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Raising taxes, cutting spending not ideal solutions to greater demands on Budget

A looming fiscal gap is likely, but timely measures can not only close the gap but also reap long-term benefits.

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How should the Government manage greater demands on the Singapore Budget?

This question has come into sharp focus with the release of the Occasional Paper on Medium-Term Fiscal Projections by the Ministry of Finance last week. The paper points out that Singapore is projected to run annual Budget deficits amounting to between $7.5 billion and $15 billion each year, during the five-year period from FY2026 to FY2030.

Government spending is expected to rise to 19 to 20 per cent of gross domestic product (GDP) during this period and potentially exceed 20 per cent by FY2030. Growth in spending is also expected to exceed the projected increase in the Government's revenues from taxation, other levies and the Net Investment Returns Contribution (NIRC), leading to a 1 to 2 percentage point gap each fiscal year.

Tax increases of similar magnitude and impact as those announced in Budget 2022 (including the 2 percentage point rise in goods and services tax (GST)) would yield additional revenues to the Government of only about $5.3 billion per annum, which would be insufficient to close the fiscal gap.

This will create a significant challenge for the prospective government in that period, as it would be required under the Constitution to ensure that Budget deficits in any year be balanced by surpluses from other years within the government's term of office.

Instead of responding to this challenge defensively, it is worth taking a problem-solving approach to this conundrum. The Forward Singapore initiative to refresh our social compact presents an opportunity to look for all solutions to how Singapore's fiscal policies and government spending could be adjusted to cope with these upcoming challenges.

CLOSING THE FISCAL GAP 1: RAISING REVENUES IN A PROGRESSIVE MANNER

Instinctive, first reactions to the need for greater government spending point to taxes that other people should pay. Indeed, a knee-jerk approach to looming Budget deficits could lead to a wide-ranging push to raise more revenues on all fronts.

To be sure, increasing the rates on existing taxes as well as introducing new taxes, such as a tax on wealth, are possibilities. But they come with trade-offs and longer-term implications.

Take pushing the rates for corporate income tax – the highest tax revenue generator – higher, for example. This must be carefully weighed against costs such as reduced economic competitiveness.

The same rationale explains why the Government does not expect any net revenue gain from the implementation of the Base Erosion and Profit Shifting (BEPS), which requires topping up corporate tax to hit the global minimum standard of 15 per cent when implemented. Any additional revenues must be used in the same space to maintain and enhance the attractiveness of Singapore as an investment destination for multinationals that can continue creating good jobs for Singaporeans and adding to a vibrant business ecosystem with spillover effects to local small and medium-sized enterprises.

Raising more revenue from taxation on individuals and households may also be looked at. However, increasing taxes on consumption after the GST hikes in 2023 and 2024 might be tricky politically even though the GST rate is still relatively low in the global context. Already, Singaporeans are feeling the heat of rising costs of living, which will be compounded by higher levels of inflation expected in the medium term.

Singapore's personal income tax system is already highly progressive with the top 10 per cent of income taxpayers contributing 80 per cent of revenues. The top bracket of income earners will also have to pay a higher rate of 24 per cent, announced at Budget 2022, up from 22 per cent. And there are limits: Overburdening the highest earners with ever higher marginal income tax rates could affect economic competitiveness in the same manner as with corporate tax at some point.

Overburdening Singapore's highest earners with ever higher marginal income tax rates could affect economic competitiveness in the same manner as with corporate tax at some point, say the writers. ST PHOTO: RYAN CHIONG

The imposition of what would be new taxes such as those on wealth – whether on inheritances, capital gains or big-ticket purchases like luxury cars or good class bungalows – would need to be introduced carefully so that those who have to pay higher taxes do not feel unfairly targeted.

CLOSING THE FISCAL GAP 2: INCREASING BORROWINGS OR THE NET INVESTMENT RETURNS CONTRIBUTION

There are other non-tax revenue sources that could be considered to close the fiscal gap. In 2021, the Government introduced the Significant Infrastructure Government Loan Act (Singa) which permits the financing of infrastructure projects through the issue of government bonds.

The issuance of Singa bonds is capped at $90 billion through to 2037, and the projects these bonds would finance are currently limited to nationally significant, long-term infrastructure investments. Examples include MRT lines, ports or airports and large-scale utilities projects – those that generate returns over the long run and benefit future generations.

Instead of raising taxes from current taxpayers to fund projects that generate economic and social returns in the long run, the Singa framework could be extended to allow the Government to issue debt to pay for other types of development expenditure and spread out expenditure over more years to ease the pressure on the Singapore Budget, especially in situations where the benefits are likely to accrue well into the future. Examples of such long-term investments might include development of hospitals, schools and other social infrastructure.

Another alternative revenue source is the NIRC that today represents 3.5 per cent of GDP and is the single largest revenue source for the Government. The NIRC framework allows the Government to use up to half of the net investment returns from the investment of the Government's financial assets, with the other half being reinvested to grow the national reserves.

There have been calls for the NIRC proportion to be raised to help pay for higher government expenditure, but this has been resisted on the basis that it would be fiscally imprudent and unsustainable, as the amount reinvested would be needed to grow the reserves in line with the economy.

Singapore's national reserves act as a buffer during times of crisis, such as in the Covid-19 pandemic when there was a $42.9 billion draw on the reserves, and it is necessary for the reserves to be of sufficient relative size to the economy in order to act as an adequate buffer.

CLOSING THE FISCAL GAP 3: STITCHES IN TIME, SAVING NINE (OR MORE!)

Apart from increasing revenues, belt-tightening might be a third obvious way to go. At present, government spending is about 18 per cent of GDP – one of the lowest amongst advanced economies. Severe austerity measures driving social and political stresses around the world should be kept in mind when going down this path. In forcing an even leaner Budget, the welfare of citizens would be directly affected when necessary spending is cut.

There could be another, perhaps better way to close the fiscal gap. The saying "a stitch in time saves nine" speaks to the wisdom of putting in timely effort to prevent more work in the future.

In this context, smart ways of managing our revenue and expenditures can derive benefits and save on what we will have to pay for in the future. This way of minimising future costs or spending more today to generate more economic growth and therefore government revenues may be a better way to close the anticipated fiscal gap.

A simple example of smart expenditure is investing in early childhood, for which the long-term benefits for both the individual and society are well recognised. Whether it is on health, education or other social aspects, early intervention not only benefits the child but could also improve the lot of the entire family in time. Later but much more costly interventions in terms of employment or other welfare aid would thus be avoided.

An example of this is the new Healthier SG, a preventive health programme put in place to encourage seniors to keep fit, maintain activity and exercise autonomy over their health, so that they will spend fewer years in ill health and any healthcare needs in their later years can be minimised.

More closely connecting the primary healthcare network of general practitioners and community care providers as partners with Singaporeans in staying healthy will likely reduce the incidence of more costly intensive care in hospitals in the future, aiding Singapore to manage public health expenditures amid an ageing population.

Spending today on climate change intervention may be another smart expenditure that can keep costs lower when the impacts materialise in the years ahead – building drains, creating more green lungs to make Singapore more resilient to heavy downpours and extreme weather events. As before, some of these interventions might even be justifiably financed through government bond issuance.

Looming Budget deficits are likely without fiscal intervention, but we are not there yet. Singapore still retains some fiscal space and has a relatively harmonious social compact. Arguing over who should pay more taxes and how much, and resorting to austerity in a public sector that is already relatively lean and efficient, would more likely strain societal bonds and lead to a fraying of that compact.

Instead, the present is an opportune time to focus on building a fair and equitable fiscal system that is also effective with "stitch-in-time" measures that increase the fiscal base and reduce the future trajectory of expenditures.

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