Do taxes in Singapore really need to go up?

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Higher taxes have become the talk of the town in the run-up to Budget 2018.

A tax increase has been touted by experts as the most logical and sustainable response to Singapore's growing spending needs.

But do taxes really need to go up? What other options are available in the face of mounting expenditures on healthcare, infrastructure, education and social needs?

'Not if, but when'

Economists and tax experts widely expect Finance Minister Heng Swee Keat to make an announcement about tax hikes when he delivers his Budget speech on Feb 19.

The motivations behind such a move have been well documented - Singapore's infrastructure investment and social spending are set to continue climbing.

In particular, the challenges of an ageing population will become increasingly acute in the coming years. Singapore, one of the fastest-ageing countries in the world, will have one in five people aged 65 and older by 2030.

In addition, the country's Budget spending has been higher than operating revenues since the 2015 financial year.

Other countries mitigate these challenges by borrowing, but the Singapore government does not borrow for spending. Instead, securities are issued for reasons unrelated to the government's fiscal needs.

Economists and tax specialists have been speculating about the format and timing of a potential tax increase, ever since Prime Minister Lee Hsien Loong said recently that Singapore will be raising its taxes as government spending grows.

Most analysts expect a hike in the Goods and Services Tax (GST), which could come as soon as Budget 2018, especially as Singapore's rates are relatively low compared with its regional peers.

Other options the government might be exploring include taxes on e-commerce spending, as well as wealth taxes.

But each tax comes with its own set of drawbacks.

Higher corporate taxes, for instance, would put a dent in Singapore's economic competitiveness and the country's ability to attract foreign investment.

Wealth taxes, which might range from additional property taxes to capital gains tax or even re-introducing estate taxes, could affect Singapore's status as a major wealth management and financial hub.

Higher GST would affect lower-income households disproportionately and could also weigh on consumer sentiment and economic growth.

Any tax hike would need to be delicately handled, but these limitations also mean it could be challenging to raise some taxes beyond a certain threshold, while others will have to be raised very gradually.

This means tax hikes alone will not guarantee the long-term health of the government coffers.

Relooking sacred cows

This begs the question of whether higher taxes really are inevitable. Does Singapore have other options?

Maybank Kim Eng economist Chua Hak Bin says: "It is quite remarkable that Singapore, with one of the highest saving rates in the world (at 48 per cent of gross domestic product) and fiscal reserves, still needs to increase taxes.

"The risk is that higher taxes may weigh on growth, which could lead to lower tax revenue collection as a result. Singapore's low-tax regime has been historically a reason for its success, its attractiveness as a business hub and a vibrant city that draws talent."

Instead of making today's taxpayers fork out more, some have suggested boosting the Budget by tapping more of the earnings from Singapore's significant reserves.

Though the full size of Singapore's financial reserves is never revealed for strategic reasons, it is estimated at more than S$1 trillion.

The reserves are managed by three investment entities: the Monetary Authority of Singapore (MAS), GIC and Temasek Holdings.

Singapore has been able to produce overall Budget surpluses in recent years only by drawing on the net investment returns (NIR) framework, which allows the government to spend up to half of the long-term expected real returns from the assets managed by the three entities.

The net investment returns contribution (NIRC) overtook corporate income tax to be the top contributor to government coffers for the first time in the 2016 financial year.

Institute of Policy Studies (IPS) senior research fellow Christopher Gee says increasing the NIR contribution to the annual Budget, or even drawing down on the reserves, could be justified on the basis of "inter-generational equity".

This is because a portion of the national reserves was generated through surpluses from government Budgets in the past, and these fiscal surpluses were in turn generated by taxes paid by earlier generations of taxpayers.

"Might it not be appropriate from a generational equity standpoint to consider drawing down on those accumulated surpluses... instead of increasing taxes on current and future generations of taxpayers?"

The counter-argument to this has been reiterated many times, most recently by Finance Minister Heng Swee Keat who said the reserves give Singapore long-term economic stability and also firepower to weather crises such as global financial crises.

He also noted that the reserves have been accumulated over many years as a result of prudent spending by past generations, and suggestions to tap it for Singapore's growing spending needs should not be taken lightly.

Ultimately, the decision to tap more of the earnings from the reserves comes down to balancing the needs of current and future generations.

This throws up philosophical questions with no easy answers: What is Singapore saving for? How big do the reserves actually need to be?

Reining in costs

Clearly, addressing fiscal sustainability simply by focusing on the Budget's biggest revenue sources will be challenging. The other side of the coin - managing costs - also needs to be addressed.

The government has made efforts to rein in costs, such as by implementing a permanent 2 per cent downward adjustment to the Budget caps of all ministries and organs of state from April this year.

But this is not expected to reduce government expenditure; rather, the move is aimed at controlling spending growth.

Some have argued that the government can afford to spend less on big-ticket items, or target subsidies more effectively.

For instance, the Pioneer Generation healthcare package should have been more targeted towards those who needed help most (by housing type or income), rather than a blanket scheme for everyone aged above 65, suggests Maybank Kim Eng's Dr Chua.

Controlling costs for households, especially healthcare costs, would also help moderate government spending on subsidies and rebates.

DBS senior economist Irvin Seah says: "No matter how much we increase healthcare subsidies, it will never be enough if costs are not kept in check."

The cost of healthcare has been rising inexorably. Between 2011 and 2016, Singapore's average annual healthcare inflation rate was 2.4 per cent, compared to an average of 1.6 per cent among developed countries.

"There is an urgent need to review the current cost structure of the healthcare system," Mr Seah adds.

The level of savings that many elderly have is insufficient to provide for their retirement, particularly when medical expenses are considered, notes Singapore University of Social Sciences economist Walter Theseira.

Radically rethinking medical subsidies and retirement adequacy may address some of these funding gaps, he notes. "But, this may be far more politically costly and difficult than raising taxes."

Long-term growth is key

The tax hike will probably be announced sooner rather than later. But in the longer-term, economic growth is still the most sustainable and effective long-term solution to Singapore's fiscal woes.

"The vibrancy of the economy and the job market is the main underpinning of the revenue base," notes OCBC economist Selena Ling.

Dr Chua says: "Raising overall economic growth - for example by relaxing foreign worker rules so more companies will expand operations - will also generate higher tax revenue."

DBS' Mr Seah adds: "If you grow the pie, then everyone gets more. This is why we need to be able to sustain growth to generate enough resources to support higher expenditure.

"But this will become more challenging, given demographic shifts."