

Ask: NUS Economists

Measuring the impact of GST hike and driver subsidy

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For The Straits Times

Q Who bears the brunt of a rise in goods and services tax (GST)? Who gains when the Government subsidises the income of cabbies?

A In mid-February, Finance Minister Heng Swee Keat said the Government would raise the rate of GST from 7 per cent to 9 per cent within four years. How will this rise affect Singapore consumers?

Separately, last September, the Government announced that it would pay \$300 monthly to 40,000 ride-hail and taxi drivers until last month. Why was that good news for Gojek and Grab?

Despite the apparent difference in contexts, the answers to both questions depend on the same underlying principle – the burden of a tax rise or the boon of a government subsidy can be shared by different parties.

In short, consumers need not necessarily bear the full brunt of the GST hike, and the earnings of ride-hail and taxi drivers need not

necessarily increase by \$300.

Consider the effect of the GST increase on the price of a restaurant meal. Suppose that the price of the meal, including 7 per cent GST, is \$42.80. The price excluding GST would be \$40.

Now, suppose that the Government raises the GST to 9 per cent. By law, businesses are required to collect GST for the Government. Superficially, the price of the meal would increase by $0.02 \times \$40 = 80$ cents to \$43.60.

All consumers would moan. More importantly, some would decide not to buy that meal. They might switch to eating at a foodcourt or cooking at home.

How many would do so is characterised by the price elasticity of demand. The more price elastic the demand (the more sensitive consumers are to price), the more the demand would decrease and the less of the tax increase that

consumers would bear.

The effect on the supply side is more subtle. Superficially, the price excluding GST would be the same whether the GST is 7 or 9 per cent. However, restaurants are also sensitive to price. They may reduce their prices rather than pass on the entire increase to consumers, in order to keep up the demand for their food.

The part of the tax increase that restaurants would bear is characterised by the price elasticity of supply. The more price elastic the supply (the more sensitive producers are to price), the less that the restaurants would bear.

Hence, how the GST increase is split between consumers and suppliers depends on the price elasticities of demand and supply.

Now to consider the impact of the \$300 monthly subsidy on ride-hail and taxi drivers. Ride-hail operators such as Gojek and Grab

as well as taxi operators like ComfortDelGro earn their revenue from drivers. Ride-hail drivers pay commissions to ride-hail operators, while taxi drivers pay car rentals to taxi operators.

Covid-19 led to a huge drop in tourist arrivals and office workers switching massively to working from home. The pandemic's fallout collapsed the demand for the services of ride-hail and taxi drivers, which in turn hurt the revenue of the transport operators.

The Government chipped in \$300 monthly to cushion the shock on drivers.

But the subsidy also benefited Gojek, Grab and taxi operators – easing the pressure on them to lower their commissions and rentals in order to keep drivers to work for them.

What happened was that the taxi operators matched the

government subsidy with \$29 million of rental rebates. However, Gojek and Grab did not.

These two examples show the split impact of a tax rise and government subsidy. The GST rise would likely be borne by both consumers and vendors, while the benefits of a subsidy to drivers would end up being shared by both drivers and transport operators.

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