Boosting wages to boost productivity

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FOR THE STRAITS TIMES

A MAJOR wage restructuring exercise took place in the 1980s (the so-called "high wage policy"), while another one is now occurring. But there are key differences.

This year, in the recent Budget proposal, a new wage restructuring scheme for the period 2013-2015 was unveiled. This Wage Credit Scheme (WCS) involves the Government's coverage of 40 per cent of the pay increases of Singaporean workers who earn a gross monthly salary of up to $4,000 over the next three years.

Labour chief Lim Swee Say said last Saturday that the pace of implementation of the WCS will be pivotal to the success of the entire wage restructuring programme.

He cautioned that too fast a pace, like what happened in the 1980s, would cause firms to fold, leaving workers without jobs.

The key objective of the 2013-2015 wage restructuring programme is to enhance the productivity of workers by inducing firms to pay them higher wages.

What is the link between wage increases and worker productivity? There is empirical evidence to suggest a positive relationship between wage increases and the productivity of workers in firms.

Economic theory, underlined by efficiency wage models, offers several explanations for the wage-productivity nexus:

- Workers paid higher wages incur higher costs of losing their jobs hence inducing them to work harder, that is, they are more productive so as to keep their jobs;
- Higher wages can encourage more workers to queue up more eagerly for the higher-paying jobs thereby enabling the firm to select better, more productive workers from a larger pool; and
- Workers who are paid higher wages are less likely to quit, thus reducing the firm's turnover and cutting down the costs of hiring and training new workers.

In a way, the high wage policy implemented by the Government over 1979-1981 was also aimed at enhancing worker productivity. At that time, the objective was to encourage firms to move out of low value-added activities to higher value-added ones that required firms to be staffed with higher skilled and more productive workers.

Nonetheless, there are three significant differences between the 1979-1981 policy and the 2013-2015 wage restructuring.

First, in the high wage policy implemented over 1979-1981, the National Wages Council recommended a 20 per cent across-the-board wage increase per annum, including contributions to Central Provident Fund accounts and to the Skills Development Fund.

In contrast, the 2013-2015 wage restructuring exercise is more aimed at helping firms ease their costs of hiring the relatively lower to middle-skilled Singaporean workers earning below a certain income level ($4,000).

Government subsidy of the wage increase allows firms in the private sector to assess, at the margin, how much more they can afford to pay their workers in line with productivity improvements. This is preferable to a direct wage subsidy to workers or employers, which might not be linked to workers' productivity gains.

Secondly, in line with the Government's objective in the recent Budget proposal to build a more inclusive society, the 2013-2015 wage restructuring exercise underlines an important redistributive element in the Budget.

The WCS, which offers government financial support for subsidising the wage increases of mid- to low-income Singaporean workers earning below $4,000, provides an added incentive for employers to raise the wages of these employees in order to raise their productivity.

With the WCS benefiting nearly 70 per cent of all Singaporean employees, the mid- to low-income groups whose monthly incomes are below $4,000 will stand to gain more than the higher income workers from the wage increases.

On the other hand, firms which hire Singaporeans whose incomes are above $4,000 do not enjoy any government wage subsidies. Hence, employers have less incentive to raise the wages of Singaporean workers who earn above $4,000, compared to those earning below $4,000.

The fact that the Government's co-payment of 40 per cent of the wage increases of Singaporean workers earning below $4,000 is funded using tax revenue also reflects the redistributive element of the Budget. This should help to narrow the income gap between the rich and poor in Singapore's society.

Thirdly, the current economic environment today is radically different from that which prevailed during 1979-1981.

Over the 1979-1981 period, the Singaporean economy grew at a rapid annual rate of 10 per cent. In contrast, the ongoing euro zone debt problems and sluggish growth in the United States economy will likely dampen the Singapore economy's growth prospects over the next one to two years.

The sub-par economic growth will hold down firms' revenues and profits, thereby hampering their ability to afford substantial wage increases for workers.

Taking these three differences into consideration, the pace of wage restructuring this time round is expected to be relatively sluggish, unlike the accelerated wage increases seen following the implementation of the 1979-1981 high wage policy. With this slower pace, the expected productivity gains will likely take time to bring about tangible benefits for firms and for the overall Singapore economy.

On a positive note, the more targeted approach in the 2013-2015 wage restructuring coupled with its slower pace of implementation suggest a smaller risk of a sharp acceleration in wages across the whole economy and a lower risk of Singapore ending up as an overly high-cost economy.

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