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# Wage Policy and its Effect on the Social Sector in Singapore

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## Abstract

This paper has discussed the wage policy of Singapore, the city state which achieved a miraculous growth rate. It has been discussed that as the focus of wage policy was to achieve higher productivity and as the government was more reliant on the market mechanism, the wage gap between rich and poor increased and the income inequality scenario seems to be approaching the Latin-American scenario.

**JEL classification:** D31, J31, J68

## 1. Introduction

The city-state Singapore of almost four million people reached a gross national income per capita of USD 22,856 in 1998, following 8 other economies in the list of 174 countries covered in the *World Development Report*, 1999-2000 (World Bank, 1999-2000). The country is also high in social development, with life expectancy of 76 years, an adult literacy rate of over 90% and enviable progress in housing, education, health and sanitation. In housing for example, over 80% of the population are owner occupiers of apartments built on a vast scale as part of the subsidized public housing program. Given such achievements in economic and social development considerable interest in wage policies has come about.

The economic policy of Singapore mostly emphasises minimising unemployment. The unemployment rate was 2% for more than 10 years before the Asian Financial Crises (1997-98) and currently the war and the Severe Acute Respiratory Syndrome (SARS) affected economy is experiencing over 5% unemployment rate (it could be higher, if the rate is solely computed on a resident labour force basis). In Singapore a periodic adjustment of labour costs through wage policy was used as an adjustment to achieve a near full-employment economy. This short paper has discussed the wage policies in Singapore. It has been discussed that although the market oriented wage system ensures a high growth rate it has adverse effect on the social sector, particularly in the absence of proper social security system. The next section discusses the development of the flexi-wage system. Section 3 makes a brief review on the wage structure on non-Singaporean workforce. The following section discusses the effect of wage policies and foreign labour policies on the social sector. Section 5 studies briefly the central provident fund system and the last section makes some concluding remarks.

## 2. The NWC and the Development of a Flexi-Wage System

In Singapore a periodic adjustment of labour costs through wage policy was used as an adjustment to achieve a near full-employment economy. In 1972 the government established the National Wages Council (NWC), a tripartite forum with representation from employers' federations, trade unions and the government. As a government advisory body, the Council recommends annual wage adjustments for the entire economy (this is non-binding but widely followed), and ensures orderly wage development so as to promote a sound economic environment. It assists in the development of incentive schemes to improve national productivity.

There is no minimum wage in Singapore. This reflects the government's total faith on the operation of the market mechanism without any rigidity (which could have restricted business and increased unemployment). Also, for the wage determination of the blue-collar workers (almost

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40% of the total labour force) the influence of unions is stronger than NWC recommendations, but market forces have influenced the unions.

During 1973-1979, actual wage increases followed NWC guidelines closely. In 1979 a “wage correction policy” was introduced, when a 3 year high wage increase was recommended. It was designed to induce productivity of higher value-added operations, to reduce reliance on cheap unskilled foreign labour and to raise labour productivity. During 1980-84, actual wage increases exceeded recommended wages by a 2.4% points per year on average arising from very high labour demand. Moreover, for unionised workers the collective agreement lasted for 2-3 years with built-in wage increases. Thus despite a relatively low starting wage, a huge inequality of earnings were institutionalised through longevity of employment and annual increases.

Mainly because of the high wage (the annual increase of wage and rise in mandatory Central Provident Fund (CPF) component) in 1985 Singapore experienced economic recession. To restrain wages, the Government instituted a “flexi-wage policy” in mid-November 1986, which became effective with the enactment of the Employment Amendment Act 1988. The flexi-wage system tries to overcome rigidities in wage structure and thus allows individual companies to adjust to rapidly changing economic conditions. The NWC recommended that up to 20% of the total wage should be in the form of an annual variable component (AVC). The AVC represented an alternative way to adjust wages in the absence of government-instituted CPF cuts. The following features were also introduced in the wage determination process:

- Annual wage negotiations on the basis that total wage increase lagging behind productivity improvement;
- Adjustment of the variable wage component by means of a formula based on company productivity and/or profitability;
- Periodic review of salaries with taking relevant factors into account. Such a review was proposed to be made no more than once in 3-year intervals and should preferably coincide with the renewal of collective agreements;
- Individual performance to be taken into account for wage increases; and
- Sharing relevant company information. These policies aim at moderating wage increases through lower growth and higher productivity both at individual and at firm levels.

By 1998 the AVC was built up to 16% of an employee’s total wage on average. More than 90% of unionised companies and 70% of non-unionised ones have implemented some form of AVC. However, during the economic down turn at the time of the Asian economic crises in 1998, only 7% firms reduced wages under the flexible system, while 25% had frozen wages and 40% provided lower annual salary increases<sup>1</sup>.

Using AVC, a company was able to reduce wages up to 16% in the course of the crisis, however, the reduction could only take place at the end of the year after negotiations between employees and employers. To increase the flexibility of the system, in 1999 NWC recommended an introduction of a monthly variable component (MVC) of 10% of wages. MVC would allow companies to adjust wage cost in a given month. It also recommended that a portion of the future wage increases would be set aside each year as MVC, until total amounts reached 10%. Therefore the future wage structure will have 3 components: the basic wage (70%), MVC (10%) and AVC (20%). NWC recommendations were accepted by the government on May 23, 2001. During that period NWC reported that 29% of the unionised companies and 2.4% of the non-unionised ones had instituted the MVC.

In 2002 the labour market was very weak because of uncertain global environment; total employment fell by 40,900 and 19,100 workers were retrenched. While total wage increased by 1.1% in 2001, it came to a standstill in 2002. Basic wages of all employees rose by only 1.8%. This increase was offset by a 15% reduction in variable component to 1.77 month of basic wage in 2002<sup>2</sup>.

<sup>1</sup> <http://www.usembassysingapore.org.sg/ep/2001/Wages2001.html>

<sup>2</sup> <http://www.nyuc.org.sg/myunion/wages/full.html>

In early 2003, severe acute respiratory syndrome (SARS) hurt the viability of business and job prospects in various companies in Singapore. Employment fell by 9,400 during the first quarter and 4,200 workers were retrenched. On April 15, 2003 NWC recommended

- implementation of shorter work-week,
- temporary lay-offs, and
- arrangement for workers to take leave or undergo skills training and upgrading provided by Ministry of Manpower and other agencies, as temporary cost-cutting measures.

In view of the impact of SARS on the economy, the NWC recommended that companies directly affected may implement appropriate wage cuts to survive the economic downturn and to save jobs. If the wage structure of the firms is not in line with current market conditions, they are asked to restructure their current wage system. Thus NWC stressed on the conversion of the fixed and seniority based pay to productivity and profit sharing bonuses by transferring more than 2% from basic wage into the MVC. The other companies who were not directly affected by SARS were asked to follow the same path. The demise of the seniority based wage system was also recommended by the Economic Review Committee (ERC) and endorsed by the government. The NWC strongly urges companies and unions to speed up wage restructuring to narrow the wage maximum/minimum ratio to an average 1.5 or less. It also recommended implementation of measures for employees whose salaries exceeded the maximum point in the desirable salary ratio, for example by reducing or freezing the maximum wage scales. These recommendations were to apply for the period for one year, subject to review by the NWC.

The recent changes in the wage structure aim at the replacement of the seniority based wage system to a performance- based wage system. At present the wage gap has been brought down to 1.7 (the maximum and minimum ratio)<sup>1</sup>. These changes are not abrupt, rather it was planned long ago at the time of restructuring in mid-1980s.

Table 1

Relative mean income of various age groups (1984-2001)

	1984	1992	1994	1997	2001	% change: 1984-2001	% change: 1992-2001
15-24 yrs	0.511	0.474	0.465	0.443	0.434	-15.07	-8.44
25-29 yrs	0.915	0.851	0.814	0.826	0.816	-10.82	-4.11
30-34 yrs	1.297	1.130	1.056	1.096	1.053	-18.81	-6.81
35-39 yrs	1.510	1.259	1.253	1.203	1.172	-22.38	-6.91
40-44 yrs	1.442	1.322	1.283	1.225	1.202	-16.64	-9.08
45-54 yrs	1.292	1.252	1.270	1.176	1.081	-16.33	-13.65
≥55 yrs	1.000	0.925	0.945	0.848	0.732	-26.80	-20.86

Computed from LFS (various years).

Table 1 shows that the relative mean income (average income of an age group compared to total average income) for all age groups has been decreasing. The pattern of the change in relative mean incomes between 1984 and 2001 is not clear (although decreasing for all age groups), however, from early 1990s the eclipse of seniority based earning is quite clear<sup>2</sup>.

### 3. Wages and Unskilled labour and the Non-Singaporean workforce

The NWC recommendation is not applicable to the foreign labours and unskilled workforce in Singapore. The persistent high demand for labour, forced Singapore government to import labour from Malaysia, Thailand, Indonesia, the Philippines and the India subcontinent. This

<sup>1</sup> The Business Times, June 3, 2003.

<sup>2</sup> See also Mukhopadhyaya (2003).

created a pressure on the wage offered to the unskilled local workers. From 210,000 in 1990 the number of foreign labour rose to 360,000 in 1995 and to 590,000 in 2001 (about 500,000 of which were unskilled). Thus 25% of Singapore's workforce consists of foreign unskilled labour while 4.5% is foreign skilled labour<sup>1</sup>. With a view not to disturb the local employment situation by the influx Singapore government sets maximum ratio of foreign domestic workers in certain sectors. However, companies in the construction sector bypass the quota satisfying the requirement only by employing *skilled local* workers.

Government of Singapore has imposed a monthly levy to be paid by the employers for each foreign worker. This levy increases the cost of employing foreign workers and thus creates disincentive to replace Singaporean workers. The levy amount is approximately a sum that the employers need to pay a local worker. The amount of levy varies for sectors and skill levels. Levy is low for skilled workers. Thus the foreign workers levy works as a minimum wage for local unskilled workers. Although theoretically the levy creates disincentives to employ foreign workers, employers find it cost-effective to hire foreigners so as to avoid the mandatory contribution to the Central Provident Fund (CPF).

Table 2

Singapore: Levy Rates and quotas for Foreign Workers (as of 27 June 2003)

Sector	Dependency Ceiling <sup>a</sup>	Category	Monthly Rates
Manufacturing	Up to 40% of the total workforce	Skilled	\$30
		Unskilled	\$240
	Between 40% and 50% of the total workforce	Skilled	\$30
		Unskilled	\$310
Construction	1 full-time local worker to 5 foreign workers	Skilled	\$30
		Unskilled	\$470
Marine	1 full-time local worker to 3 foreign workers	Skilled	\$30
		Unskilled	\$295
Process	1 full-time local worker to 3 foreign workers	Skilled	\$30
		Unskilled	\$295
Service	30% of the total workforce	Skilled	\$30
		Unskilled	\$240
Harbour Craft	1 local full-time worker to 9 foreign workers No crews (shown MPA Harbour Craft License) x 2 Lower quota will apply	Certified Crew	\$30
		Non-Certified Crew	\$240
Domestic Worker	NA	NA	\$345

NA: Not Available.

Notes: <sup>a</sup> It is believed that there are also informal unpublished quotas on the foreign workers from particular countries in particular sectors. These may change from time to time. This information however is not provided to the public by the authorities.

Source: MOM (2003: 8).

#### 4. The Effect of Wage and Foreign Labour Policies on the Social Sector

The World Bank (1993) conferred on Singapore the status of a *tiger* economy (in contemporary development literature it is called a Newly Industrialized Economy) because of its mi-

<sup>1</sup> <http://www.usembassy singapore.org.sg/ep/2001/Wages2001.html>; Wui (2002).

raculous characteristics of high growth and reduced income inequality. The second aspect (that is the reduced income inequality) has been severely criticised. The basic data on labour force in Singapore made available by Ministry of Manpower has lack of transparency, reliability and thus hampers serious independent research.

Following a tedious method of data correction<sup>1</sup> on the annual Report of labour Force Surveys, published by department of Statistics of Government of Singapore following observation is made on the income distribution scenario of Singapore (Figure 1).

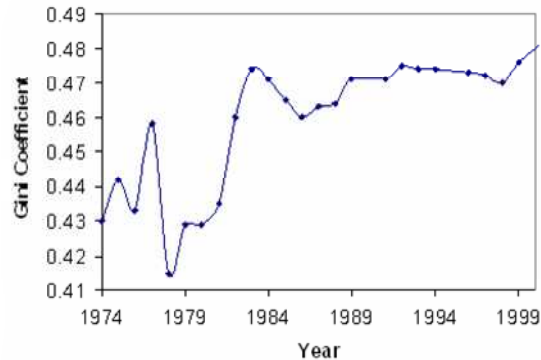


Fig. 1. Trend in Gini Coefficient in Singapore: 1974-2000

Four phases can be identified in the trend in income inequality. During the first phase till 1979 the NWC policy of lump sum contribution to each and every worker along with reduction of unemployment reduced the rich-poor gap. However, in the '80s till the beginning of 1990s inequality increases due to the restructuring process where skilled had been remunerated very highly while unskilled remained very lowly paid. In the '90s inequality was stabilised however, the period of economic crisis experienced an increase in inequality once again. Let me elaborate this recent phenomenon in further details.

Two factors were noticed for the increase in inequality in Singapore during 1999. Firstly, the number of lower income households increased: the households with monthly income below \$3000 increased to 42% in 1999, from 40% in 1998 (DOS, 2000)<sup>2</sup>. Secondly, there was a decline in the income of all the households (except the top 10%) and the lower income classes were worst hit.

Table 3 shows that during 1998-99 the average household income of the bottom decile decreased by 48.4%, while this decrease for total households is only 2.7%. One of the reasons is that the unemployment rate started rising from June 1998<sup>3</sup>. During this time the unemployment rate was 3.2% which reached a peak in December 1998 to 4.6%, came down to 3.8% in March 1999 and went up again in June 1999 to 4.6%. In the more recent time although there was a recovery in 2001 (unemployment rate: 3.4%), 2002 once again experienced a rise in unemployment rate to 4.4% and this rising trend continues in 2003<sup>4</sup>.

<sup>1</sup> See Mukhopadhyaya (2003).

<sup>2</sup> This observation is to be considered with proper care. With the economic downturn, unemployment has been tending upwards since the second half of 1997. As of June 1998, the overall unemployment rate (non-seasonally adjusted) was 3.2% compared with 2.4% in June 1997. And in June 1999 the rate was 4.6%.

<sup>3</sup> According to the Ministry of Manpower, Singapore 7131, 7309, 6633 and 8013 people were retrenched in the four quarters of 1998. During 1999 number of retrenched people decreased: 3402 in quarter 1, 3350 in quarter 2, 3395 in quarter 3 and 4475 in quarter 4.

<sup>4</sup> It is useful to note that the unemployment figures above portray a skewed scenario, for the following reasons:

- The figures have not accounted for the substantial number of foreign workers in the Singapore labor force. In an economic down turn, foreign workers bear the brunt of the first round of layoffs.
- When a person of age 50 or over is retrenched, it is assumed in several cases in the *Report of Labor Force Surveys*, that they have dropped them out of the labor force completely. This creates a down ward bias on the

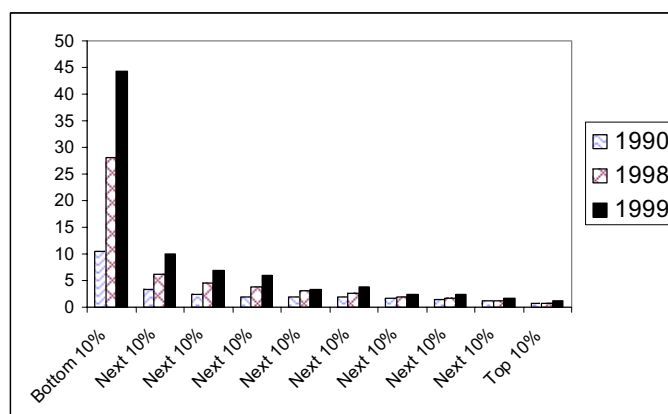
Table 3

## Average Household income from Work by Decile

	1990	1998	1999	Annual change (%)	
				1998	1999
Total	3076	4822	4691	1.6	-2.7
Bottom 10%	370	258	133	-21.1	-48.4
Next 10%	934	1332	1172	-1.5	-12.0
Next 10%	1321	2005	1853	0.1	-7.6
Next 10%	1686	2647	2470	1.3	-6.7
Next 10%	2075	3305	3137	1.6	-5.1
Next 10%	2541	4097	3900	1.9	-4.8
Next 10%	3116	5034	4828	1.9	-4.1
Next 10%	3897	6271	6023	2.9	-4.0
Next 10%	5151	8221	7937	3.2	-3.5
Top 10%	9669	15053	15451	1.1	2.6

Source: DOS (2000)

Figure 2 shows that in general the unemployment rate is very high among the bottom 10% residents and the rate increased from 28.2% in 1998 to 44% in 1999 (an increase of about 56%) while for the total labour force the increase was of 42%.



Source: DOS (2000)

Fig. 2. Unemployment rate per person aged 15 years and over in resident private household (%): various deciles

Along with the job loss all the top five occupations at the bottom decile experienced a pay cut of 13 to 34% (Table 4).

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number of economically active people aged 50 and over and consequently that generates a biased unemployment rate figure.

Table 4

## Average income of Five Top Occupation at the Top and Bottom Deciles

Occupation	Average income		Average annual change
	1998	1999	
Top five occupations at the top decile			
Specialised Managers	7643	8374	9.6
Statistical, Administrative and Related Professionals	5011	5353	6.8
Company Directors	12118	12527	3.4
Finance and Sales Associate Professionals	6581	7566	15.0
Architects, Engineers and Related Professionals	6750	6097	-9.7
Top Five Occupations at the bottom decile			
Helpers & Cleaners in Offices, Hotels and other establishments	655	573	-12.5
Housekeeping & Catering Service workers	625	503	-19.5
Stall and Market Sales Workers	620	461	-25.7
Shop Sales Workers and Demonstrators	746	492	-34.0
Personal Care & Household Service workers	494	418	-15.4

Source: DOS (2000)

Thus the increase in inequality in Singapore during the crisis is an effect of unemployment (which is more prominent at the lower decile: who are generally less well-skilled/educated) and wage cut at the lower decile along with wage increase in the upper decile. It is quite perplexing to note that during the crisis most of the top occupations in the top decile experienced salary increases (see Table 4). This is mainly due to the fact that Singapore economy is quite dependent on the foreign expatriate labour. At the phase of financial crisis when Singapore dollar depreciated vis a vis US Dollar, to stop foreign talents from leaving Singapore a more attractive salary package was offered.

Thus it is observed that to achieve full employment and increase productivity Singapore government used various NWC policies. But because of the lack of experienced skilled labour in the small economy the wage policies are biased. And this has its effect on the social sector, as has been observed above.

## 5. The Central Provident Fund (CPF)

The discussion of the wage policy of Singapore will not be complete if no mention is made about the Central Provident Fund (CPF). The CPF is a national contributory provident fund established in 1955. Singapore citizens and permanent residents only are eligible to join the CPF. Under this scheme a member over and above his/her monthly wage gets a contribution by the employer (he/she has to make a contribution as well). At the time of introduction in 1955, the employers' contribution was 5% of the wage with a maximum monthly contribution of \$50. The contribution rate increased over time and currently it varies according to sector of employment, age etc. In 1998 December the employers' contribution was 20% for age group 35-55, 7.5% for age group 55-65 and 5% for people above 65. To revitalize the business downturn as a result of the Asian Economic Crisis, in January 1999 the employers' contribution rate was reduced to 10% for 35-55 age group and to 4% and 2% for 55-60 and 60 & above age groups respectively (with a maximum limit)<sup>1</sup>. Two points are important here: (1) the CPF contribution is designed to partly de-link wages from seniority, and to reduce the cost of hiring elderly workers, and (2) as govern-

<sup>1</sup> For more detailed discussion on CPF see Asher (2002).



ment adjusts the CPF contribution rate, it gives reliance to the firms' stability during crises. Hence firms were not very keen on the transformation to a variable payment system.

Therefore, recently government of Singapore, to emphasize the flexible wage system has expressed intension not to increase the CPF contribution. But, the CPF is the only social security provision available to the residents through which they arrange their housing loan, medical expenses etc. Thus, with reduced contribution to CPF these social security amounts will also be reduced. Furthermore, Singapore is one of the fastest growing ageing economies in Asia. CPF, which works as a pension after retirement, if reduced, will have detrimental effect on the retired people.

## 5. Conclusion

Recently (July 2003) Minister of Information, Communication and Arts Dr Lee Boon Yang has emphasised that the wage reform is the responsibility of employers<sup>1</sup>. Although the government was pushing the implementation of MVC since 1999, until recently only 5.6% firms adopted this, and only 39% unionised companies and 3.9% of the non-unionised sector (this comprises the bulk of Singapore companies) have implemented MVC. Some scepticism is always there about the possible abuse of the variable component by some companies to manage their monthly profit/loss margins.

It is argued by the government that MVC might be painful but it is less painful than outright retrenchment, if the firms are able to cut the MVC initially in response to down turns. Thus the government is keen to protect the full employment situation (even at the cost of unfairness created by the firms in the salary payment).

A more aggressive action might be considered by the Government, by legislating it. To offer tax or other incentives to make the change or a penalty for companies that resist reform might be a better approach. Can the country take this approach in the globalization process?

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<sup>1</sup> The Business Times, July 26, 2003.