

Singapore Wage Price Inflation Spiral

Take a small island with an open economy highly dependent on trade and intellectual property, grow the economy to the hilt, run out of ideas, grow the population to grow the economy, to the hilt, or the shoreline, and what do you find? High inflation at each level of economic output. The open economy invites imported inflation and so a natural control variable might be the exchange rate, but what of domestic inflation caused by capacity constraints?

An ever rising disparity of income and wealth is being fuelled by differing labour capacity or supply constraints in different industries. This exacerbates the inflation problem since shelter, transportation and food account for a greater share of consumption to the lower income group and it is precisely the scarcity of land, transport infrastructure related to the scarcity of land, and food which are the main sources of inflation.

The solution to this is not wage policies or subsidies across the board or by income level. This will very likely trigger a wage price spiral since it fails to address the underlying causes of inflation and localized labour market shortages.

If the economy is operating at close to full employment and inflation is accelerating beyond economic growth, structural limitations have been met and constraints are binding. To address inflation, the economy needs to be cooled. To the extent that the inflation is imported, exchange rates can be used as a control. If the inflation is due to domestic capacity utilization limits, interest rates are the appropriate control.

Differential demand supply imbalances in the economy lead to differential pricing (or mispricing) of wages. To address wage price spiral inflation dynamics, industries facing labour shortages need to either be cooled or the specific relevant labour developed or imported. The latter approach

has been operated with great economic success but has faced social and political headwinds. The former approach has to be implemented or at least explored. Industries with monopoly or oligopoly employers tend to underpay. Such industries may require wage policy or labour unionization. Industries with numerous employers paying market wages can be left alone.

Wage price inflation spirals are due to two separate yet related dynamics conspiring to drive prices higher. A credible solution needs to address both prices and wages, separately yet in a related fashion. After all, a wage is nothing more than the price of labour.

One of the most difficult issues facing Singapore is the shortage of land. This is trivially true for a tiny island. It is thus the most likely source of inflation when the economy overheats. Call it the Rent Price Spiral. Prices rise resulting in higher profits resulting in competition for space resulting in rising land prices and rental leading to higher prices. Maintaining GDP growth through the unbounded growth of the labour force is not viable in the long term, and in Singapore, is fast approaching its limits. Maintaining Per Capital GDP growth, per capital income and per capital consumption is a more logical objective.

This is easier said than done, which is why to date, it hasn't even been said.