



## IPS Closed-Door Discussion: Fiscal Management of Singapore's Reserves: An Inter-Generational Perspective

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ON 4 April 2019, the Institute of Policy Studies (IPS) held a closed-door discussion on “Fiscal Management of Singapore’s Reserves: An Inter-Generational Perspective”. IPS Research Assistant Drew Shih gave a presentation of his working paper on the subject,<sup>1</sup> and IPS Senior Research Fellow Christopher Gee moderated the discussion.

The discussion brought together 31 policymakers, leaders and professionals from financial institutions, academics and IPS researchers. The objective of the discussion was to develop a framework for fiscal policy and the management of Singapore’s reserves that would deliver fair and sustainable outcomes for all generations of Singaporeans.

### **PRESENTATION BY MR DREW SHIH**

Mr Shih explained how the government had justified the present Net Investment Returns (NIR) framework as being intergenerationally fair. The NIR framework allowed the government to spend up to 50 per cent of the expected long-term real returns on the net assets in the reserves in each year’s Budget. Although the NIR framework was rhetorically simple, he said it was also quite arbitrary and suggested a more principled approach of achieving intergenerational equity regarding the reserves.

To that end, Mr Shih introduced four principles of intergenerational equity, explained how the discourse on the reserves in Singapore related to the principles, and provided some insights into them.

First, he proposed that each generation should pass on sufficient resources to the next generation, such that the latter can meet a “minimum threshold” — which can be interpreted as being able to meet basic needs.

He said some have argued against raising the 50 per cent cap for Net Investment Returns Contributions (NIRC) because of the risks associated with capital markets. He acknowledged that unforeseen events such as financial crises could lead to overestimations of returns, which would erode the principal amount of the reserves and leave less for future generations to meet their needs. The risk, he explained, would thus be borne by future generations. He also noted calls to continue growing the reserves in order to further mitigate

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<sup>1</sup> The working paper is titled “Fiscal Management of Reserves in Singapore: An Intergenerational Equity Perspective”, and can be accessed [here](#).

risk and prepare for the higher government expenditure in anticipation of Singapore's ageing population.

Mr Shih stated that while concerns about risk cannot be ignored, the question would be how much risk we are willing to bear.

Second, he introduced the principle that each generation should prioritise action that benefits the least well-off within each generation. He explained that because inequality was transmitted across generations, reducing inequality in the current generation would help mould a more egalitarian society in the next. He pointed out that there have been calls to use more of the reserves to reduce inequality.

Mr Shih also mentioned that adhering to the principle of reducing inequality could help meet the principle of maintaining a "minimum threshold" for future generations, as intervention to uplift the least well-off today would translate into better-off descendants in the future.

Third, he set out the principle of indirect reciprocity, where each generation should pass on the resources it had received from the previous generation to the next. However, he explained that the notion of indirect reciprocity as expressed by the political leadership in Singapore was one of reciprocating the spirit of saving up for the future and thus continuing to grow the reserves, just as the previous generations had done. He thus questioned if the demand of indirect reciprocity as expressed by the political leadership was too onerous.

Fourth, he introduced the principle of "benefiter-pays", where each generation should pay for what they benefitted from, and receive benefit from what they paid for. He said the principle had been invoked by both proponents and opponents for raising the NIRC cap. For the proponents, they argued that it was the hard work of the older segment of the present generation that "paid" for the reserves, and hence this group should receive its benefit. For the opponents, they argued that allowing a greater use of the reserves would create a future generation of Singaporeans with a "trust fund kids" mentality, who would make it a habit of not having to pay for their own spending.

However, Mr Shih argued that the principle of "benefiter-pays" had to be balanced against that of indirect reciprocity. He said that if one accepted the argument that the older generations had "paid" for the reserves and hence deserved to benefit from it fully, there would be no reserves left for the younger and future generations. On the other hand, being able to tap on the reserves allowed the impact of the "reverse dividend" — the negative financial burden that follows the period of demographic dividend — to be partially mitigated.



*Mr Drew Shih (right) gave a presentation introducing four principles of intergenerational equity for the fiscal management of the reserves, while Mr Christopher Gee (left) moderated the discussion.*

## **DISCUSSION**

Mr Christopher Gee posed three questions for discussion:

- How can we balance rising spending needs with the demands of protecting the reserves against uncertainty, inflation and maintaining sufficient wealth to generate returns for future generations?
- Can we match revenue sources with different uses to ensure they are in keeping with the principles of intergenerational equity?
- Can we conceive of scenarios under which Singapore could use more than 50 per cent of the NIR?

Several themes emerged from the discussion.

### **Total Amount of Reserves**

Two participants pointed out that it was difficult to discuss the spending rule without knowing the actual amount of reserves Singapore has, which is officially kept secret. Mr Gee presented some calculations made based on publicly available data. He calculated that although the government's total financial assets amounted to over S\$1 trillion, as at 31 March 2018, Singapore's unencumbered assets would be around S\$390 billion, taking into account just the Consolidated Fund; S\$451 billion if Development and Contingencies Funds were included along with the Consolidated Fund; or S\$490 billion if all fixed commitments to

external parties were excluded. Using these figures, he illustrated the “spending rate” of the reserves based on the various assumptions of unencumbered assets, and the number of years before unencumbered assets would be consumed based on different actual rates of returns on the reserves. He acknowledged that his calculations did not take into account further inflows to reserves, such as the amount of the NIR that was not spent each year, budget surpluses, and revenue from land sales.

### **Needs of Future Generations and Fair Transfer of Resources**

Two participants suggested that the needs of the future generations should not determine the amount of reserves to be passed on, because needs would be infinite. Another participant disagreed, stating that the notion of unlimited needs would not apply beyond some level of wealth.

A participant suggested that a fairer approach would be for each generation to have access to the same amount of reserves in real terms, and that if this principle was accepted, then calculating the amount that could be spent by current generations would be a matter of mathematics and statistical risk.

The participant explained that in this approach, each generation would be given an equivalent amount of the reserves and it would decide for itself what its priorities are. Therefore, devoting more resources to reducing inequality would be a political decision for the generation to undertake. However, another participant pointed out that the question was not just of prioritising within a given budget, but to expand that budget so there would be more to expend. This participant also questioned if the current approach amounted to a hoarding of surplus rather than saving the funds for when it was needed.

Another participant highlighted the difference between spending from the reserves and from taxation. The participant explained that there would be an incentive to obtain value-for-money when spending from taxation due to the political pain of taxation, which might not be present when spending from reserves. Although not against utilising the reserves, the participant argued that it was important to inflict political pain when funding government expenditure.

### **Ageing Population, Life Expectancy, and Preparing for Crises**

Participants debated the impact of Singapore's ageing population and increasing life expectancy and its implications for the NIR framework. A participant wondered if these two combined factors meant that Singapore should save up more for future generations, and pointed out that the 50 per cent of NIR that was not spent in each year's Budget would also benefit the current generations to meet their future needs. Another participant pointed out that Singapore “has not aged yet”, and that the additional elderly healthcare spending would likely outpace the growth of the reserves. However, another participant noted that younger generations had a better education and would be better able to finance their own needs, and that the citizen population would begin shrinking by 2020, hence the amount of reserves per citizen would increase even if the total amount stagnated.

Two participants also said that the reserves would be needed for responding to crises. One of them said a large amount of funds was potentially required to tackle disruption — for retraining the workforce and providing workers with a continued source of income as they undergo retraining. Another participant argued that building up the reserves for potential crises in the future would neglect the fact that those in poverty were currently facing a crisis.

### **Reserves as Largest Source of Revenue**

A participant said Singapore's spending from the reserves was already very high, and described how the NIRC was the largest component of government revenue, with approximately \$1 out of every \$5 of the Budget coming from NIRC. The participant compared this to Norway, where approximately \$1 out of every \$8 of its budget came from the reserves.

Another participant questioned if the debate should be about why Singapore was spending so much from its reserves, especially as it did not have natural resources unlike Norway. Another participant questioned why the government seemed unbothered by the fact that the amount of NIRC exceeded corporate tax.

### **Future Returns and Volatility**

Participants discussed the likely future returns on the reserves and its volatility. One participant pointed out that because of the high starting valuations in the market today, projected returns would likely be low. The participant highlighted that Norway had adjusted its expected returns from 4 per cent of its capital to 3 per cent, in anticipation of lower returns. Mr Gee also acknowledged that the current rate of return was lower than in the past.

On volatility, the participant said equity markets have had volatile returns, even over a long period of 20 to 50 years. He explained that the right method for forecasting returns was to use "geometric returns", rather than "arithmetic returns" which would overstate returns. The participant further warned of the impact that climate change, disruption and pandemics could have on investments and the global economy, and that no model could help predict the impact of those events. However, another participant argued that Singapore's sovereign wealth funds that managed the reserves were likely quite well diversified.

### **Marginal Benefit of Spending**

A participant proposed weighing the marginal benefit of spending in a certain time period against that of another time period. If the marginal benefit of spending on the elderly today outweighed that of spending on younger generations in the future, it would be justifiable to spend more from the reserves today. Therefore, he suggested that the 50 per cent NIRC cap should be dynamic based on the relative marginal benefits. Another participant pointed out that expenditure to alleviate poverty today would have benefits for the future as well.

Mr Gee extended the idea to suggest that spending from the reserves today would be justified if the marginal benefit of doing so exceeded the returns on the reserves. He also noted the diminishing marginal returns from investing the reserves that would result from greater accumulation of the reserves.

In his concluding remarks, Mr Gee thanked the participants for their input and remarked that Singapore was in an enviable position of strength to be debating these issues.

[Drew Shih](#) is a Research Assistant at IPS.

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