Do the right thing, not what's popular

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EVEN as economies compete to host MNCs by offering attractive terms in the form of tax advantages, land subsidies, infrastructure support and other benefits, governments are finding that they have increasingly less control over their activities across different markets.

Many countries are thus embarking on tax reforms - moving from direct taxes such as corporate income tax and personal income tax to a more broad-based, indirect goods and services tax (GST) - to better retain control over their economies. This is part of the economic restructuring made necessary by intensified global competition.

For Singapore, a small, open economy, the primary challenge is to be pro-active in enhancing its international economic competitiveness.

A responsible Singapore Government would ensure budgetary prudence and good corporate governance, initiate measures to ensure stability of financial markets and promote fair competition, improve the coverage of social safety nets, enhance mobility for social upgrading, mitigate worsening income disparity and prevent the emergence of an economic underclass in the face of global competition.

To do these successfully, the Government would have to undertake sound but unpopular policies. Ultimately, it is better to do things right than merely to be seen doing the right thing as the public perceives it.

Timing of the reform

PRIME Minister Lee Hsien Loong announced on Nov 13, 2006, that he proposed to press on with tax restructuring in the forthcoming 2007 Budget. He proposed to reduce taxes on corporate and personal incomes, and to make up for the shortfall by raising the goods and services tax (GST) from 5 per cent to 7 per cent.

Coming only a few months after the general election in May, political observers argued that the move could be seen as shortchanging voters, 66.6 per cent of whom had voted for the ruling party. It could undermine their future trust in the party.

But recall here the classic remarks by Minister Mentor Lee Kuan Yew at the 2005 Global Branding Forum: 'I do not believe that popular government means you have to be popular when you govern. I think the best thing to do is to do all the unpopular things when you are governing so that, at the end of your term, you have a choice of a date when you feel that they will be most grateful that you have done all these unpopular things and they vote for you.'

Some economists have argued against the economic timing of the tax reform. The change, they say, is neither urgent, nor even necessary, as other sources of revenue can be found. These include government surpluses, land sale revenues and the future streams of gaming revenue that must surely come once the integrated resorts at Marina Bay and Sentosa are ready.

Economic timing is a professional judgment based on what one considers to be the current strength of the Singapore economy. Since 1997, the economy has gone through a difficult phase of discontinuous growth, interspersed with small contractions in gross domestic product (GDP) for 1998 and 2001, and near double-digit expansion for 1999 and 2000, followed by weak recovery at 3.2 per cent in 2002, and low 1.4 per cent growth for 2003 due to the impact of Sars, or severe acute respiratory syndrome.

The swift economic rebounds of 8.4 per cent and 5.7 per cent in 2004 and 2005 respectively were due largely to upturns in the electronics sector, which lifted the international economy but were not felt much by most in the lagging domestic economy.

GDP growth for 2006 is expected to be near 8 per cent, with a full-scale rebound of 11.4 per cent for manufacturing and 6.9 per cent for service industries.

Unemployment has continued to decline steadily from over 4 per cent in 2003 to a near historical low of 2.7 per cent last year, with across-the-board employment creation well exceeding the number of unemployed persons for 2005 and 2006.

For the medium term ahead, I expect the Singapore economy to grow at near 5 per cent, benefiting from the momentum built up recently by the proposed integrated resorts, tourism-driven industries and the increasingly diversified manufacturing activities in Singapore.

Growing a bigger pie

AS FOR the necessity of raising GST to bring in additional tax revenue, some quarters have long urged the government to use accumulated surpluses or revenues from land sales to cover the increasingly extended social expenditure programmes. For the government not to do so, they feel, is to be ultraconservative and unnecessarily prudent.

I would like to offer a different perspective on the debate by arguing that the public has the right to instil tougher discipline in the government and to expect the government to explore and facilitate new sources of growth, instead of resorting to the all-too-easy approach of dipping into past government surpluses.

A quality government is one that creates or adds value, not one that is ever ready to unlock value or 'cash out'. The 'cash out' approach is an important psychological barrier that ought not to be breached in future budgeting exercises. It is a soft option when confronted with longer-term budgetary constraints.

Competition from Hong Kong

UNLIKE Singapore, Hong Kong has opted to allow migration of its manufacturing activities to southern China, and is fast strengthening its position as a service-oriented economy. Hong Kong also aspires to be one of the top financial centres in Asia.

Singapore must consolidate its position as a leading financial centre in Asia, with cutting-edge expertise on wealth management for the increasing numbers of the wealthy from China and Asean. The Republic must provide quality financial services to regional headquarters based here, host more publicly listed companies and expand the breath and depth of its bond and futures markets.

When competing with Hong Kong, it is paramount that Singapore moves towards a competitive and sustainable structure for corporate and personal income taxes, balanced by a broadened tax base through a higher GST. This is especially so given that Hong Kong's fiscal burdens do not include expenditures for defence and foreign affairs.

Top personal and corporate income tax rates in Singapore are presently 22 per cent and 20 per cent respectively, still well above Hong Kong's 16 per cent and 17.5 per cent, respectively.

Singapore should not go the way of Hong Kong by losing its manufacturing activities. It should continue to be a manufacturing hub, attracting and retaining MNCs, especially those with higher technology content. These are bound to involve bigger investment outlays and require longer to realise investment returns.

Foreign professionals and technical experts will continue to be needed and they must find it attractive to work and stay in Singapore. Tax rates will be a factor in their calculations whether to come here or go elsewhere.

The argument for sustaining the manufacturing hub is equally applicable to transportation, telecommunication, financial, tourism, education and health-care services.

GST offsets and redistributions

IN ITSELF, raising GST is regressive: The additional tax amount incurred due to higher GST, however small, would be a much heavier cost burden to lower- than to higher-income groups.

Small & medium enterprises (SMEs) which previously did not have to pay corporate income tax would also suffer as they now incur greater GST costs without benefiting from a lower corporate income tax.

However, Singapore has managed to take the sting out of its tax reforms because of the extensive GST offsets involving a wide range of government subsidies and rebates.

Judging from past Budgets - GST was first introduced in 1994, at 3 per cent, and subsequently increased to 4 per cent and 5 per cent in 2003 and 2004 respectively - the GST offsets lasted for several years after each increase. We can reasonably expect the 2007 Budget to do likewise.

At the moment though, given the absence of details on the GST offsets to accompany the latest rate increase, people are understandably apprehensive.

If properly formulated, the offset package can be a modern Robin Hood story. In the past, due to a lack of coordination among government agencies, and price hikes in areas not related to the government which hit lower-income groups hardest, public opinion has tended to make GST hikes a scapegoat.

Those who criticise the GST offsets as 'one-off and not long-term' display a lack of understanding of the reason behind the tax reforms, which ultimately are part of a wider restructuring package necessary to make the Singapore economy more resilient.

The GST offset package is meant to compensate those who are affected by the GST hike but do not benefit from reductions in corporate or personal income taxes because they are not paying these in the first place. In a buoyant economy, the number of people needing such compensation should decline. If the offsets were long-term, they would amount to a form of long-term income support for those who do not necessarily need it.

Another argument sometimes made is that the additional revenue from the 2 per cent GST hike should be redistributed to all citizens as offsets. I think that would be unwise. It would defeat the bigger purpose of the tax reforms: to engender the economic resilience and competitiveness which we need, and to prepare for the higher expenditure needed to fund extended social programmes to care for an ageing population.

Indeed, related to the latter, Singapore needs to broaden its tax base further and make it more stable.

Encouraging immigration would be useful in increasing the pool of personal income tax contributors, as currently 65 per cent of the working population do not pay income tax.

Effort must also be made to reduce reliance on revenue from transportation- and property-related taxes, fees and charges, which tend to be volatile sources. Such a move would also help ease middle-income stress since housing and transportation are among two of their biggest spending items, contributing to approximately 45 per cent of household expenditures.

Income gap

WHILE the Government should take the widening of income disparity seriously, the ultimate solution is not through permanent GST offsets or rebates, Central Provident Fund contribution adjustments or even Workfare bonuses.

What is needed are creative measures to ensure that there are productive and decent-paying jobs for the lowest 20th income percentile of Singaporeans. No elected government can ignore the plight of this group and it is counter-productive for a government to permanently shore up their incomes to stanch a widening income disparity.

The longer-term solution would involve inter-ministerial coordination in terms of employment creation, manpower management and meeting the human resource requirements of the modern economy.

Finally, a lighter point: Those who have been criticising the Singapore Government for deciding people's lives too much can now have some relief. The move from direct to indirect taxes puts more power in your hands. By deciding how much to consume or save, or how much, where and what to invest in, you can now influence how much revenue the government collects from you. This is another outcome of globalisation which many may have not anticipated.

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