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FOCUS ON BUDGET 2015

Four writers give their take on how tax breaks can push productivity further, enhance retirement savings and improve health insurance.

PIC: Move from subsidy to root cause

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Productivity is not just about working harder, it's about working smarter. A better solution to the problem of poor productivity is to treat the root cause – poor management – either directly or indirectly. If businesses do not wish to innovate or raise productivity, dishing out more subsidies will not help. ST FILE PHOTO

ON MONDAY, Deputy Prime Minister and Minister for Finance Tharman Shanmugaratnam will deliver the Budget statement in Parliament. One of his top priorities is surely to stimulate innovation and grow productivity. As an advanced economy, Singapore can sustain growth of living standards only by raising productivity. And key to higher productivity is innovation.

In 2010, the Economic Strategies Committee, chaired by Minister Tharman, set a target of raising productivity by 2-3 per cent a year. The Government backed up the national effort by introducing the Productivity and Innovation Credit (PIC).

Since 2011, the PIC has offered a 400 per cent tax deduction or 60 per cent cash payment on up to $400,000 expenditure per year. The PIC applies to expenditure on IT and automation equipment, employee training, intellectual property, R&D, and design projects. In 2013, the Government boosted the PIC by raising the expenditure limit to $600,000 and adding a dollar-for-dollar matching cash bonus.

When launching the PIC, Mr Tharman estimated that it would cost $480 million. Following subsequent enhancements, the annual cost of the PIC has risen to about $1 billion. So, the Government has certainly spared no effort on the fiscal side to encourage businesses to raise productivity. But what happened?

Labour productivity – which measures the amount that each worker produces – grew by 11.6 per cent in 2010 and 2.2 per cent in 2011, then fell by 1.4 per cent in 2012 and a further 0.2 per cent in 2013. Last year, labour productivity rose by 0.8 per cent in the first quarter, and then fell by 1.4 per cent and 0.8 per cent in the next two quarters.

The record on multifactor productivity (MFP) is equally disappointing. MFP is a broader concept that measures gains in production over and above the contributions of additional labour and capital. Put simply, it measures "working smarter" as contrasted with "working harder". In tandem with labour productivity, MFP grew by 9.7 per cent in 2010 and 1.4 per cent in 2011, and then fell by 2.3 per cent in 2012 and a further 0.7 per cent in 2013.

Productivity growth seems to have fallen to the point that the level of productivity is dropping. Apparently, the PIC hasn't worked. (I write with caution because we do not know the counterfactual. What if there had been no PIC? Would innovation and productivity have been even lower?) Stipulating that the PIC hasn't worked, we need to understand why.

Professional services company KPMG surveyed Singapore-based companies about business conditions and their wishes for Budget 2015. Of the 203 companies that responded, 30 per cent used the PIC to defray operating expenses without any direct impact on productivity.

Why aren't Singapore businesses taking advantage of the PIC to innovate and increase productivity? The root cause is possibly poor management, particularly among small and medium-sized enterprises.

Some years ago, the National Productivity and Continuing Education Council carried out a study of management practices.

Among manufacturers with 100 or more employees, the quality of management among multinational corporations here fell below those in the United States, but exceeded those in Japan, Germany, and Sweden. However, the quality of management among other Singapore companies was much lower, lying between those in Portugal and Chile.

Among the companies that responded to the KPMG survey, 41 per cent reported their most serious operational issue to be rising costs of rental and labour, while only 20 per cent reported it to be innovation or raising productivity. Regrettably, four out of 10 companies did not see that innovation and raising productivity could help resolve higher rental and labour costs.

Obesity contributes to heart disease and other health problems. One way to address it is to subsidise exercise. But a better solution is to treat the root cause – educate people to want to keep fit.

The PIC is like a subsidy for exercise. As with tackling obesity, a better solution is to treat the root cause – poor management – either directly or indirectly. If businesses do not wish to innovate or raise productivity, dishing out more subsidies will not help. Far better to increase competition and let the market drive out the weak performers.