Making work pay for low-wage earners

By Hoo Hian Teck

IN A widely cited 1993 World Bank book titled The East Asian Miracle, one notable finding was that East Asian economies' success in achieving high growth was accompanied by declining income inequality and reduced poverty. However, growth was not altogether equitably shared.

So what led to the recent Household Expenditure Survey finding that the average monthly per capita income of the bottom 20 per cent of households in Singapore fell by 1.6 per cent per annum between 1998 and 2003?

There are three reasons for the change in tide, causing a widening income gap and increased joblessness among the less skilled.

First, the exports of low-wage countries such as China and India put downward pressure on unskilled wages.

Second is Singapore's shifting comparative advantage, the result of its success in increasing the pool of skilled workers through education and training.

The effect of this is that firms now find it more profitable to create job vacancies for skilled rather than unskilled workers.

Thirdly, skill-biased technology leads firms to recruit workers with the skill to operate their machines, such as computers.

Because of these changes, older workers who found ready jobs despite lack of skills during the high-growth years now find employers shun them. And this happens even though the workers remain hard-working and reliable.

Why help?

ARE there any good reasons why a democratic society would choose to set aside resources to raise the incomes of less skilled workers and increase their employment?

First, the older members of the current workforce got Singapore onto the first rung of the ladder of growth. Their generally positive work attitude and willingness to maintain peaceful industrial relations despite a low-skill base surely played a part in attracting the foreign direct investment that launched Singapore's growth.

We owe it to them to provide them with a living wage despite a change in the economic headwinds.

Secondly, a fundamental view of economic justice as fairness argues for the sharing of the economic pie with the less advantaged, who are also partners in the production activity.

Thirdly, without intervention Singapore faces the risk of huge social costs from prolonged joblessness and depressed wage earnings among the less skilled part of its population.

How to help?

But how can such workers be helped without stifling their work incentives? How to make work pay?

Job redesign is an innovative way to supply better jobs with better pay for workers.

Providing retraining to re-trenched workers and matching them to potential employers also helps to reduce the duration of unemployment.

The practical policy question is whether job redesign and retraining need to be complemented by other measures.

The National Trades Union Congress recently proposed to the Government that private-sector employers be given financial incentives to recruit older workers.

It recommended a subsidy to firms for their purchase of equipment tailored for older workers.

Such complementary capital boosts the productivity of older workers, making it more profitable for firms to employ more of them.

There is, however, a more direct way to boost the pay and employment of low-wage workers that economists have studied, called employment or wage subsidies.

Economist Edmund Phelps made a case for them in the United States in the book Rewarding Work.

To understand how a general employment subsidy scheme works, let us look at an example.

Economist Lawrence Katz, in his paper Wage Subsidies For The Disadvantaged (http://www.sifer.org/papers/w579), did some calculations on the impact a wage subsidy will have on workers' take-home pay and employment.

He estimates that if the $3 an hour is now paid to the employer.

With the subsidy, the firm finds that an additional unit of labour adds less to cost than it adds to revenue.

The opportunity to earn a higher profit gives the firm an incentive to expand employment.

A 10 per cent wage subsidy is likely to result in a big boost to the pay and employment of low-wage workers.

From his review of US evidence, Prof Katz reaches the conclusion that employment subsidies combined with training and job development are effective in improving the earnings and employment of disadvantaged adults.

Should such a scheme be found feasible in Singapore, its salutary effect is that the budgetary cost of running it can be expected to decline gradually.

This is because continued investment in education means that the pool of unskilled workers will shrink significantly over time.

The author is associate professor of economics at the Singapore Management University. The views expressed here are his own.

Guest writers alternate with Chua Mui Hoong in this weekly column.