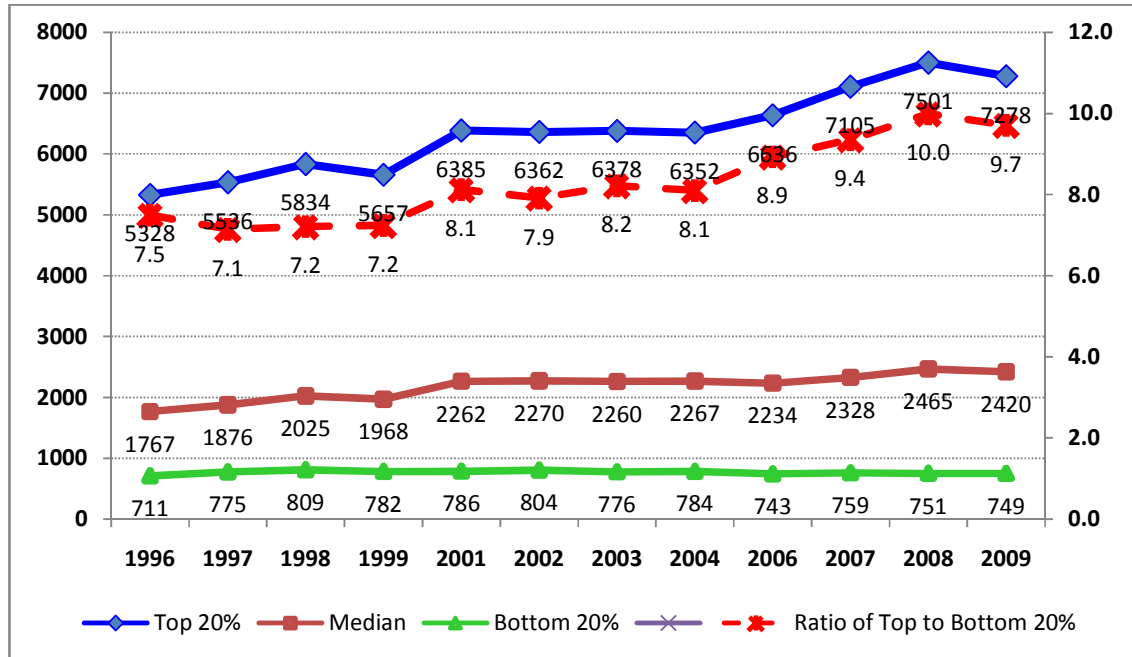
A key implication for the labour market is the increasing number of older persons who are economically inactive. There are also difficulties faced in the re-employment of older workers (i.e. those aged 50 and above).

With the liberalisation of immigration policies to augment domestic labour supply, Singapore's total population has increased by 69% from 3 million in 1990 to 5.08 million in 2010. Between 1998 and 2008, foreigners employed increased by 438,000 and formed 48% of total new employment. Most of the foreigners were employed in lower-skilled jobs. In addition, the highest population growth between 2006 and

2008 was spurred by a rise in the non-citizen population. In 2009, Singapore's permanent resident population grew by 11.5% compared to citizen population growth of 1.1%.

The dampening effect on wages brought about by the large inflows of low-skilled foreign labour, is reflected in the stagnant income levels of the bottom 20% of employed residents from 1996 to 2009 (see Chart 1 below).

Chart 1: Real Median Monthly Income of Residents Employed 1996 - 2009



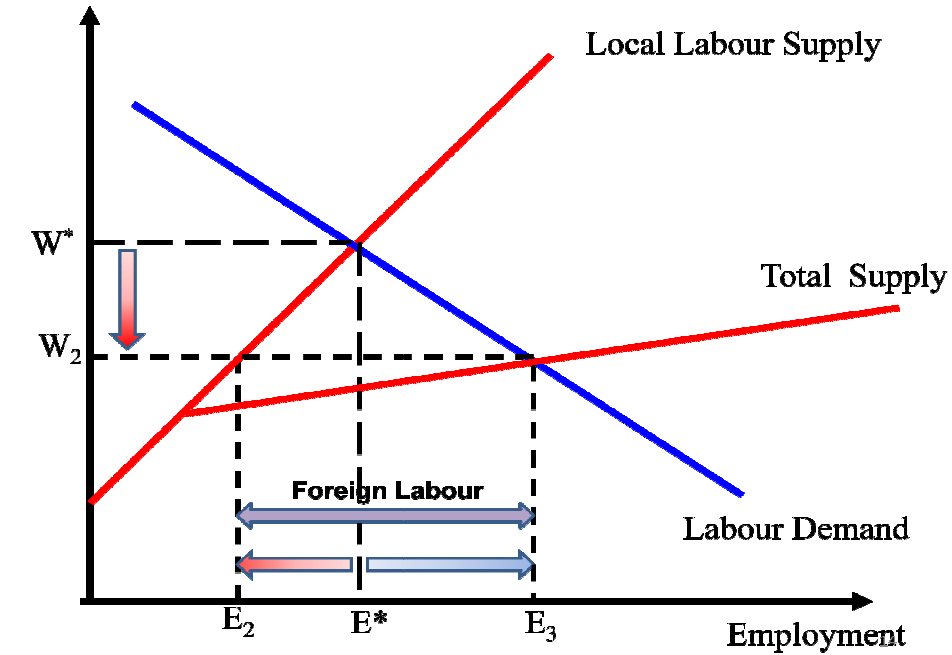
### Implications of Wage Depression

The implications of wage depression in the labour market should be a matter of policy concern. With reference to Chart 2, the influx of foreign workers has increased labour supply and depressed wages (indicated by the 'Total Supply' curve). The equilibrium wage is thus less than what it would have been in the absence of foreign labour. While total employment has increased, locals have withdrawn from the labour market due to the lower wages offered, either in favour of non-labour market activities or part-time instead of full-time work. A lower full-time employment rate of local workers leads to under-utilisation of scarce labour resources. This has necessitated the implementation of the WIS scheme to support wages, especially for older workers who have experienced stagnation in wages.

However, the group of older, low wage and less educated workers remains vulnerable, especially in times of economic restructuring and recession. They may require increased spending on other costly social support schemes. As this group of workers would spend a relatively large proportion of their wages on basic needs, wage depression would also have an adverse impact on their perceptions of

fairness. This would in turn affect morale and productivity. Social cohesion and assimilation of foreign workers at the workplace could potentially be fractured when income gaps are attributed to their very presence.

Chart 2: Foreign Workers and Wage Depression



### Introducing a Minimum Wage

A common concern that policymakers have with implementing a minimum wage is its adverse impact on employment levels. If the labour market is competitive, then a minimum wage will lead to displacement of low-skilled workers, higher unemployment, and labour market inefficiency. However, if the employer has monopsonistic power – or greater bargaining power than workers – the outcome of unfettered labour markets may not always be efficient. The key question therefore is whether the current labour market is a competitive or monopsonistic one.

In reality, there is often an imbalance in the bargaining power between the worker and employer. Given that the resources of the low-skilled worker are thinner compared to the deeper financial resources of companies, the worker would be more desperate to accept the job at a relatively low wage. The resultant wage earned would thus be lower than what the market could have offered if the worker and employer's bargaining powers were equal.

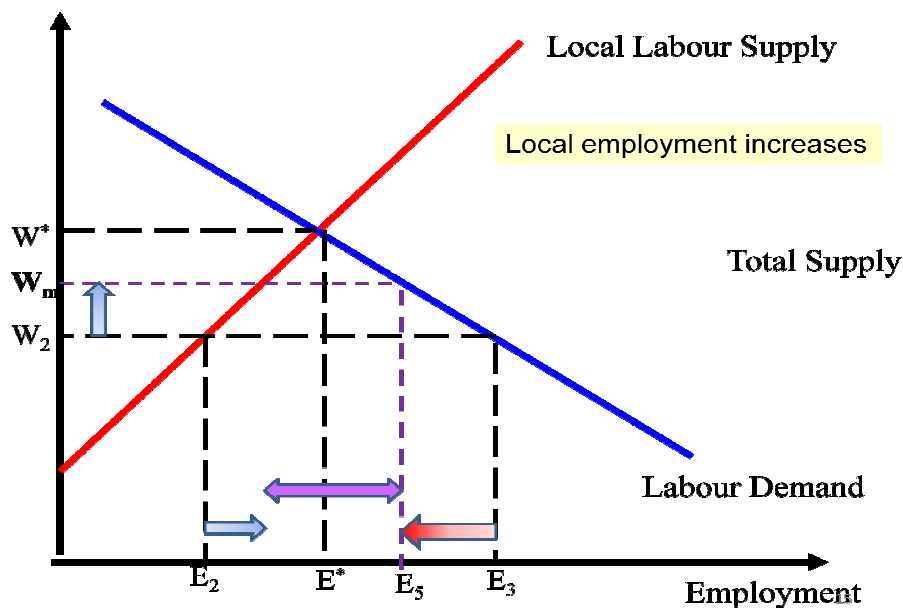
There are other factors that weaken the worker's bargaining power, namely:

- Discrimination leading to overcrowding at the low-skill end of the labour market;
- Employment laws and institutional arrangements that undercut workers' bargaining power;
- Lack of social safety nets, such as unemployment benefits and welfare payments; and
- Substantial inflow of migrant workers.

As a result of imbalances in the bargaining powers between workers and employers, competition at the bottom of the wage structure forces workers to accept very low wages, unattractive terms and poor conditions of employment..

The implementation of a minimum wage can address the problems faced and help attract more productive workers. Chart 3 shows how in a minimum wage ( $W_m$ ) above the market-clearing level of  $W_2$  will reduce employment levels from  $E_3$  to  $E_5$ , but also bring an increase in local employment levels, with a smaller number of foreign workers employed.

Chart 3: Impact of Minimum Wage



There are several measures already in place which are aimed at addressing the problems faced by local low wage workers. These are the Foreign Worker Levy (FWL) and Workfare Income Supplement (WIS) Scheme. However, while well-intended, these measures do not adequately address the issues of low-wage stagnation and lack of employment opportunities for lowly-skilled local workers.

### ***Effectiveness of Foreign Worker Levy (FWL)***

Currently, the FWL is used to help address the impact of wage depression brought about by the influx of foreign workers. While it is intended to increase the cost of employing foreign workers relative to locals, employers can offset the increase by sourcing for cheaper sources. This in turn lowers labour productivity. The experience of employing foreign domestic helpers is a good indicator of likely responses to FWL increases, where helpers from cheaper sources were engaged at the expense of the level of training and quality of service provided. Given that foreign labour constitutes a major component of the workforce, their productivity performance will surely affect overall productivity levels. Implementing a minimum wage will help attract more productive workers and increase our competitiveness and returns on training investment dollars.

### ***Workfare Income Supplement (WIS) and Minimum Wage***

The WIS was launched in 2007 and represents the fourth pillar of Singapore's social security system. It is targeted at helping low wage workers. Those above 35 years of age and who earn a monthly income of below \$1,700 (both employed and self-employed) qualify for the scheme. The objective is to encourage low wage workers to seek and continue employment, and enhance their retirement savings.

The WIS and the implementation of a minimum wage can complement each other. In comparison to the WIS which augments incomes using government revenue (tax payers), the minimum wage does so at the expense of employers' profits. While it is true that WIS raises incomes without negative employment effects, it may encourage firms to continue low wages and sub-standard terms of employment, which will impose a continued burden on the state in supporting the WIS scheme. There is also the risk of fraud in WIS payments where low wage workers may collude with employers to be eligible for the scheme. A minimum wage addresses this challenge by preventing low wage employers from competing on the basis of wage costs with other firms willing to pay above the minimum wage.

### ***Minimum Wage Implementation Issues***

Having established the value of a minimum wage, there are various implementation concerns in Singapore's context that can be addressed as follows:

- *Is the minimum wage an idea for a 'bygone era'?* The UK reintroduced the minimum wage in 1999 while in the USA, 670 academic economists endorsed a call to increase the minimum wage in 2006, including six Nobel Laureates. In addition, "minimum wages are a nearly universal policy instrument ... applied in more than 90% of ILO member States... more than 100 countries whose populations represent about 90% of the world's total population" (ILO Global Wage Report 08/09).

- *Will the introduction of a minimum wage lead to increased unemployment?* While some dis-employment is inevitable, this is offset by the benefit of removing the current 'artificial' subsidy to inefficient firms and aligning employers the wider interests of society. We have already put in place threshold wage levels for Categories P, Q and S pass holders to protect the wages of locals. The question we need to ask is why not do the same for Category R work permit holders (low wage workers)?
- *Is the minimum wage and 'minimum skills' fundamentally incompatible?* In the absence of a minimum wage, firms are less incentivised to raise the productivity and skill levels of low wage workers. After all, they will have to pay for the training and the higher wage costs that the worker can command. The minimum wage will provide the impetus for employers to ensure that workers have the skills to justify higher wages than currently.
- *Will the minimum wage lead to higher inflation?* The effect on inflation is modest and not a major cause for worry.

The minimum wage should not be seen as a solution for all low wage problems. It needs to be implemented alongside other social security measures such as the WIS. Minimum wages should also not be regarded as a replacement for collective bargaining, as collective bargaining should also include other aspects of employment such as working conditions.

The best practices in implementing minimum wages elsewhere suggest the introduction of a simple wage floor that applies to all with minimal exceptions. The needs of workers, the drive to increase productivity, and the goal of maintaining high levels of employment should also be taken into account. The minimum wage should be determined through research and supported by systematic monitoring and effective enforcement. It should also be reviewed regularly to avoid sudden or large changes shocks. Minimum wage decisions should involve tripartite partners, which is not new in Singapore's labour market history.

In summary, there is a strong case for the introduction of a minimum wage for low end wages in Singapore. It raises the incentive to work and boosts workers' morale and productivity. It also reduces the cost of future market interventions and improves overall productivity. Further, it helps government to moderate the inflow of low wage foreign labour and attract better qualified, more productive foreign workers to Singapore.

## **Enhancing our Social Safety Nets**

The main ideas outlined in this section arose from the discussion and recommendations of the REACH Manpower Policy Study Social Safety Nets Subgroup. The focus of the study was to examine how best to provide greater protection against unemployment risks without creating the moral hazard problems associated with increased unemployment benefits, as well as ways to help workers transit between jobs/sectors as the pace of economic restructuring intensifies.

The study group's key recommendation is to introduce an Unemployment Credit and Wage Insurance Scheme.

### ***Unemployment Credit Scheme***

The current social security system provides no protection against involuntary unemployment. This is where an Unemployment Credit Scheme can help reduce the hardship experienced by this group of unemployed. The features of the proposed scheme are:

- Individual Unemployment Credit Account in CPF.
- Contributions will follow a progressive funding structure. For instance, individual contributions can be set at 0.5% for those earning below \$1250 per month and 1% for those above \$1250 to a maximum of \$4500 per month.
- Government contributions will also be progressive, say 2% - 3% for those earning below \$1250 per month and 1% for those between \$1250 and \$4500 per month.
- Individuals can draw 50% of their salary for three months of involuntary unemployment (capped at a total of \$2250 per month).
- The amount drawn is to be paid back into account when employed, which earns interest when unused.
- On retirement, the account balance goes back to the worker.
- Withdrawals can be extended to 6 months in recessions with special top-ups from the government.
- Individuals can draw down a maximum of 6 months of salary over their lifetimes.

There are several advantages of the Unemployment Credit Scheme. First, it fills the key gap in smoothing unemployment adjustment and labour reallocation. Second, the short credit period facilitates an optimal job search. The fact that the individual account is part of their CPF savings reduces moral hazard. Third, there is the flexibility of extending the amount of withdrawals in times of recession, which can be a new automatic stabilizer. The public costs are also reasonable, estimated at \$620 million or 0.2 to 0.3% of GDP.

### ***Wage Insurance Scheme***

The proposed Wage Insurance scheme is to encourage workers to be re-employed as soon as possible rather than hold out for a better-paying job. Secondly, it works to motivate workers to consider different jobs/sectors of employment by broadening their job search. The features of the proposed scheme are:

- Provide payouts upon re-employment in a lower paying new job after involuntary unemployment, the amount paid being equal to 50% of the wage difference between the new and previous job, subject to a maximum of \$1000 per month.
- A fixed payout period of 12 months.
- Individual contribution of 1% of monthly pay of above \$1500 to a maximum of \$6000 per month.

The advantages of the scheme are that it reduces the reservation wage to re-employment, reduces wage losses arising from worker's transition to a new industry, and promotes an increase in labour market mobility. Social insurance funding also reduces public costs. The estimated public cost with 180,000 claimants per year (or 10% of the resident labour force) is \$690 million or 0.2 to 0.3% of GDP.

### **Conclusions**

The Singapore economy is experiencing wider wage and income inequalities, and greater economic volatility. This is reflective of a highly open and globalised economy. We need to enhance social safety nets to provide better protection against such volatility and the associated adjustment pains.

In particular, low wage decline should be addressed in a manner that is consistent with the emphasis on productivity enhancement and increased participation in the labour force. This can be achieved through the implementation of minimum wages and the proposed Unemployment and Wage Insurance Scheme, at a modest cost of about 0.5% of GDP.

An effective social safety net can be a potential new source of competitive advantage, and facilitate social acceptance of economic change. Singapore is in a unique situation to design and fund such a system due to its favourable fiscal situation and the strong work ethic of its labour force.

## **Question & Answer Session**

Moderated by Prof Lim Chin, NUS Business School, National University of Singapore)

**Question: The overall analysis does not seem to have summed up all the pluses and minuses. Implementing minimum wages in response to wage depression is akin to protectionism under the international trade model, and could suffer from similar drawbacks.**

A/Prof Hui: The efficiency loss as a result of raising wages via a minimum wage is seen in a static state. However, the productivity-enhancing effect is in the long term and will possibly reduce the negative losses and bring about positive gains.

**Question: Not all skills are transferrable among low wage workers. There are many heterogeneous submarkets with their own equilibrium wage rates. A simple uniform minimum wage may not be effective. The higher skilled workers with wages above the minimum will remain unaffected and those earning wages under will be cut out. Using a minimum wage to resolve the issues on hand is not so straightforward.**

A/Prof Hui: The key is to keep the minimum wage system simple. Set the lowest wage that should be paid to workers and unions can use that as a benchmark to bargain for reasonable wages. To set different minimum wage rates for the submarkets would complicate matters unnecessarily. A minimum wage is also sufficient adequate to eliminate income inequalities. Other policy measures such as WIS are needed as complementary efforts. Imposing a minimum wage will cause some unemployment, but the benefits in increased productivity will be reaped in the longer term.

**Question: If the objective is to help lower income groups, then a more direct method of lump sum transfers to the target group may be better than messing around with the market mechanism of determining wages.**

A/Prof Hui: The WIS already consists of direct payments to individuals' CPF accounts. The minimum wage complements this to address other policy goals. This includes increasing the incentive for firms to maximise productivity and preventing low-wage employers from competing on the basis of wage costs with other firms willing to pay above the minimum wage.

**Question: A minimum wage may hurt other sectors in economy because it raises the cost of production for businesses and reduces their competitiveness.**

A/Prof Hui: A minimum wage forces employers to bear additional costs but there are other positive effects of higher pay, the key incentive being an increase in productivity. In Singapore's context where there is a high number of foreign workers, it would be better in the long term to attract those who are more qualified and better

trained to Singapore through higher wage rates. The higher costs can be offset by increases in productivity. Compared to wages, the much larger contributor to business costs in Singapore is rental. What we need is higher wages for locals to want to take on jobs. If there were no significant foreign labour component, I would agree that it would not be beneficial to implement a minimum wage that is above the market equilibrium.

**Question: What should the minimum wage be set at? Would a simpler solution simply be to reduce the inflow of low wage foreign workers to Singapore? Could you also share any research that has been done on how firms have reacted to the imposition of minimum wages?**

A/Prof Hui: The international average is to set the minimum wage at 30 to 40% of the average wage, with developing countries setting the percentage a little higher. I agree that reducing the inflow of foreign labour will solve the problem of wage depression. There has been much written on welfare states with minimum wage impositions, but it will be interesting to see how this plays out in non-welfare states.

**Question: Is an increase in productivity as a result of imposing a minimum wage a conjecture?**

A/Prof Hui: No, it would not be a conjecture. In comparison to other countries with comparable low wage industries, worker morale and motivation is much lower here in Singapore. This is expected given the low wages paid. Worker morale and motivation have a direct impact on productivity levels.

**Question: Does the current situation not already present the best of both worlds, i.e. we enjoy the low cost of foreign labour and have the WIS to support locals?**

A/Prof Hui: This would be the case if foreign labour had no effect on locals. However, we all work as a team at the workplace where motivation levels and attitudes spill over to one another. There are also negative externalities such as congestion, brought about by a large proportion of foreign workers. If we are taking a short term view, we can enjoy the benefits from a supply of low wage foreign workers. However in the long term, a continued reliance on foreign labour is not possible without having to put up with the negative externalities on physical space, given our constraints.

**Question: If things do not work out under the recommendations made in your presentation, would the decisions be reversible?**

A/Prof Hui: If the minimum wage is below what is currently paid, it can be easily adjusted. In terms of the danger of tensions and strikes occurring, we have had a 30-year history of tripartism. In addition, we do not have the problem of a welfare mentality or militant unions, which will contribute to a successful implementation of the recommendations made.

**Question: How would a minimum wage add value if we can cut down on the number of foreign workers?**

A/Prof Hui: There is no need for a minimum wage law if there are no foreign workers in Singapore. Wages will naturally increase. However in Singapore, the reality is that we have a large proportion of foreign workers, which depresses wages. This necessitates measures such as a minimum wage law.