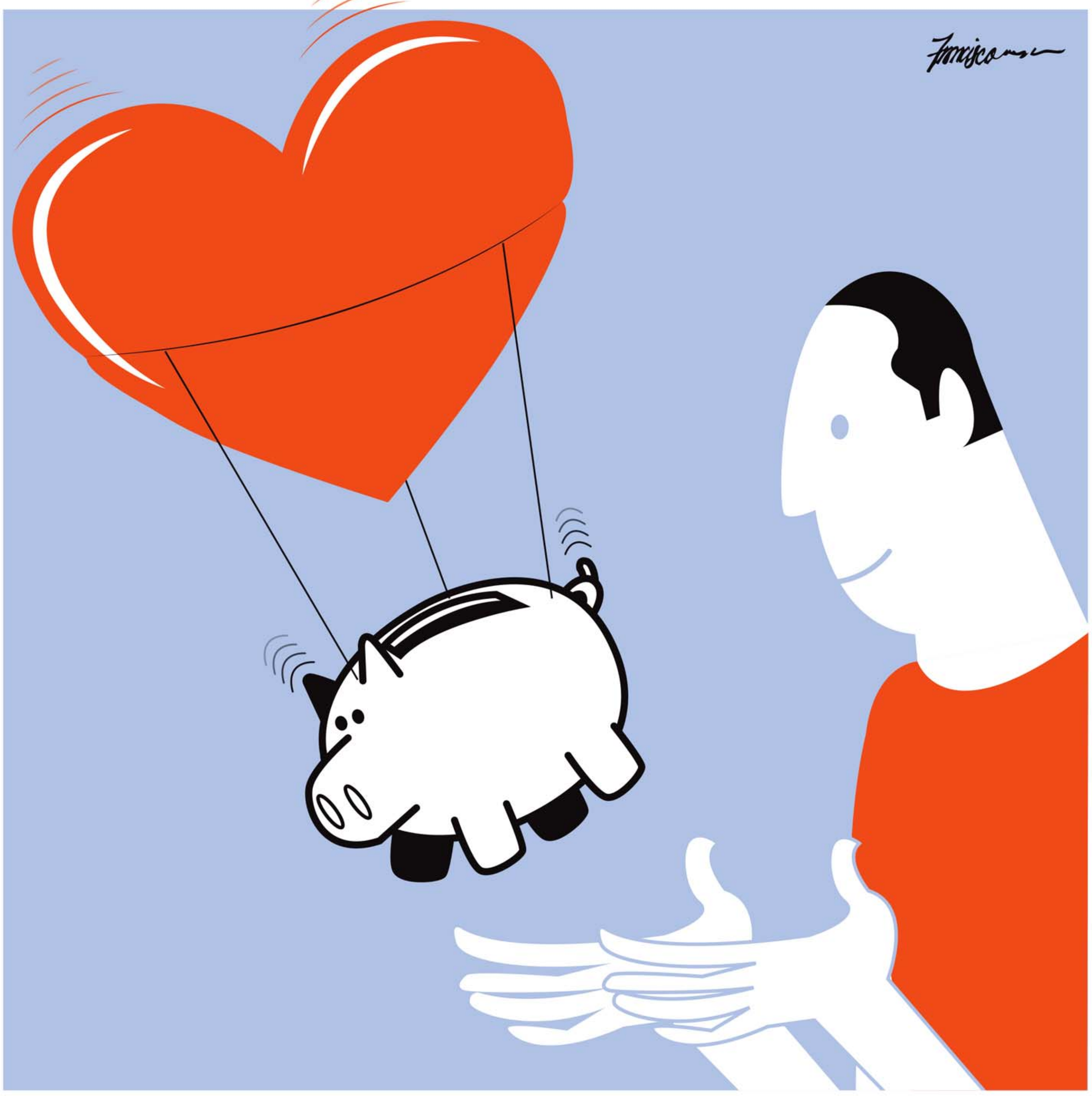
Amid the debate in the Forum pages on foreign worker levies and the passage of a new law to license operators of large dormitories for foreign workers, this writer explains why a minimum wage or bidding system for work permits will not work.

Focus on welfare, not wages, of foreign workers



By DONALD LOW
FOR THE STRAITS TIMES

IN HIS second IPS-Nathan Lecture last November, Mr Ho Kwon Ping suggested channelling the levies that employers pay for the foreign workers they hire into a savings fund, akin to the Central Provident Fund for Singaporeans. These savings would be given to the foreign workers when they leave Singapore.

In response, National University of Singapore economist Ivan Png pointed out that such a scheme, although well-intentioned, is unlikely to help foreign workers much.

He noted that foreign workers already pay, on average, more than $7,000 to work in Singapore. This price mechanism has evolved to allocate the limited number of foreign worker permits. The fees are neither set nor approved by the Ministry of Manpower; they are simply the result of the market responding to a situation where foreign workers' demand for jobs here greatly exceeds the supply of such jobs.

Creating a savings fund would simply increase the demand, raising the fees that foreign workers pay to secure work in Singapore and negating the income increase that the proposed fund would give them.

The likely beneficiaries of the proposed fund would be the middlemen, agents and employers (who respond by cutting wages) – all of whom have more bargaining power than the workers.

The economics of foreign worker policies can often be quite counter-intuitive.

For instance, many of us assume that paying foreign workers lower wages benefits low-skilled Singaporeans. But this is flawed reasoning: If Singaporean workers are paid more than foreign workers doing the same job, why would employers want to hire them?

The foreign worker levy therefore exists to narrow the wage differential between foreign and local workers. But this assumption is also questionable. Since foreign workers have much less bargaining power than employers, the levy is passed on to them in the form of lower wages. This reduces the employer's incentive to hire (more expensive) Singaporean workers or to invest in labour-saving machinery.

Can anything be done?

There are at least three policy goals worth pursuing. The first is to create stronger incentives for employers to hire Singaporeans instead of foreign workers. This is what the foreign worker levy tries to do, probably not very successfully.

The second is to raise labour productivity, the assumption here being that an over-reliance on cheap, low-skilled foreign labour has led to Singaporean companies investing less in automation and in raising the skills or technology content of their operations.

The third is to improve the welfare of the foreign workers in our midst, this objective being the impulse for Mr Ho's suggestion.

Economists have a strong preference for tinkering with incentives to produce the desired outcomes. In this instance, our instinct is to find a better way to "price" foreign workers in Singapore. If a tax on foreign workers (which is what the foreign worker levy is) is not working well, would a minimum wage or a cap-and-trade system work better?

But as I shall proceed to argue, neither a minimum wage nor a cap-and-trade system is able to achieve all three policy goals simultaneously.

Rather than look for a more efficient way to price foreign workers in Singapore, policymakers are probably better off looking to legislative and regulatory measures to achieve the third objective of improving worker welfare.

Minimum wage

BUT if policymakers want to consider better ways to "price" foreign workers' labour than the existing levy, what might they consider?

One option is to legislate a minimum wage that is applied to all workers. It would level the playing field, negating the cost advantage that foreign workers have over locals. A minimum wage may also encourage employers to reduce their reliance on low-skilled labour and introduce labour-saving, productivity-enhancing measures.

But as with the proposal to channel the foreign worker levies into a savings fund for foreign workers, a minimum wage that is higher than current wages would increase the number of foreign workers seeking employment here and push up the fees they are willing to pay.

So the likely result is that employers pay more but foreign workers are no better off.

This is not to say that a minimum wage is a non-starter.

The benefits of levelling the playing field for lower-skilled Singaporean workers and of sharpening incentives for employers to increase productivity may be sufficient justification to have one.

Cap-and-trade

ANOTHER option that economists would consider is to replace the foreign worker levy with a cap-and-trade system similar to the vehicle quota system for controlling the vehicle population.

Under such a system, the Government announces a quota (the cap) on how many foreign workers Singapore would take in (say on a monthly or quarterly basis). Employers who wish to hire more foreign workers would bid for them; the limited foreign worker permits would go to those who are willing to pay the price determined by the auction process. Employers would also be allowed to trade these permits.

Such a system would enable the market, not the Government, to set the price of hiring foreign workers. It removes the political considerations that the Government invariably has to take into account under the current levy system.

In determining the levy, the Government has to strike a balance between keeping business costs low and providing a strong price signal for companies to reduce their reliance on low-skilled labour. But because businesses voice strong objections to levy increases while hardly anyone argues for higher levies, there is a natural tendency for the levy to be kept at relatively low levels. In a cap-and-trade system, this problem goes away.

Above all, a cap-and-trade system gives the economy certainty over the quantity of foreign labour that Singapore brings in. This is a significant advantage over the current levy system, which gives price, but not quantity, certainty, especially now that the policy priority is to control the intake of foreign workers.

So why isn't the Government considering a cap-and-trade system? Because it appears to be a modern form of slave trading. Society probably finds the idea of bidding for, and trading, the rights to employ workers repugnant, regardless of how efficient the system might be.

It is also unclear how a cap-and-trade system would help foreign workers here. For one thing, the fees that foreign workers pay to get here would probably be unchanged. The underlying problem is that as long as foreign workers are willing to work for less than the prevailing wages – as evidenced by the fact that they are willing to fork out money to work here – any scheme that tries to raise their incomes directly runs a significant risk of benefiting employers, middlemen and agents instead.

Back to welfare

WHAT all this means is that we probably have to look somewhere else – instead of trying to find a better way to "price" foreign workers – to improve their welfare. Raising their incomes is not the only way to improve treatment of foreign workers.

Specifically, the Government should do more to ensure better housing conditions, provide adequate health protection, protect their rights to safe and fair working conditions, and promote more leisure options for them. Since these benefits cannot be easily monetised, it is unlikely that they would result in higher fees paid to middlemen or agents or lower wages by employers.

Just as importantly, the costs of providing these should be borne by taxpayers, rather than by employers. Since it is society at large that benefits from the low-wage work that the foreign workers perform, it is only fair and efficient for society to pay these costs.

stopinion@sph.com.sg

The writer is the Associate Dean of Executive Education and Research at the Lee Kuan Yew School of Public Policy, National University of Singapore.