



A Critical Discussion of Budget 2011

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The long-term strategic intent of the proposed budget presented on 18 February 2011 is clear and well-appreciated. The measures by which to achieve productivity growth and innovation however require finer calibration, and those to enhance social safety nets could benefit from more serious, systematic commitment. Given the looming risk of a carbon-constrained world, attention should also be given to achieving energy-efficiency as the economy strives towards labour-efficiency.

These were some of the key messages of the closed-door discussion held by the Institute of Policy Studies on 28 February at the Orchard Hotel. The objectives of the event were to gather feedback on the budget statement and specifically, on how those running local small and medium-sized enterprises (SMEs) might view it.

Restructuring the Economy

Participants recognised that the government was proposing a slew of measures to restructure the economy, raise productivity levels and reduce the economy's dependence on foreign workers. This reinforced the efforts set out in the 2010 budget to make the economy more competitive, productive and innovative. The 'stick' of increasing and extending foreign worker levies is accompanied with several 'carrots' that include tax deductions on expenditure on automation, Research and Development (R&D) expenses, Intellectual Property (IP) acquisition and registration, training and re-skilling of workers, and other tax rebates and cash grants specifically for SMEs.

These measures would certainly be better received by firms in the technology sector than firms in the high-touch services, retail and food and beverage sectors where it is difficult for entrepreneurs to automate their work processes or the production of their offerings. There is also a limited scope for national skill training schemes to add much value to workers and their companies compared to the more comprehensive, specialised courses developed to meet the requirements of specific sub-sectors and even firms, that are not yet recognised in the current scheme of incentives for worker training. One of the speakers emphasised that the artisanal quality of products produced by some of these SMEs meant that the core of business could and should not be automated. To do so would be to risk compromising quality.

It was noted that many local SMEs in such sectors survived on razor-thin margins, and often faced uncertainty from fluctuations in other aspects of business costs, especially those to do with rentals. Adjustments to labour costs through the foreign worker levy as well as tightening of the numbers allowed to work here would seriously erode margins and the business proposition of operating in Singapore. New businesses might not even be able to open when they fail to find the manpower they need. One participant also cited the land development sector and explained that the uncertainty of whether there would be projects in the pipeline deterred players from making large labour-saving capital investments as it would not be clear if and when they could recoup the costs. It is for that reason that they preferred to add more on the side of 'variable (labour) cost' to keep their operations and cost structures flexible.

More critically, participants remarked that it had become very difficult to attract local workers to the sectors mentioned, such as services, food and beverage (F&B), and construction. This was not about price as their experience had proven that even when higher than market rates were offered, Singaporeans would not take up jobs available. It was also difficult to tap older workers in jobs that are physically-demanding, require the ability to multi-task and a broad range of skill-sets. This was quite a different setting paradoxically from fast food outlets like McDonald's where job-scopes are tightly-defined and workers perform just one key task at a time. While it is possible for F&B outlets in other developed countries to rely on a very small number of workers because they are capable of taking charge of almost the full value-chain of work (from maintenance of the premises to food preparation, cashiering and service), it is not possible to find the same quality of labour in Singapore, and local workers are usually only prepared to perform the higher-level functions of running a business. Customers elsewhere are also observed to be less demanding in their expectations of food service for instance. They are prepared to pick-up their own food and clear their own trays.

As such, measures to improve labour productivity should be calibrated more meaningfully to take into consideration these conditions of operation and the work preferences of locals. To do that, it would be important to track the work preferences, and trends in work ethic of locals more carefully. A more rigorous survey of the structure of business costs for different sectors and sub-sectors would be useful so that policy-formulation and implementation can take better account of the constraints facing SMEs today. The corrective measures to reduce dependency on foreign workers should be introduced more gradually and given more time to work as it is not clear that the local SMEs can avail themselves of the Productivity and Innovation Credits scheme to offset the increase in foreign worker levies at short order.

Finally, given that property prices and rentals in land-constrained Singapore are inching towards to the relatively high levels of other first-world global cities, enterprises marketing the class of goods and services that have strong branding propositions should consider re-pricing their offerings if they do not already reflect the true cost of producing them - they should not be marketing themselves at third-world prices. Consumers should also be prepared to pay higher prices for such products. In the end, economic restructuring with regard to SMEs in these sectors would depend on the mindset of local workers and consumers.

Taking Businesses Overseas

The government has also expressed its commitment to help SMEs make inroads to overseas markets. A speaker shared that a few SME bosses had said they were going to give themselves one to two years to decide if it was tenable to stay in Singapore. If firms wished to or are forced to relocate or branch out overseas, the speaker said that it would be good if such businesses can go out 'hunting in packs', facilitated by strong institutions like an export-import financial institution that had been recommended by the Economic Strategies Committee and International Enterprise (IE) Singapore that has yet to play that role effectively especially with regard to technology firms.

Business in a Carbon-constrained World

One area that would benefit from greater attention is how the Singapore economy and country at large would cope in a carbon-constrained world. As oil prices rise, and as the economy restructures towards labour-efficiency, it is important to ensure that businesses adopting new technology and innovation also make choices that are green, energy-efficient and even environmentally-sustainable. It is important that they should not be trapped into energy-intensive capital investments that may prove to be very expensive when energy prices soar, or other rules relating to environmental impact change.

Social Provision

A good deal of the discussion also focused on another key plank of the budget – social provision. Speakers first noted that the country faced inflationary pressures and that generally, it would be good to pursue a neutral if not even a contractionary fiscal stance in this year's budget. However, given the growing income disparity and economic volatility, as well as the country's commitment to enabling social mobility, they felt that the government should commit itself to developing stronger social safety nets and investment.

To begin with, it was argued that the 'true overall budget position' is estimated to be something to the order of \$25 to \$30 billion or 7.9 to 9.5% of gross domestic product, if land sales, top-ups to endowment funds (effectively 'dedicated reserves') and net investment income (full amount) are included. Hence the budget may be 'too tight' if this 'embedded fiscal conservatism' is recognised. A participant explained how Singapore did not adopt the standard IMF cash-flow approach to accounting but a hybrid system. A speaker said that perhaps this was also done as the government did not want to public to make large claims on the state for more spending. In any case, it was important to note that the government was putting aside more for social investment that was headlined but it could also afford to do more.

There was an appeal to review the level of national savings or reserves as this reflects deferred consumption and hence 'welfare gains' by one generation of Singaporeans. One speaker estimated that reserves had grown over the past six years from 180% of GDP to 240% of GDP, although it is difficult to verify as this data is not readily available. The point is to achieve an 'optimal' level of reserves so that Singaporeans are not unnecessarily losing out on the welfare gains they might have had. If more can be done then it would be better to move from one-off top-ups and transfers to permanent schemes, say in the areas of

Education, Healthcare, Income Support, and even consider an intelligent system of unemployment insurance that would not erode the incentive to work.

Dealing with Inflation

Finally, on the broader macroeconomic issue of managing economic cycles, it was noted that the exchange rate-based approach to monetary management is now under stress. Huge capital inflows make it difficult. Tightening through exchange rate policy seems to aggravate bubbles in the real estate sector. Under the current conditions, it would be important to consider whether a more proactive fiscal policy can be used to supplement the exchange rate-based regime.

Channels of Feedback

A participant asked if there were effective channels by which SMEs could reflect their views on the budget each year. In response, it was said that there were formal institutional channels through business associations. However the quality of that was more in the nature of 'noise'. One SME operator said that there was currently no channel for SMEs to filter the more critical agenda up to policymakers.

Concluding Reflections

We note that there were resonances between the points that were raised by those in the SME sector at this meeting and those presented by parliamentarians in the formal budget debate. The latter appreciate the desire for a more gradual and calibrated approach to economic restructuring among local entrepreneurs. On a different note, discussion about measures to address social needs have also led to the emergence of so many different people groups with their respective wish list of measures to address their particular requirements. It is difficult to 'mass customise' government, or even to give the assurance that policy measures achieve their stated objectives although there is a high chance of this happening in Singapore. What is clear however is that some of the important views have been received by parliamentarians. Going forward, the level of complexity in governance may mean that we need to develop more mechanisms for meaningful multi-stakeholder dialogues, to enable different sectors and sub-sectors as well as policymakers to meet each other. This should aim to create a deeper appreciation of and engagement in the sort of mediation that has to take place to create tenable policy measures that achieve national goals they have to agree on in the first place.

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