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Singapore Inclusive: Bridging Divides

Background Paper

Inequality and the Need for a New Social Compact

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INTRODUCTION: THE INIMICAL NATURE OF INEQUALITY TODAY

Income inequality in Singapore has risen significantly in the last decade. Whether measured by the Gini coefficient, or by the ratio of incomes between the top and bottom deciles, the evidence points to an incontrovertible fact: Singapore has become more unequal in the last ten years or so.

In addition there are certain characteristics of inequality patterns in Singapore that make it especially worrying. First, the increase in income inequality has been accompanied by *wage stagnation*, and even real wage declines, for certain segments of the workforce. Between 2001 and 2008 for instance, the bottom three deciles of resident working persons experienced real income declines, while the next two deciles experienced hardly any growth at all (Economics Society of Singapore 2009). Among citizens in full-time employment, the median monthly income from work increased by 11% -- or 1.2% per annum in real terms -- between 2001 and 2010, with almost all the income growth occurring in the latter half of the decade. Workers in the 20th percentile experienced no increase in real incomes over the same period (Ministry of Manpower 2011).

Prime Minister Lee Hsien Loong spoke of the problem in his speech during the 2011 Presidential Address Debate, saying: "the most successful Singaporeans will continue to do very well. The average Singaporeans will be able to make improvements in their lives and are much better off than people in most other countries. But at the lower end, incomes have risen far too slowly, especially in real terms."

Wage stagnation for the bulk of our workforce has been accompanied by the rise of the super-rich, with the incomes of the top 1-2% especially rising very sharply. The reasons for Singapore's divergent patterns of income growth are, as we shall discuss below, complex. Suffice to say, they make inequality today more jarring and potentially more damaging to our social and political cohesion than before.

Second, there is growing concern that *social mobility* in Singapore has declined and is no longer adequate to give young Singaporeans from lower income backgrounds a chance of moving up in life. Inequality is more tolerable if social mobility is high. Furthermore, income equality and social mobility are not distinct and separate concepts. Cross-country evidence suggests that more equal societies are *also* more mobile. And even if one cares only about equality of opportunity and inter-generational mobility, one cannot ignore distributional concerns altogether. After all, it is easier for people to climb the rungs on the income ladder if these are spaced closely together.

Third, a more unequal distribution of income creates problems for good governance. It makes coherent policies that all segment of society can rally behind much more difficult to achieve. Income stratification, especially if it is combined with low social mobility, may polarise societies if different income groups begin to see their interests as competing and conflicting. Mr Lee Kuan

Yew alluded to this in September 2011 when he observed at a students' forum: "What's good for the middle income will be seen by the lower income as unfavourable... What is good for the higher income will be resisted by the middle income."

Fourth, inequality affects citizen well-being. While Singapore has experienced strong growth in GDP per capita in the last decade, this may not have translated into higher levels of well-being for all. Wages and consumption as a share of GDP are low by international standards, while Singaporeans' working hours are long. While household incomes have grown, this is at least partly the result of more members of the household working rather than the result of higher wages. Economic security has also diminished for large segments of the workforce as they face stiffer competition from globalisation, skill-biased technical change and immigration.

Singapore's social compact – founded on the ideas of individual responsibility and self-reliance, economic growth and jobs for all, and a social security system that emphasises savings and home ownership – has served Singaporeans well and is admired abroad. It has enabled Singapore to achieve "growth with equity" (World Bank 1993) and delivered high standards in education, housing, healthcare and our social infrastructure without imposing a huge burden on public spending. But in the face of significant structural changes in our operating context – globalisation, skill-biased technical change, a maturing economy, an ageing population, greater economic volatility, and a more unequal distribution of the fruits of growth – we argue that our social compact needs to be re-examined, enhanced and expanded.

Addressing the interconnected challenges of poverty, stagnant wages, rising inequality, lower social mobility, and reduced well-being in this new environment will require not just policy tweaks, but a broader, more holistic rethinking of Singapore's economic and social policies. In particular, we believe that we need a national conversation on the society we want Singapore to be over the long term (of 10-20 years) as well as a rigorous debate over the appropriate role of the state in achieving the Singaporean vision of the good society.

We will first outline the main causes and consequences of today's inequality, highlighting in particular its inimical nature due to the combination of globalisation, technological change and our recent policies. In light of these trends, we make the case for a new social compact that would take into account how Singapore's socioeconomic context has changed in recent years. The new social compact should also be informed by an understanding of the appropriate role of the state in the regulation and provision of key social goods. Furthermore, we argue that the primary objective of economic policy should not be growth *per se*, but the well-being of Singaporeans – good jobs, rising incomes across-the-board, economic security, retirement adequacy, a more equitable distribution of incomes, and a high degree of social mobility.

We then examine how the new social compact would translate into policy imperatives in the key areas of social security, housing, healthcare, education, and infrastructure and the environment. These public and merit goods are central to economic security and well-being, but their provision is fraught with market failure. In these areas, the state has a critical role to play in

ensuring socially desirable outcomes consistent with the preference and aspirations of Singaporeans.

Finally, we look at how such a new compact can be sustainably financed, and how government should work with citizens to implement these new programmes, and foster the norms and values of a good society.

CAUSES AND CONSEQUENCES OF INEQUALITY

Singapore has experienced a significant increase in inequality over the last ten years. After accounting for government benefits and taxes, our Gini coefficient rose from 0.430 in 2000 to 0.452 in 2010 (see [Chart 1](#)). The ratio of average incomes between the top quintile of employed households and the bottom quintile also increased from 10.1 in 2000 to 12.9 in 2010 (see [Chart 2](#)).

Chart 1. Singapore’s Gini Coefficient among Employed Households, 2000-2010

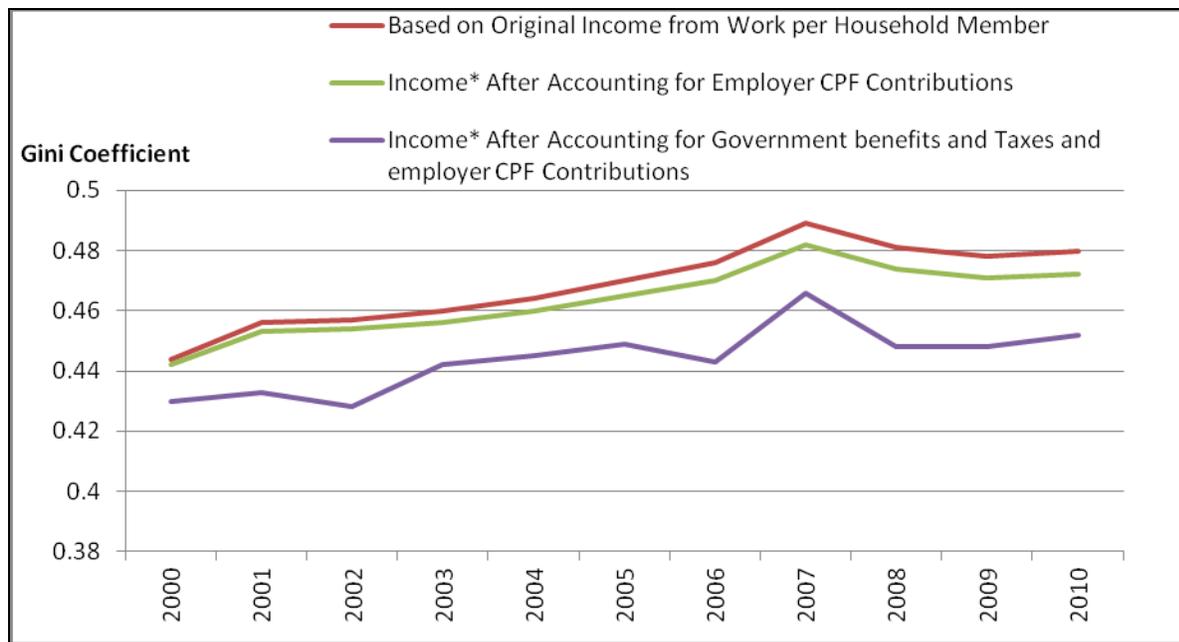


Chart 2. Ratio of average incomes of top 20% of households to bottom 20% of households

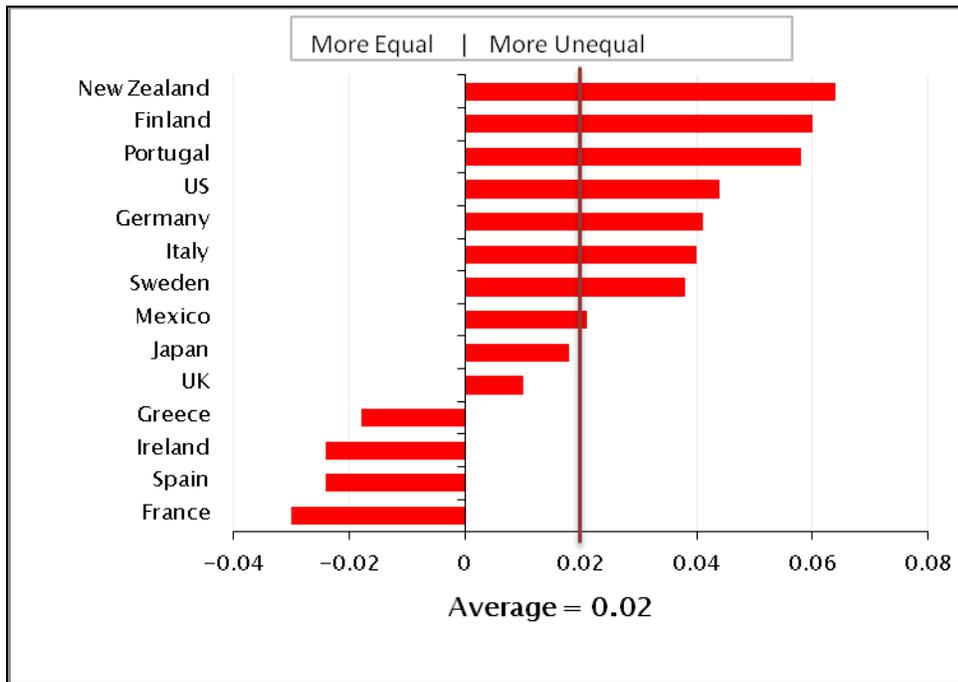
Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Ratio	10.1	11.1	11.3	11.5	11.7	12.3	12.4	13.2	13	12.7	12.0

Singapore is not the only country to have experienced a large rise in inequality in recent years. Countries as diverse as United States, most of the European Union countries, and the advanced Asian economies of Japan and South Korea have all seen their Gini coefficients rise

in the last two or three decades. What makes Singapore’s inequality picture stand out is the speed at which it has increased as well as the level which it has increased to.

Chart 3 shows the change in the Gini coefficient for selected countries. In particular, it shows that the average increase in the Gini in these countries over a twenty year period was 0.02 – the same increase that Singapore experienced in just ten years, i.e. from 2000 to 2010. In addition, Singapore’s Gini coefficient of 0.430 in 2000 was already high to begin with.

Chart 3. Change in Gini Coefficient in Selected Countries, mid-1980s to mid-2000s



The experience of rising inequality in most countries over the last two or three decades suggests that it is driven by forces that are at least partly global in nature – namely globalisation and technological change. This is not to say that local circumstances have no role to play. Domestic policies such as tax, government spending, foreign worker and immigration policies can and do have a significant impact on a country’s inequality patterns. Before examining the role of these domestic policy factors, we first look at the commonly cited forces of trade and technology.

Globalisation and Trade

The last few decades have seen a dramatic expansion in the trade of goods and services. While trade makes production more efficient and reduces overall costs, an influx of cheaper goods and services from more efficient producers confronts higher cost economies with the difficult choice of increasing productivity or keeping domestic costs and wages down. And if the

cheaper imported goods are reliant on unskilled labour, this segment of workers would suffer the most as a result of lower cost imports. In short, the benefits of more open trade are widely distributed but its costs can be concentrated in the segment of society that is least able to cope with such competition.

Low wage competition from China, India and other emerging economies has had predictable effects on lower end wages in developed economies. China is already deeply embedded in global and regional supply chains; as it moves up the value added ladder, it will bring wage competition to a larger segment of a rich economy's workers. India's concurrent economic emergence exacerbates this challenge. While it is pursuing a growth strategy more reliant on domestic consumption than China, its success in exporting middle skill information services has expanded the scope of globalisation in services, bringing wage competition to an even larger proportion of a developed economy's labour force.

The entry of Chinese and Indians workers alone into the global labour force amounts to an expansion of roughly 70% of global labour supply, concentrated at the lower end of the wage scale in developed economies. The challenge is even greater in Singapore where a more relaxed foreign worker policy in recent years has made it easier for companies to import foreign workers rather than invest in labour saving technologies or productivity improvements.

But conventional trade dynamics alone cannot explain income inequality patterns. If the wages of unskilled workers in the developed world are falling relative to skilled workers due to free trade, the wages of unskilled workers in the developing world should be rising compared to skilled workers in the developing world. Yet inequality is as much a problem in China as it is in the US. Rather, it is the interplay of globalisation, technology and domestic policies which generate the inequality patterns that we see in Singapore and elsewhere.

Technological Change and its Impact on Wages

A second important driver of income inequality is rapid technological change. Technological advances increase inequality by increasing the substitution of labour by information technologies and mechanisation, depressing the wages of unskilled and semi-skilled workers. The widespread adoption of information and telecommunications technology has brought large productivity benefits, but it also has the impact of marginalising workers who are less able to take advantage of these technological advances.

The evidence points to three main distributional effects wrought by technological change. First, the advances in recent decades have been highly beneficial for skilled individuals – particularly those engaged in abstract and analytical work, such as professionals, managers and technicians. In the US for instance, this has led to a dramatic shift in the “education premium”: degree holders earned close to twice as much as high school diploma holders in 2008, compared to 1.5 times in the 1980s. In Singapore, this education premium is also evident. A paper by MAS found that degree holders not only tended to enjoy significantly higher earnings

but they also saw their earnings increase with experience at a faster rate compared to non-degree holders.

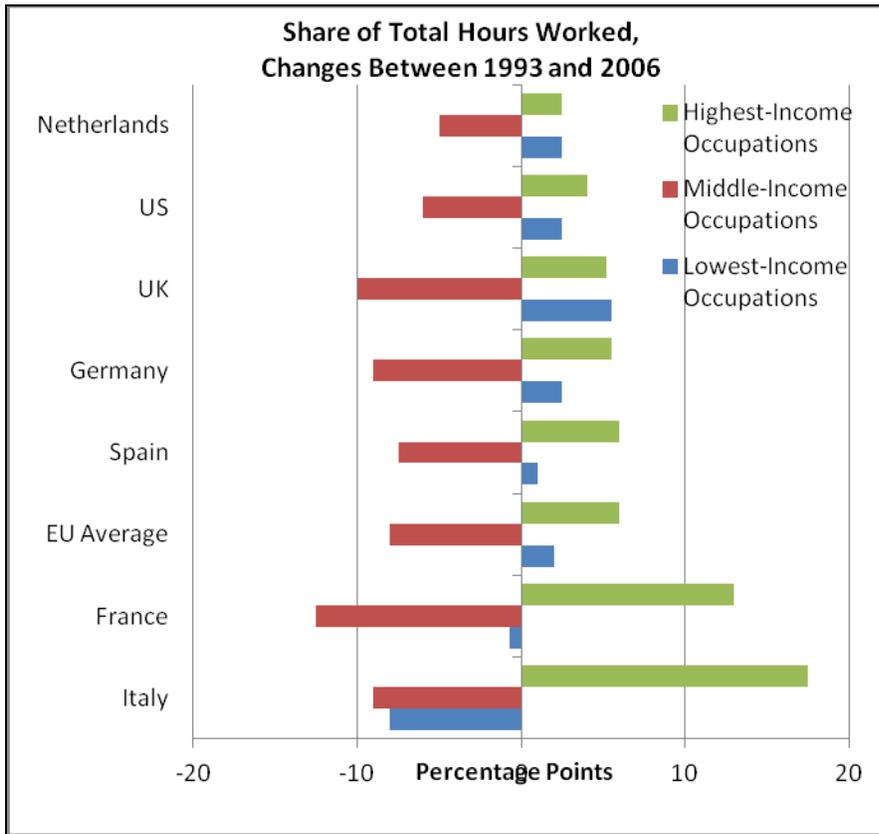
The gap between the skilled and the unskilled in Singapore is exacerbated by our relatively recent rapid development. Education levels in our older cohorts are generally low, with only around 14% of individuals in their 50s having benefited from tertiary education. Furthermore, a large proportion of women among the older generation have limited work experience, as suggested by the low labour force participation rate in Singapore for women in the 50-60 year old cohort compared to other OECD countries. All this suggests that a significant share of the older population has struggled to benefit from recent technological advances.

A second consequence of technological change is the polarisation of job opportunities. In the US for example, there has been expanding job opportunities in high skill, high wage occupations *and* low skill, low wage occupations, coupled with contracting opportunities in middle wage, middle skill jobs. Employment and earnings rose in both high-education professional, technical and managerial occupations and, since the late 1980s, in low-education food service, personal care, and protective service occupations. Conversely, job opportunities have declined, and are continuing to decline, in middle skill, white collar clerical, administrative, and sale occupations as well as middle skill, blue collar production, craft, and operative occupations. This “hollowing out” of middle income, middle skill jobs has also been experienced in most of the EU countries – indeed, more pronouncedly so in most of them (see Chart 4).

What might account for this phenomenon of the “disappearing middle”? Several authors such as Goos and Manning (2003) as well as Autor, Levy and Murnane (2003) have suggested that the growth in demand for “lousy” (e.g. cleaners) and “lovely” (e.g. lawyers) jobs can be explained mostly by technology. Computers and information technologies are able to replace jobs that are routine, but they are poor substitutes for jobs that require a high degree of personal interaction - - and so cannot be easily automated -- and those which require abstract thinking. Moreover, routine jobs are also more easily outsourced to low cost economies – for example, to assembly factories in Shenzhen or to call centres in India. Improvements in communications technology have made it much easier for global companies to coordinate their operations across the globe, thus allowing them to rely less on hiring workers in rich countries.

Chart 4. Hollowing out of middle income jobs in developed economies

(Source: The Economist, 9 September 2010)



Job polarisation in Singapore is also likely to exist. The rapid development of our economy from low value-added work to more sophisticated activities has naturally increased the demand for skilled workers. This has been supported both by rapid gains in the education levels of our population and the higher intake of skilled immigrants. Meanwhile, middle skill jobs in both white collar and blue collar occupations have been “squeezed” by automation and advances in IT. This may help to explain the phenomenon of median wage stagnation that Singapore experienced for part of the last decade.

The third channel by which technological change contributes to current patterns of income inequality is through the creation of markets in which a small handful of top performers are rewarded exceedingly well. Robert Frank (2007) argues that advances in information and communication technologies have led to the spread of “winner-take-all-markets,” in which small differences in performance translate into large differences in reward. The information revolution, Frank suggests, has led to the emergence of more celebrity-like markets in which “top performers are succeeding spectacularly well, people in the middle are only a little ahead of where they were, and those at the bottom are holding roughly even.” This effect drives up the incomes of super-rich, or the top 1-2% of income-earners.

Domestic Policy Factors in a Globalised City-State

An analysis of the causes of inequality would not be complete without a discussion of domestic factors. As a city-state with a small economy, Singapore is open to global flows of capital and labour, and highly susceptible to external shocks. It should come as no surprise that even though Singapore's Gini coefficient is high compared to other countries, it is similar or lower than that of cities such as New York (0.502) and Hong Kong (0.533), both of which are also internationally-oriented.

This is not to suggest that we should accept our high inequality as an inevitable or immutable fact of life. On the contrary, we would argue that it is *because* we are small and open that it is incumbent on government to play an activist, redistributive role. Furthermore, the fact that we do not have a hinterland where Singaporeans can migrate to if they do not like the high inequality of the city suggests that compared to other cities (which are not states), we have to harness the power of the state more actively to ameliorate rising inequality, especially through the provision of social transfers and public goods.

There is sufficient evidence to suggest that domestic policies may have worsened Singapore's income inequality picture in the last decade. First, the aggressive reductions in personal income tax rates – from 28% in 2002 to 20% in 2007 – combined with the increases in the Goods and Service Tax (GST), a more regressive tax, have made the tax system less progressive. Although these tax changes were moderated by GST offsets and other social transfers (such as the Workfare Income Supplement), it should be noted that tax changes are permanent while GST offsets are temporary. Furthermore, although the government has increased its spending on lower-income groups through Workfare, Comcare, and discretionary transfers, its redistribution has not been aggressive enough. This is shown by the fact that the Gini after taxes and transfers has increased at almost the same rate as the Gini based on market incomes.

Second, excessively liberal foreign worker and immigration policies in recent years may have contributed to rising inequality and wage stagnation. Not only have the numbers of foreign workers and immigrants increased rapidly over the last decade, but the fact that we aim to attract both high-income talent (because of our aspirations to become a “global city”) and low-cost foreign labour (to keep domestic costs low) is a source of greater inequality. High-income talent raises average incomes at the top while low-skilled foreign labour keeps wages at the bottom depressed. The result is a further “stretching out” of our income distribution.

Third, in its pursuit to be a “global city”, the government focused its attention on making Singapore attractive to the global elite. The “agglomeration effects” at the higher end of the labour market, especially in innovation-driven and creative industries, tend to raise the incomes of individuals employed in these industries faster than those of other groups. In contrast, workers in the middle and lower income groups do not benefit from the increasing returns to scale that agglomeration effects confer. But they have to put up with the negative externalities that our liberal immigration policies generate: congestion, rising house prices and inflation. The solution to this conundrum is *not* to reduce Singapore's attractiveness to global talent, but for

government to invest more in redistribution and public goods to correct for the uneven distribution of benefits that liberal immigration policies create.

While large numbers of low-skilled foreign labour help to keep Singapore's costs low, they are also likely to have contributed significantly to wage erosion at the lower end of the income distribution. For example, the starting wages of construction workers and cleaners, a key benchmark of wages for unskilled labour, fell from around \$800 in 1995 to about \$650 in 2005. At these wages, households in the bottom 10% would have barely enough to meet basic needs, let alone invest in human capital formation. While Workfare and Comcare go some way towards addressing hardship, they may not be sufficient, or provided regularly or widely enough. For these segments of the Singapore population, poverty remains a real problem.

The second and third deciles of employed households in Singapore earn average monthly incomes of \$2700 and \$3700 respectively. These amounts are sufficient for basic needs and human capital investments, but leave very little for discretionary savings, making these households extremely vulnerable to bouts of unemployment or illness. Neither can these households save enough for longer term healthcare, education, retirement or housing expenditures. This in turn leads to lower social mobility, especially when we consider that the top 20% of households have far more resources to spend not only on childcare and education, but also on housing and healthcare.

The Costs of Rising Inequality

A more unequal distribution of income imposes very real costs on society, and not only because it may increase envy of the rich. Increasing inequality can undermine social cohesion and generate widespread disaffection with the prevailing economic and political systems. In recent years, there has been an intellectual revolution of sorts in the social sciences to show that society's well-being is not just a function of economic growth or GDP per capita, but is also affected by how evenly incomes are distributed.

Cognitive psychologists and behavioural economists have long contended that contrary to the assumptions of conventional economics, people care about their relative consumption levels, and not just their absolute levels. A number of behavioural experiments have also suggested that people care more about fairness and relative incomes more than their absolute gains. In studies involving the ultimatum game for instance, people routinely reject offers that they consider too low even though they are better off accepting whatever offer greater than zero that is made to them.

Frank (2007) takes this insight further by arguing that people's concerns about relative position often lead to status competition in which individuals try to outdo one another by spending more on "positional goods" (such as branded goods, better cars or bigger homes), leading to an "arms race" over such goods. Much of this spending is socially wasteful as people's relative positions are unchanged; it is individually rational but collectively irrational for people to engage in competition over positional goods. When inequality is rising, the incomes of the middle class

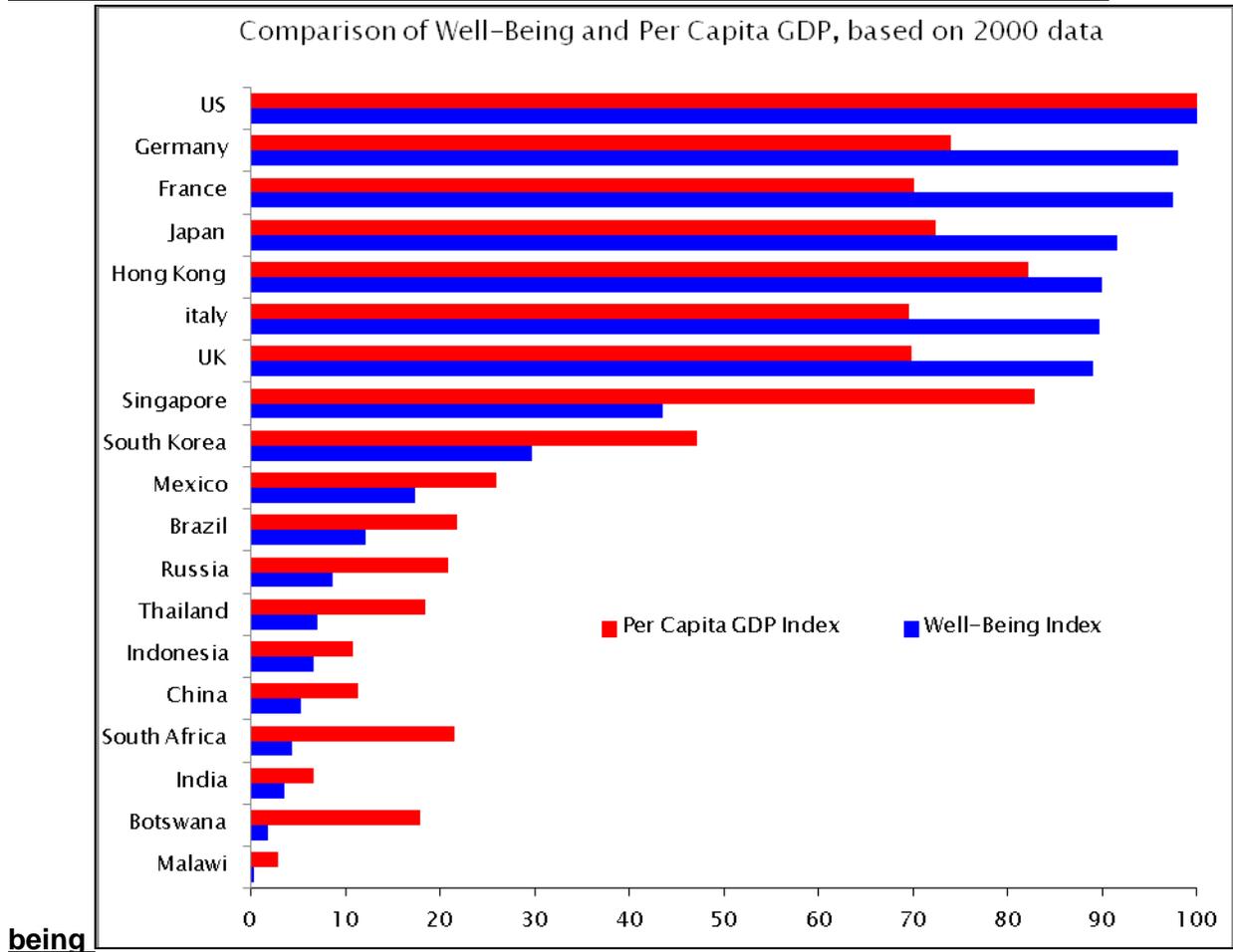
and lower-income groups are not rising as quickly. They can only spend more on positional goods by diverting resources from non-positional goods or by taking on more credit. Frank argues that rising inequality in the US caused middle and lower-income families to spend sharply higher fractions of their incomes on positional goods like housing, becoming more leveraged in the process. Another wasteful consequence of a growing concentration of wealth in the hands of the rich is that it might also lead to a diversion of resources from productive activities to financial speculation and conspicuous consumption.

More recently, Rajan (2010) has suggested that inequality in the US was the main culprit for the financial crisis of 2008/2009. He argues that faced with rising inequality and the inability of the two political parties in the US to agree on education reform or on expanding social safety nets, successive US administrations glossed over the inequality problem by giving Americans easier access to cheap credit, especially for housing. This response to rising inequality created incentives for mortgage providers to extend home mortgages to those who could not afford them, fuelled the growth of the sub-prime mortgage market, and inflated a housing bubble that was supported only by low interest rates and ever-increasing levels of household debt. The inevitable bursting of the housing bubble not only created hardship for indebted households, but also endangered financial and macroeconomic stability.

Yet another stream of recent research focuses on the harmful effects that rising inequality has on health and well-being – for both individuals and societies at large. Drawing on research by epidemiologists and other social scientists, Wilkinson and Pickett (2009) argue that high inequality hurts not just the poor but *all* segments of society. On a host of social indicators – such as obesity, infant mortality, life expectancy, rates of imprisonment, and social mobility – inequality is significantly associated with poorer performance. Wilkinson and Pickett show that this relationship holds both across a range of industrialised countries and across US states. Their central observation is that everyone suffers: even the better-off in unequal societies have more social problems than the better-off in more egalitarian ones. The reason for this relationship, the authors suggest, is that man is a social animal whose self-respect is tied up with status. Inequality has many practical implications -- an inability to fund a desired lifestyle, for example, or a loss of control -- that cause stress, anxiety, depression, and the adoption of behaviours such as overeating, drug use and criminality.

Finally, a number of economists have suggested that in measuring economic progress, governments should also take into account other indicators of well-being than simply output growth. These include consumption, health and longevity, leisure time, and how incomes are distributed. By these measures, Singapore does not do as well as our GDP per capita level suggests. Jones and Klenow (2010) show that while Singapore's per capita GDP in 2000 was 83% of the US', Singaporeans' well-being (measured by consumption and adjusted for factors such as leisure, longevity and income inequality) was only 44% of the US' level (see [Chart 5](#)).

Chart 5. Jones and Klenow’s comparison of countries’ per capita GDP and well-being



To summarise, the recent research on inequality suggests that it is not a problem that can be easily isolated and tackled with more measures to help the poor. Instead, it is a *systemic* problem caused by the interaction of globalisation, skill-biased technical change and domestic policies, and with consequences more profound and far-reaching than simply people's envy of the rich. All this indicates that addressing inequality will require structural solutions that go beyond “targeted” measures to alleviate poverty. Indeed, as we will go on to argue, addressing inequality would require us to rethink our social compact and articulate a vision of the good society for Singapore.

RETHINKING OUR SOCIAL COMPACT

The labour market trends and income distribution patterns described in the earlier section – low wage erosion, median wage stagnation, the rise of the super-rich, increasing income inequality, and the risk of lower social mobility – undermine inclusive growth, policy credibility and ultimately, political legitimacy. All these suggest our current social compact needs to be retooled, reformed and enhanced.

Our key policies in the areas of social security, healthcare, housing, education and even infrastructure – were designed and optimised for an era characterised by a youthful population, steadily rising real wages for all segments of society, full employment, and high rates of GDP and productivity growth. In such a context, a social compact which emphasised growth over redistribution, individual responsibility, high savings, relatively limited social safety nets, and public housing as the *de facto* instrument of redistribution, were successful in ensuring growth with a high degree of equity and social well-being.

This benign context is now changing profoundly. Our economy is maturing, our population is ageing, social mobility is slowing, economic growth is more erratic (four recessions in the last 13 years), and the fruits of growth are distributed more unevenly than before. These trends make it harder for Singapore to achieve the same kind of rapid GDP growth alongside rising well-being as it did in the past. They also make it more challenging for Singapore to achieve the equitable growth that it achieved before the start of the 2000s. In fact, gaps in access to social security, health, housing, and infrastructure are beginning to open up. Notwithstanding the fact that it has served Singaporeans well in the last 40 years, the current social compact would not be sufficient to ensure equitable and inclusive growth in the face of the changes unleashed by globalisation, rapid technological change, and our own policies.

In response to the changing socioeconomic environment, as well as to reflect the changes in our domestic political landscape, Singapore must find a social compact that achieves a better balance between growth and equity, and between individual responsibility and social insurance. A well-designed new social compact would not only promote a more equitable distribution of income with a sustainable GDP growth rate, but would also foster a more cohesive, less polarised society where citizens have an interest in pursuing the common good even if it means near-term sacrifices.

In formulating the new social compact, a re-balancing of the respective roles of the state and the market in a number of policy domains would be necessary. In this, we should be guided by an understanding of the relationship between state and markets in light of the economic crisis of 2007-2009.

Pre-Crisis Economics: The Rise of Market Fundamentalism

In the 30 years before the crisis, the economics discipline was increasingly dominated by neo-classical economics or market fundamentalism. This paradigm was based on three main tenets.

The first idea, known as the rational expectations hypothesis (REH), maintained that because agents would always fully anticipate the consequences of government interventions, capitalist economies did not need to be stabilised by governments or central banks. Their interventions – say policies to reduce unemployment – would not only be ineffective, but also destabilising and inflationary. The conclusion of rational expectations was the “Policy Ineffectiveness Proposition” theorised by Sargent and Wallace (1976).

The second idea, known as the efficient markets hypothesis (EMH), held that competitive (financial) markets will always make the best use of all available information and forecasts about the future. Consequently, unfettered markets will allocate resources in the most efficient manner possible. EMH “showed” that no government official or regulator could allocate resources more efficiently, or make better guesses about the future, than self-correcting and self-stabilising financial markets. Worse, government interventions will distort relative prices and generate waste, inefficiency and rent-seeking behaviours. Given efficient markets, the only constructive role of government in the economy was to deregulate and privatise.

The third idea was more abstract, but equally powerful. It stated that economics, which began as a large descriptive study of human behaviour, must be transformed into a branch of mathematics requiring assumptions that can be expressed in simple equations. Economics, it was believed, could advance only through mathematical deduction from axioms and assumptions that can be algebraically expressed. By imposing strict requirements of logical consistency and clarity on economic analysis, the mathematical formalism of economics made it difficult for academic economists to say anything useful about situations in which behaviour did not conform to the strict tenets of rationality, motivations inconsistent over time, or outcomes unpredictable.

Between them, these ideas had profound political and socio-economic consequences. They created the myth that competitive markets plus self-interested individuals produced the best possible economic outcomes. This ignored the reality of pervasive market failures – informational failures, externalities, coordination or collective action problems, monopoly power. They consigned normative questions of the political economy – such as income distribution and fairness – to the periphery of economics. These issues were ignored in part because they did not fit into the neat mathematical models of the new classical economic paradigm. But more importantly, they were ignored because doing so helped advance the ideology of market fundamentalism. The use of “scientific” mathematical models provided a convenient way to exclude discussion of issues that were at odds with the assumption of market efficiency.

Rational, efficient and mathematically inexorable economics also legitimised a host of highly controversial social and political outcomes. Widening income inequalities, employment dislocations, unprecedented riches for bankers, and the rise of winners-take-all markets could all be presented as the unavoidable outcome of impersonal economic forces (such as globalisation and technology advances), rather than highly contingent arrangements that can be corrected by political and policy action. Any suggestion that government action could improve

outcomes in areas such as income distribution, industrial policy, or financial regulation was dismissed as undermining the efficiency of markets.

Economic Governance in the Post-Crisis World

The economic crisis of 2007-09 has exposed the ideas of rational agency and efficient markets as over-simplified and unrealistic. The crisis showed how financial markets are prone to speculative booms and busts. Coordination problems and informational failures abound. The new classical economists' models of policy ineffectiveness may be internally consistent, but bear little resemblance to the external reality of liquidity constraints, imperfect information and foresight, uncertainty and unpredictability, and inconsistent expectations about the future.

It is still far from clear how economics will evolve in the aftermath of the crisis, but the broad contours of a new economics are already taking shape. Two key ideas should guide our understanding of the new economics and what it means for our social compact.

First, it should be clear that a stable market economy is only possible with an *activist government*. The idea that *laissez faire* governments and markets that are left alone can deliver stability and prosperity should have ended with the crisis. Governments are necessary to regulate, stabilise and legitimise markets. Effective government and resilient markets are both necessary for the successful functioning of the capitalist system. This has far-reaching implications in a number of policy domains. It suggests, for instance, that governments need to actively correct for market failures in number of policy domains – such as healthcare, the environment, housing and social security to name but a few – to achieve socially desirable outcomes.

Second, there needs to be a more explicit recognition of the inherent uncertainty and interactive complexity of the market economy. There is no room for ideology and dogma – either of the market fundamentalist variety or of the statist, big government variety. Instead, there needs to be a high degree of policy flexibility and institutional adaptation on the part of governments. Markets and governments can both fail. Acknowledging that it can fail should not paralyse government; instead, it should be an invitation for government to explicitly encourage policy experimentation and innovation. This emphasis on constant change and adaption, on flexibility and nimbleness, differentiates the new economics from the big government, bureaucratic rigidities of the Keynesian era from the 1950s to the 1970s.

Successful economic governance will require governments to embrace the ideas of complexity, adaptation and resilience. They should take on board the new approaches to economics that have emerged in recent years based on psychology (behavioural economics), sociology, complexity and network theories, and practical business insights. A multi-disciplinary approach to economic policy – as opposed to a singular emphasis on conventional economics or efficient markets – is likely to generate better policy options.

Implications for our Social Compact

What does all this mean for the social compact in Singapore? The Singapore government has always prided itself on pragmatism and eclecticism, on eschewing dogma and ideological fads. It has also not shied away from state activism to correct for market failures or achieve desired policy outcomes, intervening aggressively in areas such as housing, industrial policy, financial assistance for low-wage workers, and financial regulation. Thus at first glance, it would appear that the new post-crisis economics – with its emphasis on active governments, ideological flexibility and policy adaptation – affirms Singapore’s approach.

A closer inspection reveals a more complicated picture. For a start, it is not entirely true that the Singapore government is devoid of fixed mindsets. In some areas, long-standing policies reflect certain policy beliefs that may not be robustly or sufficiently questioned. For instance, the idea that sturdier social safety nets will erode economic incentives and undermine competitiveness tends to be an argument used reflexively. In a similar vein, the government can be quite insistent on the virtues of small government and low income taxes, even though the current low shares of public sector spending and low rates of income taxes are relatively recent phenomenon. It was only in the 2000s that government spending fell below a fifth of GDP. Empirical evidence on the positive growth effects of low income tax policies is mixed at best.

These long-standing assumptions and beliefs are seldom questioned. These policy biases could hamper efforts to deal with rising income inequality, while the government’s reluctance to contemplate a more redistributive system of taxes and transfers risks could undermine public support for growth-oriented policies such as being open to immigration, globalisation and economic restructuring.

The Singapore government, in line with global policy trends, has also tended to embrace “market-mimicking governance” in recent decades. Much of this makes sense. For instance, pricing negative externalities such as congestion or pollution, rationing demand for scarce resources through user co-payment, and injecting competition to previously monopolistic utilities are mostly sensible policy decisions. But in other areas, a rigid application of new classical economics has wrought questionable outcomes. For example, the idea that the Housing and Development Board (HDB) should be self-financing and seek to recover its costs probably led it to under invest in new flats. The BTO system, which was introduced to shield it from the risk of an over-supply of flats, increased the HDB’s efficiency, but at the expense of passing risks to potential home-buyers and citizens.

In the post-crisis world, successful governance will require the government to think pragmatically and creatively about its policy outcomes and processes. Given the increasing complexity of various economic and social policy issues, the government can create collaborative platforms that enable it to draw on the collective intelligence of citizens and businesses. It can participate as a coordinator, convenor, facilitator and partner, with the ideas co-created with other stakeholders. Governance should also be driven less by free market dogma, and more by pragmatic experimentation and institutional adaptation. The governments

that succeed will be those that blend purposeful state interventions with the dynamism of markets.

Principles and outcomes of a new social compact

Singapore's most successful social policies – public housing, the CPF system, the 3Ms in healthcare, Workfare – reflect this combination of an activist state and market-based incentives. In rethinking our social compact, we should strive to preserve and adapt this dynamic balance between state and markets, between social protection and individual responsibility. In particular, we think that a new social compact should reflect the following values and norms of a good society in Singapore's context:

- **Work as foundation of the good society:** This reflects the principle of reciprocity or mutual responsibility. Specifically, public support should be tied to individual effort and initiative. Even as we rewrite our social compact and strengthen our social safety nets, we should continue to emphasise the centrality of work as the basis of a successful society.
- **Opportunity society:** This principle emphasises the importance of helping every individual achieve his/her full potential. Although Singapore prides itself on meritocracy, there is growing concern that opportunities are increasingly uneven because of rising inequality. An opportunity society is one that corrects for these inequities in opportunity, and provides everyone a fair chance of moving up in life. It also reaffirms our commitment to social mobility.
- **An activist state:** This principle recognises that a functioning market economy requires an activist government to stabilise, regulate and legitimise markets. The state has a role not just of correcting for market failures, but also of investing in areas that will moderate inequalities, ensure equal opportunities, and promote social mobility. This principle also suggests that the government needs to play a bigger redistributive role as it embraces certain economic growth strategies that expose workers to greater income volatility and employment risks.
- **Harnessing the energies of the community:** State activism is necessary but not sufficient. The state must also tap on the collective wisdom of citizens through co-creation and co-production.
- **Pragmatic, adaptive, learning-by-doing approach:** Our social compact should not be static but should be constantly revised and refined in light of changing circumstances. This calls for policy experimentation and evaluation, and an avoidance of dogma and ideology. In turn, policy experimentation requires a population that is more tolerant of government errors and that sees these errors as a necessary part of learning and innovation.

In terms of the outcomes we seek, our social compact should aim to maximise the well-being of Singaporeans. This means a Singapore which treasures its citizens, where its citizens live in a

secure society in which the worth of every one of its diverse citizenry is valued, and where every citizen has as much opportunity to rise as is practically possible. Moreover, it means a society which provides citizens with the key things they need but which they will not be able to obtain or organise on their own without some form of government intervention or assistance. This includes a first class education system, adequate provision for retirement security, good and affordable healthcare and housing, excellent infrastructure, some measure of protection against unemployment, consumer protection agencies, an appropriate competition framework, community support organisations, and so on.

Achieving such a vision of a good society also means that government should aim to optimise across a broad range of economic and social indicators. This would include consumption per capita (not just GDP per capita); a fair distribution of incomes, as measured by the Gini or the gap between the top and bottom deciles; environmental indicators; and social indicators such as morbidity rates, the incidence of crime, etc. A more comprehensive measure of the well-being of Singaporeans which incorporates these various economic and social indicators would also help government gauge the impact of its policies on citizens' well-being. The report by the Commission on the Measurement of Economic Performance and Social Progress (Stiglitz, Sen & Fitoussi 2008) would be a useful starting point.

INVESTING IN OUR PEOPLE, BUILDING A GOOD SOCIETY

Faced with a fast-changing socioeconomic context, Singapore needs a new social compact founded on the ideas of an activist, more redistributive state, and one that aims to strike a better balance between social protection and individual responsibility. The Singapore state can more effectively ensure access, affordability and quality in the key social goods of social security, public housing, healthcare, education, and infrastructure and the environment.

First, in each of the five social policy domains, there are significant market failures that necessitate government regulation, subsidy or outright provision. The economic crisis of 2007-2009 has demonstrated how unregulated, unfettered financial markets can lead to undesirable, even disastrous, outcomes when there are significant market failures such as externalities and informational asymmetries. Markets in social security, housing, education, healthcare, infrastructure and the environment – all of which are key determinants of individual and social well-being – are similarly fraught with market failures. In these areas, the state has a critical role not only in ensuring “socially efficient” outcomes, but also in pursuing policy outcomes that are consistent with the preferences and aspirations of Singaporeans.

Second, in the last two decades or so, as the government pursued market-mimicking policy changes, it may also have *shifted* risks from the state to citizens. Many of the policy changes introduced in recent decades reinforced the emphasis on individual (and family) responsibility and on “getting incentives right.” While these changes have increased efficiency for individual government departments, they did not always result in an allocation of risks to the entities that were best able to cope with those risks. We witnessed this transfer of risks (and costs) from the

state to citizens in public housing, social security, healthcare, and infrastructure and the environment. As the economics Nobel laureate Joseph Stiglitz has argued, at a time of rising uncertainty, volatility and inequality, the state should instead be actively absorbing the increase in risks or insuring citizens against them.

Third, although the current mix of social policies was highly successful in meeting the needs of Singaporeans at a time of strong economic growth and rising incomes across-the-board, it proved less effective at a time of erratic and volatile economic growth in which the benefits are more unequally distributed. This was particularly apparent in public housing and the social security system, but was also evident in our education and healthcare systems. What this suggests is that our social compact – and the policies it entails – has to be adapted and retooled to suit the changing context. It also suggests that while our current social compact – with tweaks and adjustments at the margins – might still be adequate in the near-term, it is unlikely to be so over a long-term horizon (of 10-20 years) without significant reforms and enhancements.

Seen in this light, government and citizens would have to engage in a national conversation on how Singapore's social compact should evolve over the longer-term. The alternative – of making piecemeal adjustments from year-to-year, when fiscal surpluses allow, without the anchor of a long-term vision of a good society – is not likely to be a sound approach. In each of the five policy domains, policies often operate with long time lags; they may also have to be properly sequenced and coordinated to be effective. Just as importantly, the desired norms and values of society that are necessary for the new social compact to be sustainable take time to foster. All this suggests that government must forge a societal consensus on a long-term vision, set out its policy objectives and articulate strategic roadmaps in the five policy areas, and constantly adapt and adjust its policies to achieve the desired outcomes forged with citizens.

Fourth, there has been a general tendency among government agencies to instinctively reject some of the ideas on grounds of how costly they would be and/or how they would undercut Singapore's competitiveness and economic growth. While these concerns are not entirely misplaced, we think they are often over-stated and hamper creative thinking and pragmatic policymaking. To begin with, the effect of more social protection on economic performance is an empirical, rather than an *a priori*, question. What is more important than the level of spending on social protection is the way the programmes are designed, and the incentive effects they create. Among OECD countries, for instance, it is not the low welfare spending countries of southern Europe (Italy, Spain or Portugal) that are the most prosperous or competitive, but the high spenders of Germany and the Nordic countries. This is not to suggest that more welfare spending leads to more competitive economies and higher growth, but simply to point out that the relationship between social protection and economic growth is a complex one that defies simple, reductionist arguments. Policymakers should therefore approach these issues with an open mind and be prepared to consider previously rejected solutions.

Fifth, we acknowledge that in pursuing its redistributive objectives, the state too can fail. Progressives often suffer from a naïve faith in the ability of governments to do good – eliminate poverty, reduce inequality, and promote social mobility. The experience of large welfare

programmes elsewhere is mixed at best, harmful at worst. Instead of eliminating poverty, many welfare programmes entrenched poverty and undermined social mobility. Instead of enhancing fairness and equality, they often cut welfare recipients from work and education opportunities. The risk of government failures in big social protection programs is as large as the market failures that necessitate government intervention in the first place. Reformers ignore this reality at their peril. They need to acknowledge that culture and ethos matter, and that while government programmes can redistribute incomes, they can also do harm in undermining the virtues of work, self-reliance, and community help. Again, this calls for a government that is willing to experiment -- to find out what works and what does not -- and a citizenry that is more tolerant of government mistakes, for learning and innovation can only occur through mistakes.

Sixth, in formulating our policy ideas, we should ensure that they are not only consistent with economic incentives, but also with desired social norms and values. The work of psychologists on how people respond not only to economic incentives, but also to social norms, is instructive here. For instance, the conventional economic response to inequality is to increase taxes on the rich and increase social transfers to the poor. While these measures are necessary in an era of rising income inequality, we should also think about how we can strengthen society's norms of inclusion and fairness. The Workfare Income Supplement (WIS) in Singapore – a wage supplement for low-wage workers – is an example of a policy that produced the right incentives and supported desirable norms. As a wage supplement it aims to “make work pay” and provides a stronger incentive for low-wage workers to stay in work. But more than that, it also supports norms of inclusion and fairness. A job is not just an income-generating activity; it also enables people to participate more fully in society. Meanwhile, taxpayers are more likely to see transfer payments as fair – and are more likely to support them – if beneficiaries have to work to receive the subsidy.

SUSTAINING THE GOOD SOCIETY

A social compact that is appropriate to the realities of globalisation, skill-biased technical change, rising inequality, and low and median wage stagnation will be a more costly one, requiring a larger state. Criticism of such policies usually cite “cost” and “incentives” -- or more specifically “who pays?” and “what incentive effects will these policy changes have on Singaporeans’ work ethic and on Singapore’s economic competitiveness?”

Who Pays?

On the issue of who pays, the sceptic might argue that in the context of Singapore’s ageing demographics, a new social compact would be fiscally imprudent or unsustainable. Against this line of argument, the first thing to highlight is that notwithstanding the failure of many developed countries to finance their generous social programmes on a sustainable basis, there are also notable success stories of developed countries organising their social protection programmes in a fiscally prudent way without producing serious work disincentives. Canada, Germany, Switzerland, the Netherlands, Australia, and the Scandinavian countries come to mind. Many of

these countries finance their social spending partly through environmental taxes which account for a sizeable 2-3% of GDP. Closer to home, Hong Kong, South Korea and Taiwan all manage much larger social programmes without high direct tax rates or loss of economic competitiveness.

Second, Singapore starts from a much stronger fiscal position and has far more room for fiscal manoeuvre than almost any other country with a similar standard of living and GDP per capita (excluding the oil-rich states), even after we take into account our demographics. For instance, Singapore runs a very healthy structural surplus once we include land sales as revenue and exclude one-time development expenditures, both practices that are based on accounting conventions consistent with IMF guidelines.

More importantly, owing to our persistently high savings rate, we have higher unencumbered official reserves -- government reserves not backing any liabilities -- on a per capita basis than almost any developed economy. Although the size of Singapore's financial reserves is not public information, they should still be growing quite rapidly due to a high national savings rate, stable long term capital inflows, and the fact that we run a managed exchange rate that tends to accumulate external reserves rapidly in the face of large current account surpluses.

Furthermore, the changes introduced to the government's spending rule in 2008 allow for the use of half of the expected long term real returns of the reserves. The other half is ploughed back into reserves and invested to help grow their value for future generations. The growth in our unencumbered financial reserves would mean that by around 2030, when our elderly population reaches a peak and our savings rate naturally slows, significant percentages of GDP should be available to the government as a current fiscal resource, while still allowing the protected reserves to grow at a pace commensurate with economic growth. We should think deliberately and strategically now about how these future revenues streams can be invested in our people rather than make piecemeal adjustments, or worse, increase special transfers on a discretionary basis from year to year.

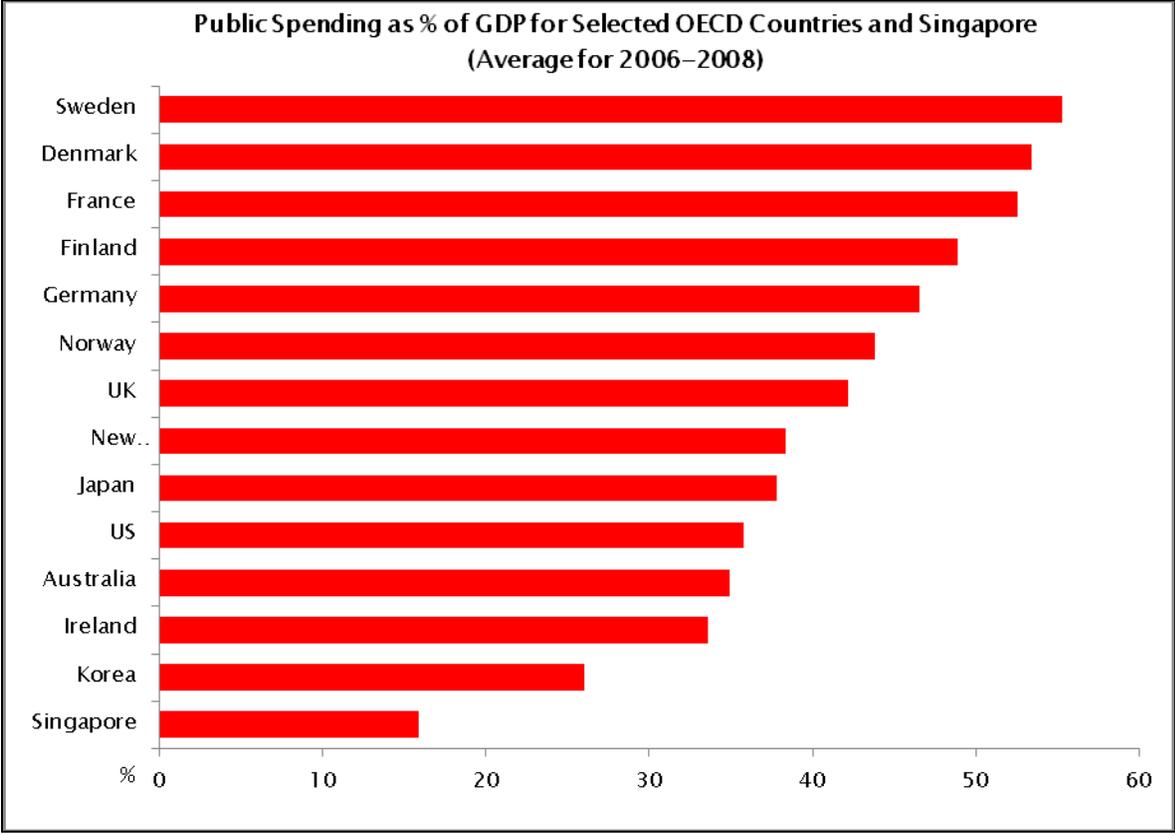
Third, from a national balance sheet perspective, many global economic policymakers (including the IMF) have argued that it is not obvious at all that a strategy of reserve accumulation is still optimal for Singapore. In the short to medium term, bond yields are likely to remain depressed and equity returns will be volatile. We also face significant exchange rate risks when investing our reserves abroad. In this environment, the financial returns on our reserves, in Sing dollar terms, may well be lower than what we managed to achieve in the past. Compared to these financial rates of returns, the *social rate of return* on our investments in education, healthcare, social security, housing an infrastructure may well be higher, especially in areas where public investments are starting from a low base (for example, in early childhood education).

On the expenditure side of the ledger, more inclusive social security and healthcare systems would not be either fiscally imprudent or economically unsustainable. While estimating these costs clearly needs more detailed research, our initial calculations suggest that over a 10-20 year time frame, as our demographic profile becomes older and would be in need of larger

healthcare and social security expenditures, we would require an *additional* 2-3% of GDP for social security, 2-3% for education, and 3-4% of GDP for healthcare. All this would increase public spending from the current 16% of GDP to around 25%, over a period of 10-20 years. In fact, it is unlikely that in any single year, spending on these new social programmes will grow by more than a 1-2% of GDP. In short, the additional spending, spread over 10-20 years, would be neither fiscally unsustainable nor a source of inflationary pressure that crowds out private investment.

Even if we increase public spending from the current 16% of GDP to around 25% of GDP (over a 10-20 year time frame), Singapore would still be one of the smallest governments among developed economies. Public sector spending in advanced economies is usually well over 40%; among advanced Asian economies, it is typically 25-30% (see [Chart 6.](#)) Furthermore, public spending of around 25% of GDP is closer to our own levels of public sector spending before the start of the 2000s. Singapore’s government spending was about a quarter of GDP for most of the 1980s; as recently as the late 1990s, it was still around 20%. While we do not suggest that public spending in Singapore increase to the levels of the large European welfare states, we nonetheless believe that with careful fiscal management, we can *return* to higher levels of government spending in the long term without sacrificing fiscal rectitude.

Chart 6. Public spending as a share of GDP for selected OECD countries and Singapore



What Incentive Effects?

A larger concern than whether we can afford these social programmes is how they would impact our work ethic, economic competitiveness and growth prospects. The central criticism against any expansion of social protection is that such increases are detrimental to the efficient operation of market economies and, over the long run, reduce people's drive, the economy's growth rates, and the country's (relative) living standards. To begin with, it is commonplace for critics to argue that high income taxes that these programmes require represent a serious work disincentive among the most productive and educated segments of the population. A second line of argument holds that generous social transfers discourage work, especially among the less-skilled workers. Alongside these arguments about work (dis)incentives, critics also commonly argue that there are deadweight costs associated with high overall taxes, which lower the rate of savings and investment in the economy.

Against the market fundamentalist's critique, an extensive body of research has emerged to point out ways in which social protection programmes may actually *enhance* economic efficiency and growth. One strand of this approach emphasises that a great deal of social spending can be seen as a form of investment in human capital. This is most evident in education and training programmes but it also holds for healthcare and income support programmes that improve economic conditions of the lower-income and enhance their ability to take advantage of economic opportunities. The fact that the largest welfare states – the Nordic countries – also invest the most in worker retraining programmes and have world's most productive workforces (and competitive economies), provides evidence that such social programmes can yield significant economic benefits.

In a different vein, some scholars question the market fundamentalist's assumption that work effort is essentially a function of incentives. Perceptions of fairness may also affect worker motivation. As Akerlof and Yellen (1990) found, wage compression (or smaller wage inequalities) at the firm level yield more harmonious labour relations and greater employee effort. To the extent that this logic also operates at the societal level, social programmes that redistribute incomes or promote a sense of economic security among workers may contribute to labour productivity.

Yet another argument proceeds from the observation that the social benefits provided by employers (retrenchment benefits, for instance) represent an obstacle to labour mobility. In Scandinavia, the expansion of social insurance under public auspices has often been justified on the grounds that if such benefits are provided by governments rather than companies, workers will be more willing to move between firms, providing for a more efficient allocation of labour.

Finally, the association between economic openness and the size of the public sector deserves to be highlighted here. Economic openness promotes economic efficiency by exposing firms to worldwide competition. But continuous economic restructuring in response to global market forces has a negative impact on the economic well-being of certain segments of the labour force,

particularly less skilled workers. Referring to the welfare state as a mechanism of “domestic compensation,” Katzenstein (1985) suggests that welfare benefits might be seen as side-payments to the losers in global competition, financed from the collective gains from trade. The public provision of social welfare, in other words, is an important political lubricant, facilitating social acceptance of economic change – especially the phase-out of employment in industries exposed to competition from low wage countries.

The arguments advanced by these competing traditions of thought on the relationship between the state provision of social welfare and economic growth are not mutually exclusive. It is entirely possible that social protection programmes financed by progressive income taxes are a source of work disincentives and, at the same time, facilitate society’s acceptance of economic restructuring and globalisation.

Clearly therefore, the relationship between social protection and economic growth is more complex than we have commonly assumed in Singapore. Our own investigation suggests that the relationship between more social protection and economic growth or efficiency have more to do with the *design* of specific social programmes than with aggregate levels of spending. Accordingly, policymakers should approach these issues in pragmatic way – all the while asking whether the growth-promoting effects or the growth-inhibiting effects of increased social protection prevails, and constantly exploring how social protection programmes can be designed to maximise their social benefits and minimise adverse incentive effects.

Forging a New Social Compact over the Long Term

It should also be borne in mind that what is proposed here is a *long term strategy* to construct a new social compact. After all, our first social compact took 20-25 years to achieve fruition. Pursuing a long term vision of what Singapore society should be requires careful long term planning and implementation. Public financing should grow incrementally in line with the actual growth of fiscal resources. New social programmes should be rolled out on experimental basis in line with the expansion of public sector capabilities, and rigorously evaluated; those that work would be scaled up, those that do not would be adjusted or dropped. Such an evolutionary, learning-by-doing approach, over a 10-20 year period, will result in a far-reaching overhaul of the way the Singapore state provides social security, housing, healthcare, education, and infrastructure and environmental goods.

In crafting the new social compact, we should also recognise the interdependence and interactive complexity of social policies. Dealing with complex issues will require government and citizens to embrace a pragmatic, learning-by-doing, trial-and-error approach to social policy that eschews dogma and ideology. For government, this means relentless pragmatism and empiricism: testing and evaluating a variety of policy measures, rejecting those that do not work, and scaling up those that do. For citizens, this means accepting that government will sometimes get it wrong but that such failures are a necessary corollary to successful, innovative policies.

We should also be realistic about the possibility of government-driven change. To begin with, the levers of change are not always within government's control. Some aspects of the new social compact will require not only a change of policies, but also a wider shift in societal norms and values, and there is clearly a limit to how much government can do in this regard. For instance, achieving a more inclusive social security system is more than just increasing social transfers, perhaps financed by higher taxes. It is also contingent on, and must be sanctioned by, society developing an egalitarian ethos founded on norms of fairness and inclusion.

Finally, we should avoid the naïve belief that government policy can mandate cultural change. For instance, the socio-cultural advantages/disadvantages of being born into a higher/lower socioeconomic class (life experiences, social networks, the willingness to take risks, etc.) cannot be easily corrected or equalised by government policy. Ultimately, our goal should not be the unrealistic one of equal outcomes, but the more realistic and achievable ones of fairness, inclusion and opportunity.

CONCLUSION

The current social compact served Singapore well for the first forty years of its nationhood. It ensured growth with equity, and delivered good education, fiscally sound social security and healthcare systems, housing for all, and an excellent infrastructure. Nothing we say in this paper is meant to diminish the achievements of the Singapore government in building the current social compact.

At the same time, we believe that the social compact as it is currently conceived is not adequately equipped to deal with the inimical forces unleashed by globalisation, technological change and our own policies. Singapore's socio-political and economic contexts are also changing, and strains are already showing in our social and political fabric. The unhappiness of many Singaporeans, expressed in the elections of 2011, was not just over relatively short-term issues – such as the inadequate investments in public housing and the public transport infrastructure – that can be resolved using current policy paradigms. Instead, we think it also reflected a discontent with the current model of economic and social development: the overriding emphasis on growth over distribution; the inadequacy of our social safety nets and the uncertainty that this creates; wage stagnation for significant segments of the workforce even as a small segment at the top enjoys large increases; and the increase in inequality.

These factors indicate that the Singapore state needs to reinvent and expand the current social compact. Many elements of the old compact should be present in the new. These include the emphasis on work, the goal of achieving fairness and inclusion rather than equality of outcomes, and a pragmatic balance between the state and the market. But the new social compact should also incorporate a number of new elements: broader measures of citizen well-being including how fairly incomes are distributed; sturdier social safety nets that make intelligent use of social insurance; a more realistic appraisal of the “social value” of house price appreciation; expanded health insurance; the recognition that educational outcomes are affected by socioeconomic

background of the child and a willingness to correct for that; and a stronger appreciation of the relationship between the built environment and our sense of community .

In reinventing our social compact, we should be informed by the rethinking in economics and governance that is currently underway, as well as by the examples of fiscally sustainable and well-designed social programmes elsewhere. The main obstacle to this, in our view, is *not* the dearth of practical and workable policy ideas. Neither is it the case current social policies are failing or do not serve their intended purposes, and need to be overhauled completely or jettisoned entirely. On the contrary, most of our policies are well-designed and implemented; they provide a strong foundation for Singapore to meet the challenges that globalisation and technological change pose to society. Rather, the main obstacle lies in a mindset that often does not recognise the need to make important, and sometimes radical, systemic changes as the operating context changes. Creeping market fundamentalism and the belief in the virtues of small government and low taxes are relatively recent developments in our policy history. They need to be reconsidered in light of the post-crisis re-appraisal of economics and governance.

Similarly, the policymaker's reflexive belief that an expansion of our social safety nets will erode our work ethic and reduce national competitiveness may have been appropriate for a previous era. These widely held beliefs and assumptions are not entirely unjustified; they were likely necessary and largely correct for an earlier context. But they may also now hold government back from thinking creatively and comprehensively about the inimical nature of today's inequality and how it should be addressed over our long-term future. What is needed therefore is a return to the innovative, integrated problem-solving, pragmatic and adaptive approach that characterised the Singapore government when it first formulated the current social compact and built institutions like the HDB, the CPF or the EDB.

More than anything else, this mindset change is necessary to help contain the negative effects of the divisive forces inherent in modern globalisation outlined in this paper, and shift Singapore decisively back towards a fairer, more inclusive pattern of growth given our inescapable destiny as a globalised city state.

APPENDIX 1

SOCIAL SECURITY

Singapore's social security system is premised on the principles of individual and family responsibility, community help (sometimes referred to the Many Helping Hands Approach), and government assistance as a safety net of last resort. Besides housing and healthcare, the main expressions of our social security system are the CPF system to help Singaporeans achieve a certain degree of retirement adequacy, and more recently, Workfare to help low-wage workers stay in work. For the chronically poor and others requiring targeted assistance, various programmes under the umbrella of Comcare have been developed in recent years, and delivered at the community level.

Gaps and Weaknesses in our Social Security System

The three main innovations in our social security system over the last few years have been the Workfare Income Supplement (WIS), CPF Life, and enhanced Medishield. The first addresses the problem of wage stagnation among low-income earners by government topping up the wages of low-wage workers; the second addresses longevity risks by introducing social insurance into a system that has otherwise emphasised individual responsibility; while the third addresses the risks of catastrophic illnesses by increasing insurance payouts for a wider range of medical conditions and treatments.

We acknowledge that these measures are important steps in strengthening our social security system and that the government has implemented a raft of important measures to help less well-off Singaporeans¹. But we also argue that our social security system still has significant gaps and is not sufficiently robust for three main reasons.

First, our social security system provides hardly any protection against the risks of involuntary unemployment. Workfare is targeted at employed, low-wage workers in the formal sector (roughly corresponding to the bottom fifth of the income distribution). CPF savings cannot be withdrawn before the individual reaches 55. Even the subsidies that government channels into various training programmes are mostly mediated through employers. While the unemployed are not excluded from these training subsidies, the principle of co-payment requires them to fork out their own monies to benefit from government subsidies in training and skills upgrading. We should think hard about how we can provide lower and middle-income Singaporeans better protection against the risks of involuntary unemployment without creating significant risks of moral hazard.

Second, for the majority of Singaporeans, our social security system relies mostly on the principle of individual savings. With the exception of the subsidies in healthcare, Medishield and

¹ Other notable measures include the expanded Continuing Education and Training (CET) funding, the recent SPUR training programme, and HDB's Lease Buyback Scheme implemented in 2009.

CPF LIFE, Singaporeans do not fully benefit from social insurance and the power of risk-pooling to deal with contingencies such as a loss of earnings, disability, or an extended period of illness. They are almost entirely reliant on their own accumulated resources to deal with such episodes of income instability. While self-reliance is a good principle in general, it may neither be efficient nor just if taken to extremes. We should think hard about how our social security system can find a better balance between individual savings, social insurance, and direct subsidies.

Third, despite Singaporeans having one of the world's highest savings rates and highest social security contribution rates, many Singaporeans struggle with attaining retirement adequacy. This has different causes for different segments of the population. Among lower-middle to middle income Singaporeans, the lack of retirement adequacy is in large part due to the fact that so much of their CPF savings are locked up in housing. While housing represents a store of value that can be unlocked for retirement needs, this presumes that monetisation incurs relatively low costs. The fact is monetisation options are currently quite limited, not to mention the fact that households which need to unlock their housing assets may be in the wrong part of the property cycle. While we acknowledge that the recent lease buyback scheme introduced by government is a step in the right direction, it is also incumbent on the government to develop more monetisation options for older Singaporeans.

Among the poorest Singaporeans, both poverty in terms of difficulties meeting basic needs (i.e. the bottom 10% of working households) and the lack of retirement adequacy (i.e. the bottom 30% of working households) arise from the fact that their wages are barely enough to meet basic needs that they are unable to accumulate sufficient savings for retirement. The solution for this smaller segment of the population will probably need to be some combination of increased workfare (especially the cash component), direct subsidies to meet their basic needs, and government assistance to pay for medical and longevity insurance.

Principles for Reforming our Social Security System

We suggest that Singapore's social security system needs to be enhanced and reformed along two key principles. First, our starting premise is that global competition, low-wage competition and rapid technological change will combine to intensify the pace of economic restructuring, thereby increasing economic volatility and income inequality. If so, our social security system needs to be expanded to go beyond meeting the retirement, housing and healthcare needs of Singaporeans to also provide a cushion and a buffer against rapid economic change and adjustment. Such a social security system would facilitate the process of economic restructuring, help our workers transit from one industry to another as the economy moves up the value chain, provide them greater protection against periodic bouts of unemployment and income instability, and enable the large majority of them to save enough for retirement. Seen in this light, an expanded social security system is an essential counterpart of our basic economic strategy of plugging into the global economy.

Second, well-designed social protection programmes can be achieved through the careful incorporation of social insurance into our social security system. We contend that the incentive

effects of increased social protection have more to do with the design of social protection programmes than with aggregate levels of spending. Our own experience in healthcare financing provides a “model” for how the overall social security system should evolve. In healthcare, we have accepted that it is neither efficient nor equitable for individuals to save for large medical bills arising from catastrophic illnesses, and we have – over time – expanded the use of medical insurance to deal with more of these risks and contingencies. In dealing with longevity risks, we have also come to accept that such risks are best dealt with through risk-pooling and social insurance in the form of CPF LIFE.

The main alternative to the expanded use of social insurance – a greater reliance on direct subsidies financed by taxation – although necessary, is a less attractive one. The most useful subsidies are those that can be also directed at incentivising work or training like current workfare programme or the wage loss insurance scheme proposed below. While we acknowledge that tax-financed subsidies are needed and will have to increase in some areas (for example, in healthcare and in government support for the very old), it should not be the principal source of funding for the enhanced social security system we are proposing. To avoid moral hazard, tax-financed subsidies have to be rationed administratively – either through queues (i.e. “rationing by ordeal”) or through some form of targeting (such as means-testing). These do not foster social cohesion as they accentuate the distinction between those who are entitled to subsidies and those who are not. Social insurance, in contrast, can be designed to promote participation in the labour force. It also fosters a stronger sense of solidarity and citizenship since coverage is usually (near-) universal.

Constructing a more robust social security system that provides Singaporeans greater protection against the uncertainties and vagaries of the global economy is an economic, not just a social, imperative. By providing Singaporeans greater social protection, the government builds public support for the tough policy choices necessary in globalisation and economic restructuring – attracting and integrating foreign talent, outsourcing or relocating lower value-added jobs, maintaining flexible labour markets, and increasing Singapore’s integration into the global economy. A more robust social security system also gives Singaporeans a stronger stake in the nation – enabling government to use social insurance programmes to foster social cohesion.

Unemployment Savings and Wage Loss Insurance

A possible response to the weaknesses highlighted above is to argue that it is not a bad thing for our social security system to provide little by way of unemployment benefits. Within policymaking circles, it is often argued that unemployment benefits create moral hazard. Indeed, most research evidence suggests that increases in unemployment benefits are associated with longer periods between jobs.

But even if our policymakers remain sceptical about the prospects of designing an incentive-compatible, labour market-friendly unemployment insurance scheme, they cannot avoid the structural question: how should our social security system help workers transit between sectors

as the pace of restructuring intensifies? How can it provide greater protection against unemployment risks without creating moral hazard? To address this lacuna in our social security system, we propose an unemployment savings programme and a wage loss insurance scheme.

An unemployment savings programme would be a relatively affordable way of providing workers a degree of protection against short-term unemployment, while giving workers a cushion as they search for new jobs. One of the main benefits of such a programme – besides the fact that it is consistent with the principle of individual responsibility – is that it helps the unemployed worker to spend an optimal amount of time to seek a suitable job as opposed to taking up whatever comes first, regardless of its appropriateness, due to liquidity constraints.

With middle and higher-income workers, the contribution to the unemployment savings programme would probably amount to 2-3% of their monthly incomes. For lower-income workers (i.e. those in the bottom three deciles), the state would probably have to make most of the contributions on their behalf. In terms of payouts, the unemployment savings programme could be limited to say three months (which experts say is the optimal period for job search), and capped at half the worker's last-drawn salary, up to the CPF salary ceiling of \$5,000, i.e. the maximum payout would be \$2,500 for up to three months, subject to the individual having sufficient funds in his unemployment savings account.

In addition to unemployment savings, we should also consider some form of risk-pooling to deal with unemployment risks. The conventional approach of unemployment insurance suffers from problems of moral hazard. An alternative to unemployment insurance is a wage loss insurance system. Wage insurance differs from conventional unemployment insurance in two main ways. First, benefits kick in upon re-employment, not unemployment, thus giving participants a greater incentive to find new jobs rather than stay unemployed. Second, benefits are set as a percentage of the difference between the participant's previous and current wage (and paid for a fixed period of time). The idea here is again to encourage participants to re-enter the labour market as soon as possible, even at a lower wage, rather than hold out for a better-paying job (which may not come). The main goal of wage insurance is to smooth the incomes of workers who suffer job displacement and declines in their earnings.

Wage insurance also acts as a subsidy for "firm specific" on-the-job training for the worker's new employer. Generalised retraining programmes may not only fail to guarantee a worker a job but also cost the worker the wages that he could earn by accepting new employment sooner. In contrast, the retraining that a displaced worker receives on a new job provides new skills that contribute directly to his performance and is therefore useful to him and the new employer. Yet another benefit of wage insurance is that it encourages workers to consider different types of jobs and sectors of employment. By encouraging the unemployed to broaden their job search, wage insurance can increase labour market mobility.

To facilitate the training that may be necessary for job transitions, we can also consider structuring the wage insurance scheme such that a portion of the payout can be used to pay for the unemployed person's training programmes between jobs. Such payouts will help address

the current problem of the unemployed having to fork out their own monies to participate in government-funded training programmes. It will also reduce our reliance on direct subsidies for training, and minimise the moral hazard problems that over-generous (and hard to monitor) training subsidies might create.

Introducing a wage insurance (WI) scheme for low and middle-income earners designed in the way described in the preceding paragraphs will have four main benefits. First, it encourages the unemployed to seek re-employment quickly, thereby avoiding the moral hazard problems associated with conventional unemployment insurance. Second, it helps the unemployed who wish to move to a new industry pay for his training, thereby increasing labour mobility. The training insurance functions as de facto individual learning accounts that workers can draw on for training purposes when they are laid off. Third, it provides greater social protection against the risks of unemployment and income volatility without imposing a significant fiscal burden since this programme can be financed mostly by employer and employee contributions, with government subsidies limited to helping low-income workers pay their premiums. Fourth, it improves labour market flexibility by reducing workers' reliance on employer-provided retrenchment benefit schemes. Seen in this light, wage insurance is a way of making retrenchment benefits portable.

Helping Singaporeans Achieve Retirement Adequacy

Beyond the pressures created by globalisation, wage competition and technological change, Singapore's social security system will also come under significant pressure from its demographic changes. Many of today's older workers are unlikely to have built up sufficient retirement savings, and even if they have, may have invested too much of them in housing. As the population ages, our current policies to encourage home ownership will have to be adjusted to enable Singaporeans to "de-cumulate". At a broader level, we should also question whether our current housing and CPF policies are contributing to an excessive allocation of the country's savings to housing. That our housing subsidies are not particularly progressive (since buyers of bigger flats receive larger subsidies) is another reason to rethink government's public housing policies and the role of housing as the primary instrument of social security.

Among the poorest segments of our population, policy has to be finely balanced between providing more financial support and creating stronger incentives for those who can work longer to do so. This suggests a two-pronged approach. First, for the "young old" aged 55-70, we propose an increased WIS that will increase their annuity payouts under CPF LIFE. Second, for the "old old" aged 70 and above, we propose establishing a basic, inflation-indexed monthly retirement grant. This grant can be means tested on the basis of both income and savings (Hong Kong has a similar scheme) to provide lower payouts to younger, better educated cohorts with higher savings.

It should also be possible to phase out this basic pension over time, as the other measures proposed in this paper ensure that future generations will have sufficient retirement adequacy. The basic old age grant could be supplemented by age-progressive (the older you get, the

higher the subsidy rate) medical and transport subsidies. In particular, the government should consider extending Medishield to cover congenital illness and Singaporeans above 85. As the premiums required for such insurance coverage are likely to be large, government would probably have to provide means-tested subsidies to fund the premiums of the low income elderly and disabled.

To reduce any work disincentive effects that may arise from introducing a basic pension for the very old, the government should consider increasing the WIS substantially for the bottom three deciles for all age cohorts to help those most exposed to wage stagnation and erosion save more for their retirement. A portion of these increased payments could also be used as premiums for the proposed WI scheme, Eldershield or any new insurance programmes introduced to address Singaporeans' long-term care needs. The rationale here is that risk-pooling is most effective if coverage is widespread and members participate early in their working lives.

APPENDIX 2

HEALTHCARE

Access to Good Healthcare and the Social Compact

Security of access to good basic healthcare is not just central to societal well-being, but it is also often considered a right, which is sometimes even enshrined constitutionally (e.g. in Canada). This notion of ensuring access to good healthcare, irrespective of an individual's economic or social circumstances, is termed "universal healthcare" by the WHO and is a cornerstone of international healthcare development programmes.

The relationship between health and the economy is well-established empirically. At the individual level, health levels affect one's capacity to work in terms of time and energy levels. Increased productivity in turn leads to higher income levels. Conversely, an individual's income will affect his ability to provide good healthcare for him and his family. A widening inequality of incomes can therefore compromise access to good healthcare unless government policy actively and deliberately addresses the inequities in access. Health can also affect productivity at a macro level through several mechanisms. A longer life expectancy may lead to more investment in education due to higher expected returns. Improvements in child mortality and morbidity rates may also create incentives for greater labour force participation.

This positive feedback loop between health and income highlights the importance of universal healthcare access for the economic and social well-being of the country. If access to decent healthcare is limited to only those who can afford it, the social compact will often come under increasing stress, even in a rich country like the US. Epidemiological studies also suggest that income inequality is correlated with health inequality; among rich countries, higher inequality tends to be associated with poorer health outcomes and higher morbidity rates.

Singapore's public healthcare system is widely considered to be a well-designed and financially sustainable one. The 3Ms system of financing (Medisave, MediShield and Medifund) ensures that the large majority of Singaporeans have affordable access to good healthcare while still providing patient choice. For instance, seven out of ten patients in our restructured hospitals do not have to pay anything out-of-pocket. The state's ownership of public hospitals and its constraints on the supply of healthcare help to limit cost pressures. Meanwhile, the government's emphasis on individual responsibility and co-payment curb the tendencies for over-consumption, a phenomenon that is common in heavily subsidised or "free" healthcare systems. In addition, the provision of a low-cost, near-universal catastrophic insurance scheme (MediShield) provides citizens a certain degree of protection against the risks of catastrophic medical episodes.

Nonetheless, looking ahead, Singapore's healthcare system will come under increasing stress for at least three reasons. First, our population is ageing. Increasing longevity and a larger proportion of older persons in our population will, almost inevitably, require a higher national

expenditure on healthcare. The state will come under increasing pressure to expand its financing of healthcare. Second, medical advances will push healthcare costs up as more medical conditions become treatable and as more effective drugs and treatments become available. Again, there will be rising public expectation for the state to provide these new drugs and treatments on a subsidised basis. Third, the combination of demographics and medical advances will increase the interactive complexity and interdependence between the different parts of the healthcare system (for instance, between primary, acute, intermediate and long-term care). At the same time, citizens will expect seamless, integrated care that hides the boundaries between the different specialities and providers of healthcare. Adapting to these long-term, structural challenges will require Singapore's healthcare system to develop efficient and sustainable financing schemes that provide citizens greater assurance, deliver integrated care across providers and different care setting, and operate in a more networked and coherent manner.

Singapore's Healthcare Financing compared to Advanced Asia

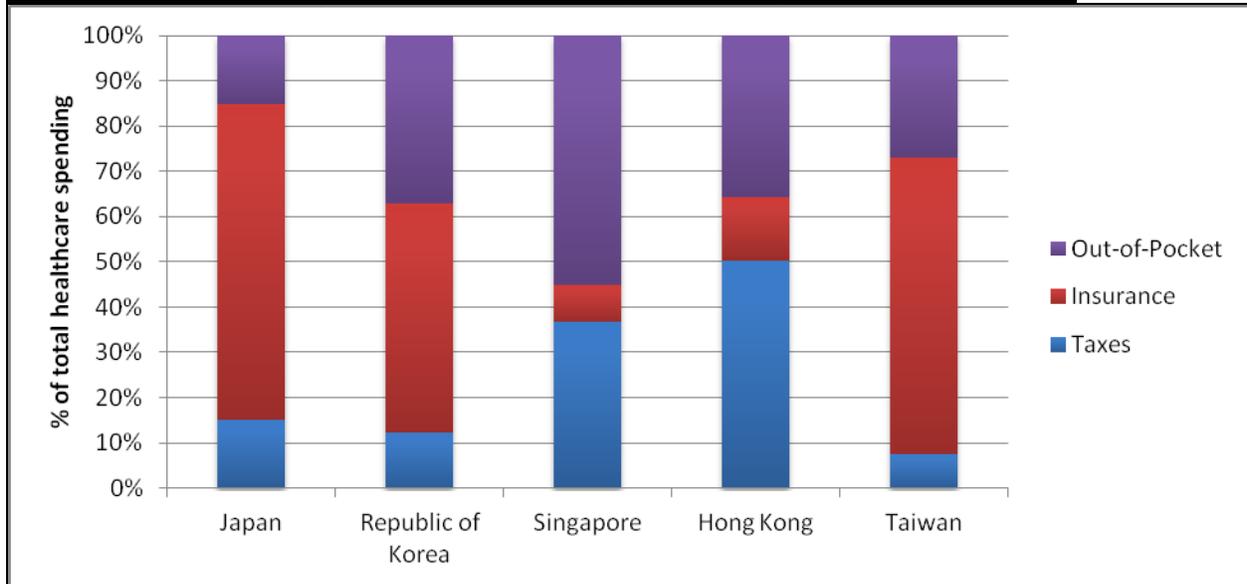
Singapore's healthcare system has been lauded for its high standards and cost effectiveness. There is excellent physical access to healthcare. Due to our geographical density and a good spread of healthcare facilities across all settings and investment in high quality healthcare infrastructure and technologies, Singaporeans are not restricted in their choice of healthcare institutions, and public hospitals are typically staffed by well-trained healthcare professionals.

The 3Ms model of financing – a combination of self-funded medical savings accounts (Medisave), insurance for catastrophic diseases (Medishield), and a safety net for low-income families (Medifund) – has thus far enabled the Ministry of Health to largely achieve its mission of providing good and affordable healthcare for all Singaporeans. Patient co-payment is a central feature of the system, as the healthcare financing philosophy is underpinned by the emphasis on individual responsibility. This helps to contain healthcare costs and avoid over-consumption. Costs are also contained through the government's constraints on the supply side through fee controls and the ownership of public hospitals.

Nonetheless, the larger increase in healthcare costs relative to median and lower wage growth in recent years has led to gaps in the ability of low and lower middle-income families to afford good healthcare over their lifetimes. This is particularly true for those reaching their retirement and elderly years when such costs often escalate dramatically. While healthcare remains on average affordable for Singaporeans, our long term income trends and the imbalance between public and private spending are a source of concern. The confluence of these factors may result in inadequate access for a significant and growing minority that have insufficient financial provisions for long-term healthcare but who face growing risks of needing it.

A relatively large proportion of healthcare expenditure in Singapore is still funded out-of-pocket, with 55% of healthcare spending financed directly by patients². In comparison, patients in other developed Asian economies pay about 30% out-of-pocket (see [Chart 7](#)).

Chart 7. Out of Pocket (OOP) Health Spending Percentages in Advanced Asia



Health financing data for Japan, Korea and Singapore are from the World Health Organisation Data Observatory and refer to 2009. Hong Kong and Taiwan data are from 2007 and 2008 respectively and obtained from national health reports.

The introduction of more universal health insurance (UHI) models in Japan, South Korea and Taiwan has seen out-of-pocket shares for healthcare fall significantly. While co-payment also features in these systems, out-of-pocket amounts are capped for insured services, and the exposure to the risks of extremely high spending is much reduced. While UHI models are clearly more expensive, they also ensure peace of mind for citizens and reduce the uncertainty and stresses that unexpected catastrophic illnesses bring to patients and their families. It is also worth noting that South Korea and Taiwan shifted to their current models of UHI as a consequence of political liberalisation and democratisation when their own social compacts were being restructured (Gault et al. 2006).

² Singapore’s out-of-pocket spending figure excludes Medisave, which is categorised under “Insurance” in this study. The figure also does not fully reflect the extent to which Singaporeans pay for healthcare as the total expenditure includes healthcare spending by foreigners – both long-term residents as well as medical tourists. While this caveat applies to the other Asian economies to varying degrees, it applies with particular force to Singapore given our higher levels of non-citizen consumption of healthcare.

Chronic and Long Term Care

As the demographic profile in the previous half-century has been relatively young, the focus of the healthcare sector has been primarily on the acute care setting, and relatively less emphasis has been placed on developing long term and chronic care. With a projected rapid growth in the elderly population in the next twenty years – 23% of Singaporeans will be 65 and above by 2030 – the government needs to make urgent and decisive policy shifts to ensure that the healthcare needs of the future population will be adequately met.

As opposed to catastrophic “big ticket” medical bills covered by Medishield, the higher frequency, medium impact nature of chronic and long term care limits the viability of self-funded insurance schemes. The existing medical insurance coverage systems are not currently designed to cope with the long term nature of chronic care. The costs of chronic care accumulate over an extended period of many years in different medium to long term care settings. Such cumulative costs are also likely to become increasingly unaffordable as a result of growing number of chronically ill low- to medium-income individuals.

In Singapore, the stringent approach taken for means testing in the long term care sector embodies the philosophy of maintaining family support as the prime source of care. Gross incomes of not only the patient, but also his immediate family members, as well as his/her private property assets are taken into account for assessing long term care subsidies. For Singapore citizens, there are no government subsidies for residential, long term care services should the monthly per capita income of the family exceed \$1400. While we acknowledge the importance and value of family support, this subsidy framework puts considerable stress on middle income families that fall outside the current means-testing thresholds.

This could also be exacerbated by the lower levels of Medisave balances and Medishield coverage among Singaporeans aged 70 and above. As Medisave was only introduced in 1984, these older citizens, in particular those who chose to retire earlier, may have limited Medisave savings. This has significant knock-on effects on medical insurance coverage, as the lack of Medisave funds could consequently mean that this group of elderly do not have the means to pay for their Medishield premiums. Hence, families that have to support their parents may not be able to depend on the protection from catastrophic illnesses that the 3Ms framework provides.

To provide more support for the elderly, the government introduced Eldershield in 2002 as a supplementary insurance scheme for severe disability. Eldershield premiums are kept at a low rate to encourage greater participation, but this also means the payouts are limited, both in scope and in quantum. Eldershield provides a monthly cash payout of \$300 to \$400 per month for up to 72 months. While this scheme alleviates some of the financial burden for families with elderly, the payout is barely sufficient to cover the costs of staying in a nursing home, not to mention any additional medication and care required. Eldershield is also relatively limited in scope: it requires the individual to be unable to fulfil three of six activities of daily living – mobility, feeding, transferring, dressing, bathing and toileting – in order to be eligible for the insurance

payouts. While this provides relief for the elderly with more serious conditions, the elderly with lesser disabilities would still be excluded.

As our population ages and chronic healthcare costs rise exponentially, this gap in access to long term care will continue to grow unless it is addressed more structurally. Schemes like EldersShield that encourage early contributions and are partly state funded are good innovations that enable greater risk pooling. But because of our emphasis on individual responsibility and on ensuring low premiums, the scope and level of payouts are not likely to be sufficient to meet the needs of our rapidly ageing population.

Furthermore, the costs of long term care extend beyond the quantum and the period of time that the scheme currently provides for. A report by the Strategic Society Centre in the UK refers to the “catastrophic costs” of long term care as the total costs that accumulate when care of different levels of cost is required and purchased over an extended period. This could last ten to twenty years depending on the onset of disability and the life expectancy of the individual. In the longer term, this care could lead to significant bill sizes even for asset-rich families, resulting in situations where individuals are “forced to sell their home to pay for care”³. Inevitably, government will have to play a bigger role financially to strengthen the safety net. This could be done through more subsidies for the premiums of such long term health insurance and through government financing of the infrastructure to provide good long term care. As with acute care, the government has to make the difficult decision in striking the right balance between providing families with peace of mind through the reduction of out-of-pocket payments, and avoiding problems of moral hazard which lead to families placing the elderly in nursing homes instead of the alternative of keeping them at home.

Infrastructure and Manpower

Besides strengthening the financial safety net, there should also be more investments in healthcare infrastructure and manpower. This would ensure that Singapore maintains the current levels of physical access. Today, acute hospitals are already facing high bed occupancy rates, which translate to longer waiting times for patients. The problems in infrastructure and manpower have been caused by an unanticipated increase in population in the last decade. Between 2000 and 2010, Singapore’s total population increased by 26%, fuelled by an astonishing 73% increase in the number of non-residents. While the Ministry of Health has been steadily increasing the medical school intakes in recent years, the long lead times in the training of doctors mean that Singapore will continue to face a manpower crunch in the short to medium term.

To avoid a situation of physical access being curtailed in the short term, the Ministry of Health could tap on the private sector to provide services for subsidised patients. There is certainly

³ Compared with OECD countries and developed Asian economies, Singapore’s healthcare expenditure and the government’s share of healthcare expenditure are significantly lower (refer to Chart 8). Government expenditure as a percentage of total healthcare spending is also much lower at 31.9% in 2005.

capacity to do so – the private sector employs 40% of all medical specialists⁴, while only catering for 20% of healthcare needs in the acute sector. The portable subsidies funding model that is already used in the primary care setting today could be transplanted to the acute sector and alleviate public sector capacity issues.

In the long term care sector, there is an even greater impetus to ensure that there is sufficient capacity to provide for the ageing population. The current average waiting time for admission into a nursing home is 49 days⁵, wherein the patient could be extending their stay in an acute hospital. The current model for the long term care adheres to the Many Helping Hands approach, and long term care institutions for the needy are typically run by voluntary welfare organisations. While this has met the objectives of leveraging on community care, the VWOs do not typically have the capacity or capability to expand their services. Hence, there may be a need for government to play a bigger role in providing funds and support for infrastructure development in the long term care sector. The government could also tap on the private sector to play a bigger role in the development of infrastructure for the long term care sector.

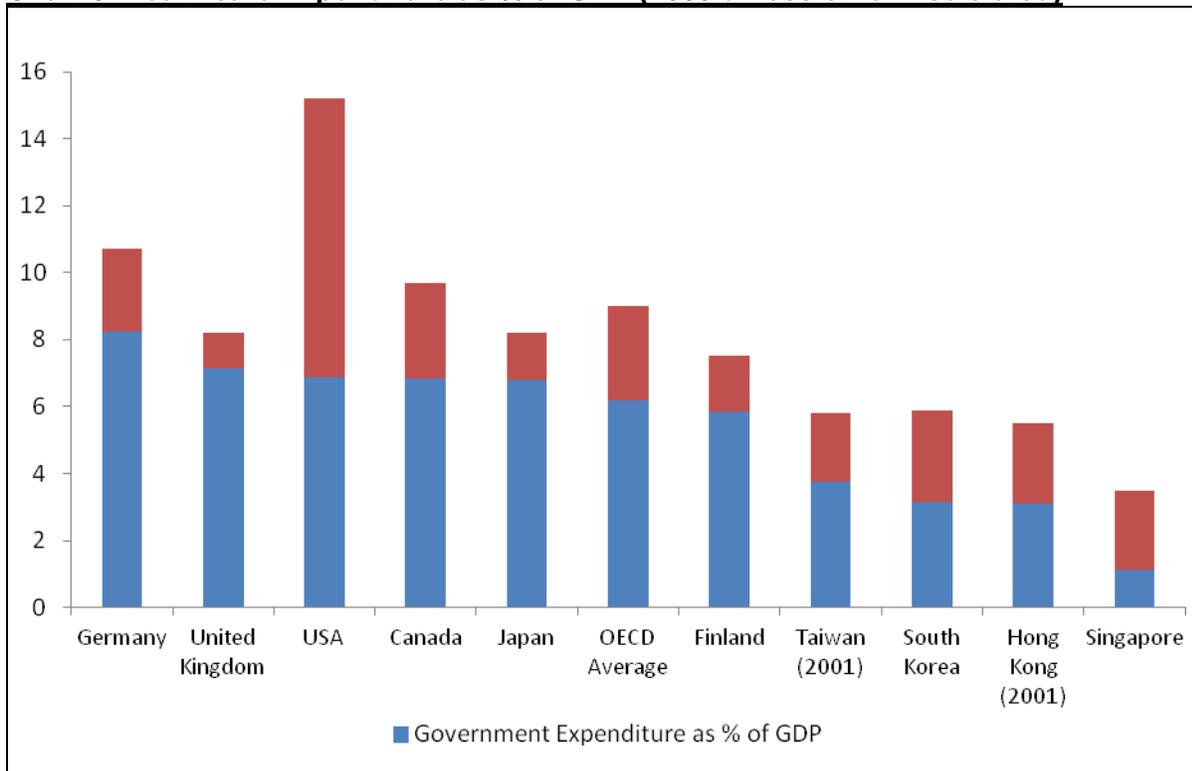
Conclusion and Recommendations

While the government should be commended for its efforts in improving healthcare productivity and keeping healthcare costs low and quality high, the extremely low share of public expenditure in healthcare should not be viewed as an achievement in itself. Rather, it should be a signal that the government can expand its effective healthcare services, and ensure both access and affordability without compromising fiscal sustainability.

Compared with OECD countries and developed Asian economies, Singapore's healthcare expenditure and the government's share of healthcare expenditure are significantly lower. Government expenditure on healthcare is only around 1.5% of GDP and government expenditure as a percentage of total healthcare spending is also much lower at 32% in 2005. In contrast, total government health spending as a share of GDP in Korea, Taiwan and Hong Kong ranges between 3-4% of GDP, while government expenditure as a percentage of total healthcare spending is between 50% and 65%. These shares are even higher in the OECD where government health spending is typically 6-7% of GDP and public health spending is 75% of national health spending (see [Chart 8](#)).

⁴ Data from Singapore Medical Council 2010 report

⁵ "Target to cut waiting times for nursing home places", *Straits Times*, 12 Jun 2011

Chart 8. Healthcare Expenditure as % of GDP (2005 unless otherwise stated)

We acknowledge the inherent complexities of healthcare financing and that there are no easy answers on achieving the right balance of quality, accessibility/affordability and sustainability. It is also difficult to maintain high levels of government funding over an extended period of time for long term and chronic care. There is a natural tendency for healthcare costs to creep upwards, and this rising trend will be exacerbated by the increasing proportion of elderly and rising expectation of healthcare provision. Trade-offs of quality against universal access will become starker, especially in the rapidly rising costs of terminal elderly care.

Nevertheless the healthcare gaps discussed above and the experience of some of the developed Asian countries (which also have their own problems) suggest that we can deliver better access to good quality care without necessarily compromising longer term fiscal viability. This new balance will combine the traditional emphasis on individual responsibility with more extensive risk pooling through social insurance, and a higher level of government spending to reduce patient co-payment and fund the insurance premiums for low to middle income families. We also need to review whether current means testing criteria, especially those that require the means testing of family members, are too strict to ensure universal access over the long term.

There also needs to be a continued emphasis on preventive healthcare and healthy lifestyles. Singapore has thus far excelled in such health promotion efforts, done through school and workplace-based health programmes, and healthy lifestyle campaigns for anti-smoking and healthy diets. This commitment to healthy living goes a long way towards reducing likelihood of illnesses and lowering long term healthcare costs.

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