

Foreign Worker Policies through Lens of Economics

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The recent strike by a group of bus drivers from China at public transport operator SMRT has polarised public opinion in Singapore.

On one side, civil society groups have framed the issue as one of human rights and morality. They have decried the uneven distribution of power between corporations and workers, the unfair wages paid to foreign workers, and the poor conditions they labour under.

On the other side, the Government has emphasised the illegality of the drivers' actions, the availability of legitimate channels for workers to voice their grievances, and the country's "zero tolerance" of acts which disrupt industrial harmony.

What seems to be missing from the debate is an economist's perspective. There has not been a wider discussion of the economic rationale and implications of the Government's foreign worker policies.

Analysing Singapore's foreign worker policies through the lens of economics leads to some surprising conclusions which suggest that neither the position taken by the civil society groups nor the current government approach is viable on its own.

A good place to begin our economic analysis is to ask whether foreign workers are properly priced. Foreign workers are prepared to work for lower wages than Singaporeans doing the same job. Allowing low-skilled foreign labour unfettered access to Singapore would therefore depress wages in those sectors that are more dependent on foreign labour.

A tempting, but economically flawed solution, is to require employers to pay differential wages so that a Singaporean worker earns more than the foreigner doing the same job. But somewhat counter-intuitively, this does not serve the interests of Singaporeans. If Singaporeans are paid more than foreign workers who are equally productive, what incentive would employers have to hire the Singaporean worker?

The argument that Singaporeans should be paid more because they have more needs or face higher costs is also misguided. Wages should reflect the marginal productivity of the worker, not his needs. If wages are based on needs, workers would be justified in demanding a wage increase from their employer for having more children.

Externalities

If it is bad economics to (artificially) raise the wages of Singaporean workers relative to foreign workers, should we then impose additional costs on the latter so that they are more expensive to hire? Foreign workers impose "external" costs on society. These costs include increased

congestion, competition for infrastructure and public goods, and wage depression. These costs are not borne by the foreign workers or their employers; instead, they are borne by society.

The standard economic response to this market failure is to impose a tax that forces the parties in the economic exchange - in this case, the foreign workers and their employers - to internalise the social costs of their exchange. This provides the economic justification for the foreign worker levy that the Government imposes on employers who hire low-skilled foreign workers.

Economically speaking, it does not matter which party the Government imposes the tax on. Economics predicts that the foreign worker levy would be borne by workers.

This is because employers' demand for labour is elastic while workers' supply of labour is not.

This means that employers' demand for workers is very responsive to wages since they can hire more, or fewer workers, depending on the amount of wages they have to pay. They can also fire one group of workers and hire another.

In contrast, foreign workers can't just switch employers easily if they are unhappy with their wages or working conditions, especially when their work permits are tied to specific employers.

Employers thus have superior bargaining power and can pass the added cost to foreign workers in the form of lower wages.

This situation leads one to question the efficacy of the foreign worker levy in reducing the demand for foreign labour, and in raising the costs of foreign labour. Since it is the foreign workers who bear most of the tax, employers will still find them cheaper relative to Singaporean workers. And if Singaporean workers are pricier, why would employers want to hire them in place of foreign workers? This is perhaps why, in addition to the foreign worker levy, the Government also needs the dependency ceiling to manage demand for foreign workers.

All this suggests that the foreign worker levy, on its own, is unlikely to "protect" Singaporean workers from the wage pressures created by our open foreign worker policies. In the short run, the only way to assure Singaporeans of wage increases is to continue tightening our foreign worker policies. The reduction in the supply of cheap foreign labour would raise wages, particularly in those sectors which have been more reliant on cheap foreign workers. But there is a price for this. Rising wages would translate into rising prices - unless productivity, or output per worker, increases at a faster rate.

Collective Action

Another perspective which is useful in analysing Singapore's foreign worker policies is the economics of collective action. Besides the collective action problems faced by workers who are not all organised into unions, we can also view the employers as facing a collective action problem of their own.

While it may be in the common interests of all firms to be responsible employers, to pay their foreign workers fairly, to provide them with proper housing and health care, and to maintain a motivated (foreign) workforce, individual firms may find it in their own interest to gain a cost

advantage by shirking from these responsibilities. Such an employer would enjoy the collective benefit - of Singapore being perceived as an attractive destination for economic migrants - without having to contribute his fair share to the production of the collective good.

The economics of collective action says that in these situations, the outcome we should expect is one in which individual actors rationally "defect" from contributing to the collectively desirable outcome. As Mancur Olson argues in *The Logic Of Collective Action: Public Goods And The Theory Of Groups*: "Unless the number of individuals is quite small, or unless there is coercion or some other special device to make individuals act in their common interest, rational, self-interested individuals will not act to achieve their common or group interests."

The collective good which our foreign worker policies should strive to provide is Singapore's reputation as an attractive place for immigrants and foreign workers. Maintaining this reputation requires employers to play their part. But as Olson and other economists have pointed out, the logic of collective action says that individual employers will always face a strong temptation to free-ride, shirk or act opportunistically. The larger the group (of employers), the harder it is to organise collective action.

The standard economic solution to the collective action problem is to have a central authority to impose the cooperative solution, monitor for compliance and punish defections. This is also the solution advanced by some civil society groups that have called for stronger government regulation and enforcement against abuses in the foreign labour industry.

But greater government regulation, while necessary, faces inherent limitations. The most serious is the fact that individual employers will always seek ways to circumvent regulations. Government also often lacks the information to act against defectors. This increases the benefits, and therefore likelihood, of defection.

Besides the policy solution of stronger regulation and enforcement, we need an institutional solution where groups (of employers) come together to set standards for themselves, enforce their codes of fair employment practice, and punish or shame recalcitrant members.

Such self-organising, self-regulating solutions are likely to be more sustainable, and are less likely to suffer from the informational problems that typically afflict regulatory agencies. Having small groups of employers (say organised by industry) also reduces the risks of free-riding and increases the likelihood that such collective goods would be provided.

Identity

A third economics perspective relevant to the current debate is provided by George Akerlof and Rachel Kranton in *Identity Economics: How Our Identities Shape Our Work, Wages And Well-Being*. Akerlof and Kranton argue that the worker's identification with the organisation partly determines his work effort and productivity. They argue that the worker's output is determined not just by monetary incentives but also by his "identity utility".

Workers who identify with the firm and see themselves as "insiders" put in higher work effort, as that increases their identity utility. The opposite is true for workers who see themselves as "outsiders" - they are more likely to shirk or put in low work effort.

Akerlof and Kranton also found that in organisations where employees had a strong identification with the organisation, the pay needed to induce higher effort (and higher productivity) was lower than that for organisations with low worker identification. The worker's identification with the employer in turn derives from his sense of being fairly treated and remunerated.

The economics of identity challenges standard notions of cost savings. Encouraging companies to "invest in identity" and job satisfaction among employees may raise business costs in the short run but reaps benefits for our economy in the long run. Normalising such practices also means that as our domestic services, public transport, construction and health-care industries require more foreign workers in the future, Singapore does not have to compete for these workers on the basis of monetary incentives alone.

As with many other policy challenges Singapore faces, the problems posed by the large number of foreign workers in Singapore require not just the right incentives but also the right norms and institutions. Economists have widened their analysis beyond the study of incentives to incorporate ideas on how the right rules and norms can sustain cooperative solutions and promote collectively desirable outcomes.

Singapore's foreign worker policies should not only aim to create the right incentives but also promote the right employer norms of fairness, industry self-organisation and regulation, and employee identification and well-being.

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