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## Shock Therapy II Revisited

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# SHOCK THERAPY II REVISITED<sup>1</sup>

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## **Abstract**

In this presentation, Professor Lim Chong Yah revisits his original proposal for “Shock Therapy II”, paying particular attention to the need to have a pause for three years for the very top income-earners with a view not to slide into “unconscionable salaries”. He also outlines the need to consider the introduction of minimum wage, should NWC’s quantitative guidelines fail to exit workers with income less than \$1,000 a month in two years’ time.

Keywords: Economic restructuring; income inequality; labour market

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<sup>1</sup> Paper presented at the Singapore Economic Policy Forum 2012 on 25th October 2012 at the Orchard Hotel, Singapore.

<sup>2</sup> Professor LIM Chong Yah was the founding Chairman of the National Wages Council (NWC) and the founding Chairman of the Skills Development Fund Advisory Council. The opinions here are his personal views.

## **“SHOCK THERAPY”**

Professor Euston Quah as President of the Economic Society of Singapore invited me in April 2012 to give a public lecture on the Singapore economy. I titled my lecture “A Proposal for Economic Restructuring II”. The lecture was chaired by Mr. Ho Kwon Ping, a very prominent Singaporean who is incidentally also the Chairman of the Board of Trustees of a sister university, the Singapore Management University (SMU).

I thought then, for a moment at least, I was in a pure academic world. The words I used were thus words like isoquant curves, factor proportions, inflexion points, transformation curves, demand for and supply of labour, labour participation rates, wage/GDP ratios,  $P_{90}/P_{10}$  indices and Gini Coefficients. The lecture was attended by a small group of about 65 persons. I was told that the Economic Society of Singapore could not afford to invite more than 65 people to a function held in this same hotel! At the Q and A session after the lecture, a young, very discerning journalist asked me, “In your actual Economic Restructuring One, why did you telescope it only into three years, 1979 – 1981?” I remember I replied that the three-year period was intended as a sort of “shock therapy”, to get the economy as quickly as possible out of the low-level equilibrium trap of very low-wages, low-productivity, highly-labour intensive industries to a more capital-intensive, skill-intensive, technology-intensive and knowledge-based economy. I did not expect the Singapore media, particularly the print media and the

social media, to give so much attention to the term “shock therapy” and its ramifications. The extensive national public debate that followed spoke well for Singapore as a participatory industrial democracy. The Singaporean society has changed, has grown. It has grown into an orderly, participatory parliamentary democracy. Hallelujah. That was my diagnosis, hopefully and undoubtedly, a correct one.

The proposal for Shock Therapy II emanated from a seriously increasing Gini Coefficient, from 0.422 in 1980 to 0.454 in 2001 and to 0.473 in 2011, and also from a declining already low wage/GDP ratio from 46% in 2001 to 42% in 2010. True, government should be greatly complimented for trying to close the gross income disparity gap through numerous taxation and transfer measures, such as the Workfare Income Supplement (WIS) Scheme which tops up the income and CPF savings of low-wage workers and the GST Voucher Scheme which helps lower-income and middle-income households with their expenses. Government reported that in 2011, resident households in HDB 1- and 2-room flats received government transfers amounting to an average of \$3,267 per household member while resident households in HDB 3-room flats received an average of \$2,087 per household member. It is also not commonly known that amongst resident households living in HDB 1- and 2- room flats, government transfers were as high as 43.8% of their annual household income from work.

True, government has tried very hard to lower the ex-post Gini Coefficient. Notwithstanding such numerous taxation and transfer measures, the ex-ante Gini Coefficient, which our earlier figures refer to, increased to a high of 0.473, quite close to the often used dangerous level of 0.500. It was against this background that I made the Shock Therapy Proposal II, aiming at calling a halt to the further deterioration of the ex-ante Gini Coefficient.

### **THE TWO EXTREMES**

My remedial proposal had two parts. One aimed at lessening the number and percentage of workers at the lowest end of the income ladder. Two advocated a three-year pause to the ever increasing rate of escalation of income of the highest income group. Media reports on the salaries of some top executives in Singapore can range from \$2.5 million a year to \$5.5 million a year, or roughly \$208,000 to \$458,000 per month. In one instance, I recall 4 top family-related directors of a publicly listed company paid themselves between \$2 million and \$3 million each, when the company did not see it fit to pay a single cent dividend to its shareholders. When a very brave shareholder at the AGM asked the Chairman of the Board of Directors for an explanation of this dichotomy, he replied to the effect, "If you do not think this is a good company to invest your money, you are of course free not to invest in our company."

The shareholder walked out of the AGM. \$2 million to \$3 million is two thousand to three thousand times that of \$1,000 per month, the figure later used by the tripartite National Wages Council (NWC) below which a quantitative wage increase guideline was recommended.

Why has there been such a serious upward escalation of pay for the upper income group followed by a freezing or declining of pay for the lower income group is another story, another mystery, another enigma. In my view, this is associated with global Darwinian capitalism, and in Singapore's case, exacerbated by the huge intake of cheap, very low-wage workers from our neighboring countries. In other words, Shock Therapy II addressed the two extremes in our salary and wage system in Singapore.

### **NWC AND GOVERNMENT STAND**

The final outcome of the vigorous public debate that followed my Public Lecture ended up with the NWC on 23 May 2012, as alluded to earlier, making a recommendation to increase the pay of the lowest paid category, that is, workers earning below \$1,000 a month, by at least \$50 a month. The proposal, I understand, was put forward by the NTUC to the tripartite NWC. The employers' and government's representatives in the NWC, after deliberation, gave the NTUC's proposal their unanimous support. The Cabinet too endorsed the NWC's recommendation. So, in a

sense, to me, “all’s well that ends well”. A serious attempt to narrow the serious income gap was done. For the first time, after many years, the NWC resorted to a general quantitative guideline recommendation.

### **THREE YEAR MORATORIUM**

However, my proposal to have a 3-year pause to the salaries of the highest income group (the pyramid or apex group) was put aside. Indeed, there was little public interest in this matter. Actually, I did not propose a maximum salary ceiling. Neither did I propose a super-tax for this group. I only proposed a salary pause for a period of three years, and through moral suasion, or NWC recommendation with the endorsement of the Government. My fear was that without the recommendation of a pause, the salaries of the top pyramid group would continue its upward trend, as it had come to pass in the last decade or so. As the pause would take the form of a recommendation, prior contracts for salary increases should be adhered to. Legal contracts are sacrosanct and should not be broken. The pause, however, would have at least the effect of the top-tier salaries not pulling further and further away from the central salaries. Top company executives might even think of rewarding the shareholders and also themselves with dividend payment in lieu of still higher salary increases. It is important that our salaries at the top, already at times at stratospheric heights, should not move into a morally



indefensible position of unconscionable but perfectly legal rewards. Every procedure and every step as required in the Companies Act has been followed. Competitive escalation of salaries emanated from the top salary echelon and its cumulative spiraling effect on the second- and third-tiers could eventually make our companies and our economy internationally uncompetitive to the detriment of all of us; lowest, middle or highest income groups.

### **RECESSION OR INFLATION**

Since the NWC's quantitative recommendation of increase in pay for those earning up to \$1,000 a month was announced in May 2012, the world economy and the regional economy have both deteriorated. One world pivotal economy, the eurozone economy, unfortunately took the lead in this global contractionary process. Does it mean that my pyramid pause proposal should be called off? No. In my view, it should go on, though much more so now with the declining global general income tide. It would serve to drive home the point that in a declining global, regional and international economic tide, top salary leaders too should set an example by having a salary pause, voluntarily of course. Hopefully, media should give publicity to any breach of this voluntary salary pause or restraint, through national tripartite consensus.

Indeed, Singapore did have, it may be recalled, a nation-wide across-the-board pay cut, and voluntarily, not by law. This was necessitated in 1985 and also in 1998. In 1985, Singapore was faced with a serious regional recession, consequent on regional commodity slumps. In 1998, Singapore was also faced with a regional recession, though different in causality; consequent on regional exchange rate crises.

So, my call for a pyramid salary pause or moratorium hopefully would not have to end up with a more unpalatable apex salary cut instead as in 1985 and in 1998 in the next round of NWC deliberation! I doubt this will happen, as I doubt the world is heading for a second dip in the Great Recession of 2008-09, despite the austerity measures taken by so many highly-indebted developed countries.

Since September 2012, a new monetary easing policy has been pursued by the European Central Bank (ECB), the US Federal Reserve Bank and the Japanese Central Bank. The US Federal Reserve Bank calls it Quantitative Easing III (QE3). Should their actions result in serious global inflationary pressures by early next year, Singapore's responsive strategy may have to alter *pari passu*, bearing in mind the increasing income inequality gap would remain, if not further aggravated. I think a pause or a cut policy in Singapore would still be in order for the top executives, coupled with another respectable increase in pay for those drawing \$1,000–\$1,500 and below. In other words, Shock Therapy II should continue for the remaining two-year period. Indeed, *the*

*disadvantage of announcing one year pay increase without the commitment to the two more years would hardly have favorable impact on economic restructuring: the substitution of capital for labour and the re-organization of workforce to raise productivity.*

## **MINIMUM WAGE PROPOSAL**

Coming back to the wage pyramid base, some responsible public opinion-makers in Singapore have proposed a statutory minimum wage as a way out, as an “open sesame” for extremely low wages to exit, to disappear. Maybe of interest is that way back in early 1972 when the NWC was formed, I did submit a memorandum to the NWC for the adoption of a minimum wage scheme. Brain-storming sessions followed in the NWC. All three social partners disagreed, and my proposal was put in cold storage. Of course, there were pros and cons in such a proposal. But as Chairman of the NWC, I must abide by its decision, unanimous decision.

One main reason for objection was that it would create unemployment. Those workers with marginal productivity value below the minimum wage would be unemployed. NWC then had among its top priorities optimum employment. Indeed, even today, Singapore still has an unemployment rate of only 2.0%, one of the lowest

and one of the most enviable in the world, contrasting with Greece 25.1%, Spain 25.1%, and the USA, 7.8%.

Another explanation for non-adoption of my 1972 minimum wage proposal was that NWC then had a yearly quantitative wage guideline system, and that gave flexibility to yearly wage adjustments bearing in mind the optimum employment objective or target. In other words, NWC preferred a more flexible wage system. The Chairman went with the NWC.

Soon after NWC rejected my proposal for a minimum wage scheme for Singapore came the publication of Milton Friedman's very widely read book "*Free to Choose*". Indeed, I suggested, and Professor Kernial Singh Sandhu, then the well-known and very able Director of the Institute of Southeast Asian Studies, arranged for our TV station to have Professor Friedman's TV version telecast. In it, *inter-alia*, the globally influential American, Professor Friedman, disagreed with the minimum wage system. In the US, he maintained, thousands of Americans would have been employed but for the minimum wage. He warned that most of those forced to be unemployed in the US by the minimum wage system were blacks, African Americans. NWC's decision was thus re-enforced by Professor Friedman's stand on the subject.

## ***QUO VADIS***

Since 1985, NWC moved into a qualitative guideline system. For the last decade or so, the floodgate for low-wage foreign workers was opened. Our economy continued its impressive growth rates, no doubt the low-wage foreign workers must have contributed enormously to its continued spectacular growth.

Where do we go from here? *Quo vadis?* In May 2012, NWC had recommended a quantitative guideline aiming at raising the pay of all the lowest paid workers in Singapore. I hope, as stated earlier, that this “partial shock therapy” would continue for the next two years with the addition of apex wage pause for the next three years as well. If these measures do not succeed in halting the further decline in the ex-ante Gini Coefficient, perhaps a compulsory minimum wage scheme should be seriously looked into by the NWC and the Government.

### **MINIMUM WAGE: \$1,000**

If a minimum wage scheme were to be adopted, perhaps a figure like \$1,000 per month should be looked into. This would mean an estimated 120,000 full-time resident workers (approximately 6.7% of full-time employed resident workers) in Singapore would fall below the minimum wage. However, by 2014, hopefully this number would

be considerably reduced, perhaps to a minimum, if in the interim, some deliberate upward adjustments of their wages are done. If inflationary pressures turn out to be more serious, then even the \$1,000 a month norm might turn up to be a non-starter: it would be too low. *En passant*, in the 1974 inflation, the NWC recommended a wage increase of \$40 + 6% net, amounting to an approximate 17% general wage increase. The country sailed through with it with flattering outcome.

With a minimum wage of \$1,000 a month and assuming that full-time workers work 44 hours a week (or 2288 hours a year), it would be \$5.25 per hour. The per hour yardstick is meaningful to the 194,700 resident part-timers in Singapore.

Is \$1,000 a month too high or too low? This reminds me of a Chinese proverb, “比上不足，比下有余”， which means “better than some and worse than some”. As compared to Australia, France and Japan, S\$5.25 is about one-quarter of the Australian minimum wage of A\$15.96 (or approximately S\$20.10), about one-third of the French minimum wage of €9.40 (or approximately S\$14.95), and about one-half of the Japanese average minimum wage of ¥744 (or approximately S\$11.70). But as compared to the other 3 Newly-Industrializing Economies (NIEs), S\$5.25 is slightly lower than the South Korean minimum wage of 4,860 won (or approximately S\$5.40) but higher than the Taiwanese minimum wage of NT\$103 (or approximately S\$4.33) and the Hong Kong’s minimum wage of HK\$28 (or approximately S\$4.40). S\$1000 is also three times the

Malaysian minimum wage of RM800 – RM900 (or approximately S\$322 – S\$362). One must bear in mind the median wages of these countries are not the same as ours, and so are their per capita incomes and their income distributions, besides changing exchange rates.

### **PRODUCTIVITY CONCEPTS**

As an addendum, I shall touch on a point of serious concern to many public opinion-makers in Singapore. It is the absolute necessity of wage increase to be commensurate with productivity increase. This is a good basic guideline principle; one that has been faithfully followed by the NWC since its inception in February 1972.

Three concepts of productivity change would, however, be identified here. One, national productivity increase. A good proxy for this is productivity increase per worker. Two, company productivity increase. The usual practical measure is company profit. Three, personal productivity contribution. Of the three, the third is often the most difficult to measure. This is thus best left to the company management to handle, as is required under our Industrial Relations Act and the Employment Act. Each company too has its own performance appraisal system to take care of individual assessment.

For NWC and for the country, the national measure is used, and has been used for the last 40 years. This national concept may involve the wage to GDP ratio as well.

This ratio is relatively very low for Singapore. In other words, the sharing of the national cake is involved. At the national guideline level, the decision must be made on the equitable sharing of the national income. Also of importance is that money income is used, not real income. Profits and payment of wages are in money terms, not real or physical terms. This point is of particular importance if inflationary pressures are high, and more often than not our inflationary pressures are import-generated.

For company productivity growth, this has been handled at the company level. The company, however, should take and has taken cognizance of the national guidelines. At the company level, this may involve, unfortunately, adjustment to the profit margin in a situation where profitability has not increased. Since the guidelines are not law, a lot of flexibility is there in rewarding workers by the company according to the national guidelines. The increase in wages of the low-wage workers could be the impetus to the restructuring of the companies' production processes toward the greater use of labour-saving devices and the substitution of capital for labour.

Lastly, the NWC system is unique to Singapore. It is one of those exceptionalisms which are associated with Singapore. No country in the world has the NWC system, except Singapore. Dr Hilton Root, an impartial American observer in his book *"Small Countries, Big Lessons"* says of the Singapore wage system thus: "NWC allowed Singapore to overcome labor unrest, thereby transforming a liability into an asset.



Labor relations have improved to the point where firms can respond efficiently to economic indicators without the typical strife that accompanies rapid economic transformation in both developing and mature economies. Moreover, the council is an outstanding example of how consultation can promote growth with equity.” The International Labour Office (ILO) in the *Report on ILO Study Mission on Singapore's Tripartism Framework* adds, “Strong tripartite partnership has been a key competitive advantage for Singapore. It underpins its economic competitiveness, its harmonious labour-management relations, and the overall progress of the nation as a whole.” Ms. Cleopatra Doumbia-Henry, Director of the International Labour Standards Department of the ILO also says, “This tripartite culture has enabled Singapore to create a climate of industrial harmony leading to a favourable investment climate, economic growth, social and political stability and a higher standard of living and better quality of life for Singaporeans. Tripartism has become Singapore's competitive advantage.”

Also, when NWC in May 2012 recommended a minimum \$50 increase for workers earning below \$1,000 a month, it must have in mind the national definition of productivity and not the company or personal definition. Whatever it is, NWC recommendations have always in mind the continued ability of Singapore to create the national cake, not to diminish it. One certainly does not want to throw the baby out of the bathtub. One certainly does not want to frighten the goose that lays the golden eggs.

That, however, does not mean that a society should ignore excessive income inequality altogether, be it reflected by the Gini Coefficient or by the wage/GDP ratio or by the  $P_{90}/P_{10}$  index.

### **THREE PROPOSALS RESTATED**

Lastly, I would like to add that in this paper, I have made three proposals for a more inclusive society in Singapore.

One, that NWC should continue with the issuance of quantitative wage increase guideline for those earning less than \$1,000–\$1,500 a month for the next two years.

Two, that NWC should call for an across-the-board temporary three year moratorium of salaries of very top executives both in the private and public sectors.

Three, should the wages of the lowest paid resident workers remain stubbornly very low in two or three years' time, serious consideration should be made to introduce a compulsory minimum wage scheme with, say, \$1,000 a month as the start-off quantum.