

Beware the welfarism trap

Ker Sin Tze

For *The Straits Times*

The major goals of the Government, as illustrated by Deputy Prime Minister (DPM) Tharman Shanmugaratnam in his speech at the Economic Society of Singapore SG50 Distinguished Lecture, are to sustain income growth, mitigate income inequality and enhance social mobility.

The Government has systematically devised a series of plans to achieve these, particularly since 2006, he said.

After a decade of policy implementation, Singapore has managed to sustain income growth across the board, including the low-income households. The bottom 20 per cent of employed citizen households saw their incomes per household member from work rise 37 per cent from 2004 to 2014 (after taxes and transfers).

With the use of government transfers from tax revenues, income inequality has been mitigated. The long-term solution for the uplifting of low-income households is to maintain social mobility through education and skills training.

On top of attaining the three goals, the overall objective is to develop Singapore into an innovative and inclusive society.

In his National Day Rally speech on Aug 23, Prime Minister Lee Hsien Loong announced more schemes to help low-income and middle-income households. These include higher housing grants, more generous Baby Bonus payments and an extra week of paternity leave. The income ceilings for couples to purchase Housing Board flats and executive condominiums were also raised.

All these mean more expenses to be financed by government transfers through tax revenues.

Using tax revenues from the rich to help the poor is a common

practice across the developed world, notably in European and Scandinavian countries.

The state imposes highly progressive tax rates to pay for health expenses, education costs, unemployment benefits and other social benefits. The marginal tax rates are steep, and attract criticism that they discourage people from working harder in these welfare states.

Welfare benefits, once given, are not easily withdrawn without dampening popular support. High tax rates are necessary to keep on providing welfare benefits, and the two are closely intertwined.

The welfarism trap weakens work incentive and hobbles the development of entrepreneurship. In his speech at the British Chamber of Commerce in Singapore in 2004, Mr Lee Kuan Yew said: "Cradle-to-grave welfarism blunted the ambition of many budding entrepreneurs. Worse, high personal taxes dampened the desire of many to achieve wealth and success."

He also pointed out in 1982 "the folly of populist politicians who win elections playing the politics of equal rewards or egalitarianism: squeeze the successful to pay for the welfare of the poor, and end up with the equalisation of poverty".

Although his comments were made in a different context, they may still be relevant in the discussion of policy formulation in Singapore.

EROSION ON WORK ETHICS

There is no free lunch and everyone should work and earn his or her own living. The Government has rejected the idea of welfarism since our independence.

After a few decades of development, the economy has grown substantially but the distribution of the fruits of growth has not been even, which is to be expected in a competitive meritocracy where greater rewards go to those who succeed.

Income disparity hence becomes greater, and the divide between the



With the income inequality gap widening in the past decade, the amounts of government transfers needed to reduce the gap have been on the rise year after year. This may seem to be a move towards being a welfare state. ST FILE PHOTO

successful and the poor becomes more evident. The Government has mitigated the inequality by providing affordable housing and public transport, better healthcare and the Workfare supplement to help low-wage workers.

The Government also encourages the successful to help those who have lagged behind. After the General Election in 2011, it has obviously changed its approach, and dished out more goodies to help the low- and middle-income groups. HDB grants, healthcare benefits, baby bonuses and other subsidies have increased. This gives an impression that the Government has been moving towards welfarism in recent years.

DPM Tharman acknowledges that government transfers have been deployed to subsidise low-income households for nearly a decade, and explains that it helps to narrow the inequality gap and yields a lower Gini coefficient after taxes and transfers.

While Mr Tharman is mindful to keep the overall tax burden low, particularly for the middle-income group, the increasing freebies given now and in the future will drive up tax rates to be more progressive. The change in property taxes from a flat rate to progressive ones in the past few years is one example.

Is this approach of taxing more, either in rates or in form, and giving more to citizens, a move towards

creating a welfare state?

The Government's answer, I believe, is definitely no. Some critics, however, call Singapore a welfare state that works.

DEBT BURDEN FOR FUTURE GENERATIONS

In the traditional welfare state, the state adopts populist policies in providing goodies to such an extent that the present generation might go bankrupt, leaving debt burdens to future generations.

This is certainly not the case for Singapore, whose Budgets remain healthy with surpluses in most years, going into occasional minor deficits in past decades. No debt burdens are likely to be carried forward to future generations. The Government also does not need to draw on past reserves or Budget surpluses from earlier generations to pay for current expenditure.

The fear of falling into the traditional welfarism trap is unfounded, which is true at least in the present and next few years.

But how long can this happy state of affairs remain?

With the income inequality gap widening in the past decade, the amounts of government transfers needed to reduce inequalities have been on the rise year after year.

People's desire for a change of lifestyle and an increase in living standards will force the Government to increase the types and amounts of transfers over the years. For instance, every resident household member received an average of \$3,370 in transfers from the Government in 2014, compared with \$2,700 in 2009, an increase of 25 per cent.

This is particularly true in a democratic regime where the electorate can use votes to make demands.

The Government will have to either increase marginal tax rates, making income taxes and property taxes more progressive, and/or levy new taxes to finance the ever increasing transfers and freebies.

The rich will probably have no qualms about paying more taxes

here, which are still relatively low compared with high taxes in other countries, but the middle-income earners, especially fixed-income employees, will suffer.

As in Hong Kong, the present low personal and corporate income taxes regime is Singapore's advantage over countries with high taxes such as Britain, Australia and the Scandinavian countries. If the taxes are raised to be more progressive, the advantage may gradually vanish. The goods and services tax (GST), Certificate of Entitlement (COE) premiums and import duties for motor vehicles, stamp duties for property transactions and all kind of levies have increased costs and made Singapore a costly and expensive city for all residents, local as well as foreign. These will further reduce Singapore's comparative advantage, which may impact income growth adversely.

We have come a long way to reach where we are today. The sustained economic growth over the years has transformed Singapore into a First World nation.

With the development of a knowledge-based economy, those who possess advanced knowledge, new skills and high technologies are greatly rewarded and earn more. Income disparity has become stark as a result. There is no question that the successful should help the less privileged through taxes and government transfers.

But the Government should be mindful to avoid falling into the welfarism trap as voters' demands may be insatiable and transfers can over the years snowball into unbearable burdens.

The Government should, therefore, dampen the request for more transfers and keep Singapore far away from becoming a welfare state similar to those in the West.

stopinion@sph.com.sg

• The writer, a former People's Action Party MP, is an adjunct professor at the Lee Kuan Yew School of Public Policy, National University of Singapore.