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## Analysing the budget

*While it puts surpluses to good use, public expectations for handouts should be tempered*

**By TAN KHEE GIAP**

FROM my conversations with people prior to the FY2005 Budget announcement, I found that, quite naturally, the public at large tends to be most interested in the potential handouts and rebates they are likely to receive. Private sector participants are more interested in lower business taxes, fees and charges, and market analysts in whether it will be another year of budget surplus or deficit.

As an economist, I am naturally interested in the way in which budgetary measures promote competitiveness in the midst of economic restructuring. I am also interested in the public's perception of the government's budgetary philosophy and the expectations that go along with it, which indeed have moved substantially over the past decade according to changes in economic climate and other circumstances.

I am, however, most concerned about how the government uses its revenue streams and expenditures to promote a more equitable society and opportunities for upward social mobility. I have witnessed over the past few years how the 'middle income stress' has been significantly eased, both by government policies and economic circumstances. For instance, we have seen a moderation in the prices of residential properties and a substantial reduction in the prices of cars - the two most important cost items for Singapore's middle class.

In the 2005 Budget, we have further cuts in personal income tax and cuts in the foreign maid levy, in addition to the baby bonus scheme enhancements. These measures will ease more middle income stress, even if some of it is often self-imposed.

### **Serious efforts**

I am also happy to see serious government efforts in this 2005 Budget to further promote the services sector including financial services, logistics and tourism. These are the most effective sectors to mitigate structural unemployment, because they can help to smooth the employment transition from manufacturing and provide great scope for skill matching, job retraining and redesigning. Thus, at least in the foreseeable future, the Workforce Development Agency, which is already doing a great deal, is expected to play an even more crucial role in mitigating structural unemployment.

It is also worth noticing that the government has fine-tuned the foreign worker policy by regulating labour demand through price levies instead of using both prices and quantities - such as the 'dependency ceiling', which required a minimum proportion of a company's total workforce to be local.

Higher levies for foreign workers would significantly alleviate fears that local workers will be priced out by cheap foreign labour. At the same time, it will not stop flourishing businesses that depend on foreign workers from expanding their activities.

While it is true that the monthly amount of \$500 per worker over and above the dependency ceiling may not be a burden to multinational corporations (MNCs) as wages constitute only about 15 per cent of their total costs, it may be steep for small and medium enterprises (SMEs). However, like any new measure, the levy can always be fine-tuned, or special provisions can be made, for SMEs or for certain job categories.

In redistributing government surpluses, the 2005 Budget adopted a purposeful and targeted approach towards helping the less well-off and senior citizens through top-ups in the Lifelong Learning Fund, Comcare Fund, Edusave, Medisave and Medifund, rather than relying on indiscriminate across-the-board cash handouts as in past years. Such a targeted approach is especially appropriate given that the structural bias towards budget surpluses may be a thing of the past.

It is important to appreciate that the potential danger of a structural budget deficit is real for future Singapore governments. Thus, unrealistic high expectations on future budgetary spending ought to be moderated as the Singapore economy meanders through a volatile era.

It has been argued that since most of the decline in unemployment since 1965 has been structural in nature, most of the fiscal surpluses successive governments have achieved over the decades have also been structural.

The major reason for such structural surpluses was that Singapore grew above her potential output level throughout most of the last four decades. At given tax rates, and with no corresponding proportionate increases in government spending, we were able to generate fiscal surplus.

However, since 1997, Singapore has entered into an era of growth discontinuity. I estimate that, given the existing policy stimulants to mobilise the necessary human resources, capital investment and technology progress, the potential output of the Singapore economy in the medium term would be around 4.5 per cent and is likely to be volatile from year to year.

Such potential output growth, if realised, would still be respectable even if compared to the average growth of over 8 per cent achieved over the 1965-1996 period.

However, it will be associated with higher unemployment. I venture to suggest that Singapore's longer-term unemployment rate has indeed risen from the low of 2 per cent over the past decade to about 4 per cent in the medium term, and part of it is structural in nature.

In fact, the government's operating revenue has been on the decline since the middle of 1990s from about 23 per cent of GDP to 15 per cent in 2004 and has

begun to trend lower than total government expenditure since 2001. This partly reflects the transition process to put in place a competitive direct tax rate and the shift from a reliance on direct taxes to indirect taxes.

At the same time, total government expenditure - excluding special transfers - continues to hover around 15-20 per cent of GDP. If such trends persist and if long-term unemployment rises and the economic growth moderates, there is indeed a potential structural bias towards deficits as we move forward.

It is thus important that Singapore sticks to its budgetary philosophy, which is that the budget must be balanced, on average, over the business cycle, with surpluses accumulated during good years and deficits incurred during not-so-good years.

Increasingly, future budgetary resources will need to be supplemented by net investment income (NII), a timely dividend resulting from early decades of prudent surplus accumulation and investment. NII will help Singapore to put in place further measures to strengthen its competitive tax structure, meet possible increases in spending on defence, social needs, healthcare, job facilitation and cope with an aging population.

Some economists have pointed out that Singapore's budgetary accounting is highly conservative and not in line with international norms, in the sense that investment income and land revenue are not included in government revenue streams and development expenditure are regarded part of government expenditure.

### **Comfortable surplus**

Hence, the argument goes, if only we adopt international norms of budgetary accounting, there would be a very comfortable fiscal surplus each year. My rough calculations suggest that the government would have racked up substantial surpluses for the past decades if it had adhered to international norms in its budgetary accounting.

However, such arguments can lead to unwarranted public pressure to force the government down the road of welfarism and other forms of populism. NII can fluctuate from year to year, and land revenue cannot last forever. But welfare expenditure, once incurred, are recurring and difficult to retract.

Such indeed is the current budgetary dilemma facing Hong Kong. It will require considerable public persuasion and political will to roll back institutionalised social spending and healthcare obligations.

Finally, questions have been raised about the purpose of accumulating substantial government surpluses if we are not going to use them. Moving forward, perhaps we can clarify and classify with greater transparency the treatment of relevant investment income, and under what circumstances and conditions such income can be used as a fiscal buffer.

Once this is done, I believe there will be less unrealistic expectations and less public pressure for giveaways in future budgetary announcements.

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