

What it takes to keep Singapore in good fiscal health

A closer look at the numbers that matter in balancing the Budget, both now and in the future.

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If a company runs into deficit more often than not, the concern is that the management is losing the plot.

The same scrutiny can be trained on Budget 2015, which the Government tabled along with its latest fiscal position data on Feb 23.

The Budget this year outlined initiatives to strengthen the social safety net, build up infrastructure and develop the local workforce, but these programmes come with a hefty price tag.

Since the financial year 2009, the nation has run into basic deficit four times in six years. A basic surplus or deficit is the figure after taking into account the revenue from taxes and deducting expenditure such as spending by ministries on operations and development, plus special transfers, which range from the typical annual handout of GST Credits and Central Provident Fund (CPF) top-ups, to the money forked out for recent initiatives such as the Productivity and Innovation Credit scheme and the Pioneer Generation Package.

With the special transfers amount rising - from 2009's \$5.48 billion to an estimated \$11.67 billion this year - Singapore may be hit by a basic deficit of \$9.62 billion in 2015.

The more important figure, however, is the overall surplus or deficit figure, arrived at after investment returns and dividends from the Monetary Authority of Singapore (MAS), GIC and Temasek Holdings - which are tasked with managing Singapore's reserves - are taken into account. After an overall deficit of \$0.13 billion last year, the figure is estimated to widen to \$6.67 billion for 2015, the largest deficit on record if realised.

As government spending is expected to rise to between 19 and 19.5 per cent of gross domestic product (GDP) on average over the next five years, the Government has moved to boost its future revenues.

Running out of financial levers?

THE latest change, announced by Deputy Prime Minister Tharman Shanmugaratnam in Budget 2015, seeks to include Temasek Holdings within the Net Investment Returns (NIR) framework. Introduced in 2009, the NIR framework allows the Government to spend up to 50 per cent of long-term expected real returns - which include realised and unrealised capital gains - generated from the assets managed by GIC and MAS.

Currently, Temasek's contribution to the Budget comes from its dividends paid to the Government, which is its sole shareholder. The move to put Temasek under the NIR framework will likely yield a larger pool of returns that the Government can tap for its funding needs.

This change - with a Constitutional Amendment Bill to be presented later this year - has some Members of Parliament concerned about fiscal sustainability

Among them is Mr Hri Kumar Nair (Bishan-Toa Payoh GRC), who said: "Every additional dollar spent today simply means more than a dollar less for the future. More importantly, we are running out of levers to pull. After Temasek, there is no next."

Net Investment Returns and fiscal stability

ONE issue related to this upcoming NIR change is whether the contribution from Temasek will be a stable source of revenue for government coffers. After all, returns from equities are bound to be more volatile than assets such as bonds.

The Government has explained that the NIR is based on long- term expected real returns which are compounded and averaged out with a 20-year view.

The resulting rate - which will be reviewed by GIC, MAS and Temasek boards annually - of any given year will mean a steady stream of returns regardless of gains and losses in the portfolios. In other words, the Government will not have to cut its spending when markets are bad, allowing for better long-term planning.

The framework is also meant to be prudent and forward-looking, Mr Tharman noted in his speech to Parliament in 2008 when presenting the amendment Bill for the NIR framework: "We will retain the 50 per cent cap on the amount of returns that can be taken out for spending. This is in addition to setting aside the full inflation component of our returns in past reserves. In this way, the real returns on investments will be shared between the current Budget and past reserves. This allows the past reserves to grow in real terms, and thereby provide for a growing economy in the years to come," he had said.

To illustrate - in a year when return is 10 per cent and inflation rate is 3 per cent, that 3 per cent will be set aside for the reserves, and only the remaining 7 per cent will be available for spending, again subjected to the 50 per cent cap under the NIR framework.

Beyond issues of stability around the NIR framework, another perennial question is how Singapore is to fund increasing social spending, when its capacity to raise taxes is limited by the need to remain competitive.

The bulk of Singapore's annual spending is still funded by tax income.

Operating revenue has grown every year since 2009's \$39.55 billion to \$61.35 billion last year. Its top three tax revenue sources are corporate and personal income taxes, and goods and services tax (GST).

Last year, corporate income tax yielded \$13.46 billion, GST revenue was \$10.11 billion, while personal income tax contributed another \$8.94 billion to the government coffers. Together they accounted for around 53 per cent of last year's total operating revenue of \$61.35 billion, which came in slightly more than the total operating expenditure of \$57.20 billion.

Is there more tax revenue to be tapped? Already, the Government has moved to augment tax income. A key change announced in Budget 2015 is a higher personal income tax rate for top earners that will bring in an estimated \$400 million extra revenue. The change will take effect in 2017.

Further and gradual steps to adjust the current tax regime can be a viable move if and when the Government needs to broaden its tax revenue stream. But the approach can be more nuanced than just raising income tax rates.

A 2 percentage point increase in GST can be considered in the coming years, which can raise tax revenue while the impact on poorer households can be offset by GST vouchers, PwC's head of tax Chris Woo said.

"But a more meaningful change is to look at the Government's approach of growing Singapore companies and attracting higher-value foreign investments with corporate tax incentives. Without changing tax rates, we can perhaps tweak our requirement to ensure greater benefits - by having these companies hire more locals for senior positions, by having them develop their intellectual properties here, which in turn create more jobs for locals.

"That's the key for better sustainability in corporate revenue - to bring in new industries and capabilities, create long-term, intrinsic value to the economy and the local workforce, and, ultimately, to increase GDP and the overall tax base," Mr Woo said.

KPMG Asia Pacific chairman and managing partner Tham Sai Choy agreed that, while raising GST can be an option, higher tax rates may be counterproductive for Singapore. Singapore's competitors, such as Hong Kong and Ireland, already have lower corporate tax rates, and the top line personal income tax rate will rise to 22 per cent in 2017, way above Hong Kong's 15 per cent, Mr Tham said.

"The best option is to focus on growing Singapore's economy. A growing economy directly increases the takings from taxation without the need for excessively high tax rates, while sharing the fruits of economic growth with everyone, including taxpayers."

Singapore also has the option of implementing capital gains tax as a means to broaden tax revenue if indeed necessary, Lee Kuan Yew School of Public Policy research fellow Christopher Gee said. Currently capital gains through sales of assets such as property is not taxable here.

Government spending: Is it justified?

THE other way to ensure fiscal sustainability is by trimming expenses.

The Budget's estimated deficit of \$6.67 billion this year is not a result of profligate spending - but a case of canny investment in the future.

A big chunk of that deficit is due to setting aside a \$3 billion development fund for Changi Airport's fifth terminal. Another \$3 billion will be used to fund the Productivity and Innovation Credit scheme and top up the National Productivity Fund, which will in turn drive the SkillsFuture initiatives in the coming years.

The latest Budget retains past years' emphasis on boosting public infrastructures, improving business productivity and helping local workforce upskill, as the nation continues its economic restructuring.

If executed properly, these projects could strengthen the foundation for this multi-year transformation that Singapore is going through. As for what the Government should spend on, that is an inherently political question that depends on its vision for Singapore, said Mr Gee.

"It can take a short-term populist approach, a hard-headed long-term approach, or something in between. Perhaps that's the national debate that we need to have," he added.

As for the state of Singapore's finances, Standard & Poor's sovereign credit analyst Phua Yee Farn explained why S&P reaffirmed Singapore's AAA credit rating in February despite the deficit projected for 2015. "Singapore has been rated AAA with a stable outlook since 1995 without any movement in between. That is an indication of its extremely strong fiscal position," he said.

"Items that are counted as revenue by other countries are not booked above the line in Singapore's case. For instance, unlike Hong Kong, Singapore does not count capital receipts, which include land sales, as revenue. That amount was \$14.6 billion last year and \$22.9 billion in 2011 during the height of the property boom - and that's a huge chunk that would have left the Government with a substantial surplus every year," Mr Phua said.

Instead, capital receipts automatically become part of Singapore's past reserves. As well, there are checks and balances such as the constitutional requirement that prohibits a government from running an overall deficit by the end of its term in office.

Looking at the systems, principles and fundamentals in place, one can still make a strong argument for the current strength of Singapore's fiscal health.

In the end, long-term fiscal sustainability depends on whether reserves can be built up - through prudent investments and above all through growing the economy - while meeting operating and development needs. Only then can a country safely be sure of long-term fiscal sustainability.