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Singapore needs to consider the size of public spending and how to fund it, including how much to extract from the state's reserves. PHOTO: YEN MENG JIIN, BT

Debt and spending: How we can be fair to both current and future generations

Should we really expect those coming after us to pick up the tab for the bills we're racking up today? **By Terence Ho**

EARLIER this month, Fitch downgraded the United States sovereign credit rating by one notch from the highest AAA to AA+.

This was not entirely unexpected, given that the ratings agency had signalled this possibility earlier in the year, a key factor being political brinksmanship in the repeated stand-offs over the US debt ceiling.

Still, the Fitch downgrade has reignited debates over the growth and sustainability of America's public debt, notwithstanding US economic heft and its reserve currency status. Meanwhile, public debt continues to rise across the developed world in the wake of pandemic support measures and fiscal stimulus.

Mounting debt, along with unfunded pension liabilities, has significant implications for both economic health and intergenerational fairness.

Opinions, however, are divided. Will record debt levels in the US and other major economies sap economic vitality and lead to an eventual reckoning, or can governments continue to rack up debt without adverse consequences? Is it unfair to expect future generations to pick up the tab for today's spending, or is this entirely justifiable given that our children and grandchildren will be better off than we are today?

These debates are pertinent to Singapore, as we too consider the size of public spending and how to fund it, including how much to extract from the state's reserves. Planning for future needs should factor in the costs of climate change and the risks from a more volatile external environment. At the same time, we should redouble investments in people, technology and productive capacity.

The debt debate

For developing countries with weak institutions and governance, large and rising foreign debt is a clear and present danger. Currency depreciation could send interest payments on foreign debt soaring, while loss of investor confidence could precipitate capital flight and spark a debt crisis.

Developed economies have more leeway to incur deficits and increase borrowing, particularly if debt is mainly held domestically. However, this is not without limits. Beyond a point, borrowing will push up interest rates, crowding out private investment. Neither is printing money to finance deficits the solution, as this could stoke inflation.

Credibility is critical, even for advanced economies. In the UK, the unveiling of a mini-budget in 2022 featuring unfunded tax cuts led to a sell-off in the British pound and government bonds as investors took fright.

Among major economies, the United States ought to have the highest capacity for debt. After all, it has the deepest and most liquid capital markets; foreign governments hold large portions of their reserves in Treasury debt, which is also a safe haven asset in times of economic turbulence.

> Singapore may have a public debt to GDP ratio higher than even the US, but it has assets well in excess of its liabilities, justifying its triple-A sovereign credit rating.

Prominent economists such as Harvard's Jason Furman are sanguine about record US debt levels, since the cost of servicing this debt is now a smaller share of gross domestic product or GDP (1.87 per cent in 2022) than it was at its peak in 1991 (3.2 per cent), with real interest rates on a declining path over decades.

Much depends on whether real interest rates will remain low – as some believe demographic trends imply – and whether demand for Treasuries will be sustained even at low yields. While most observers believe a serious reckoning if any is still far off, a number have pointed to the importance of getting the US fiscal house in order.

A high debt relative to GDP could expose public finances to greater risks from interest rate increases and slowing GDP growth, while reducing the fiscal space available to deal with future economic shocks.

As an indicator of fiscal sustainability, gross debt to GDP ratio is incomplete as it does not factor in the size of a country's assets. Singapore may have a public debt to GDP ratio higher than even the US, but it has assets well in excess of its liabilities, justifying its triple-A sovereign credit rating.

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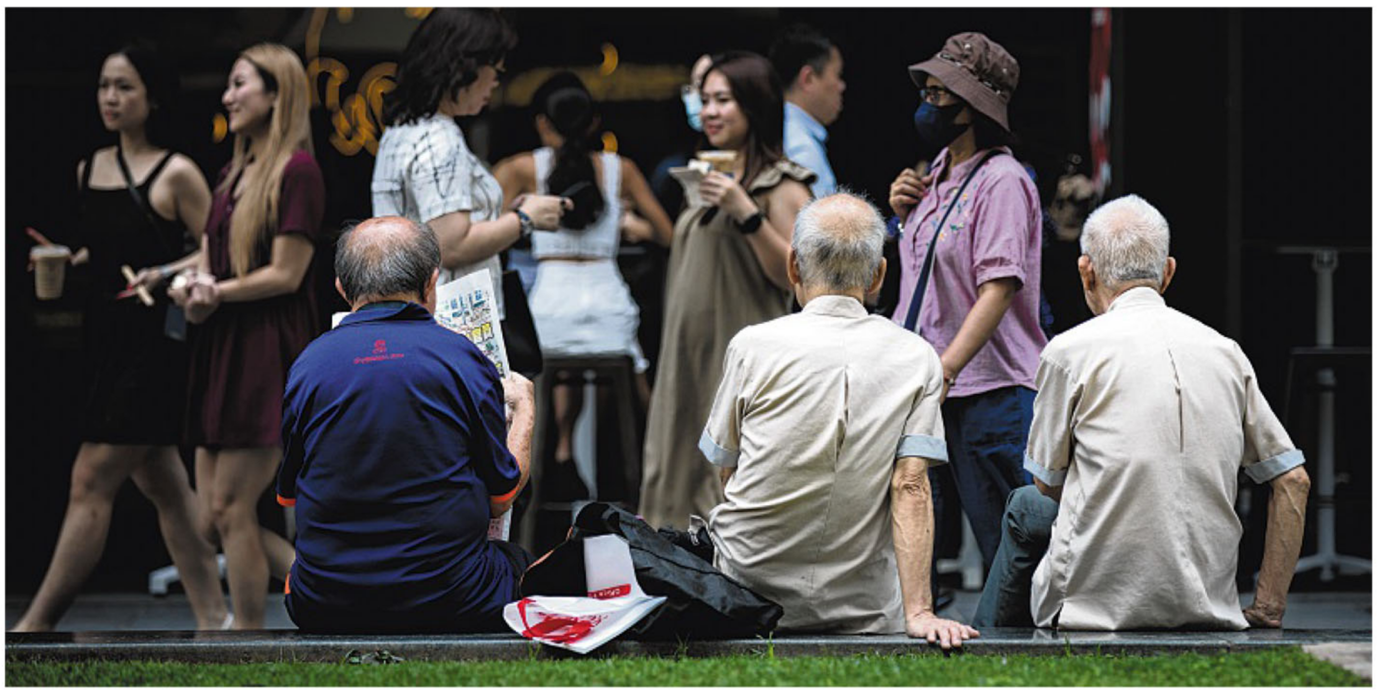

With an ageing population and higher social spending needs, balancing the budget has become much more challenging today PHOTO: CHERYL ONG, BT

The appropriate indicator is public sector net assets or net worth, but data on this is only published by the International Monetary Fund for a select group of developed economies.

Is the future brighter or bleaker?

What about intergenerational fairness? Besides public debt, unfunded pension obligations in many developed countries represent a significant contingent liability for governments which future taxpayers will have to bear.

In fact, pension systems are already under pressure as the ratio of retirees to working adults rise. Reforms to pensions and retirement age can be politically very challenging, as widespread protests in France this year attest to.

Meanwhile, healthcare spending is expected to rise sharply as populations age and the cost of medical care grows. These trends suggest the need for significant "fiscal consolidation" across the developed world: lowering service levels, levying higher taxes, or both.

Placing a higher burden on future taxpayers may be acceptable from the standpoint of intergenerational equity if indeed every generation is better off than the one before – that is, if real income growth continues to rise on the back of sustained economic growth.

However, conventional measures of real GDP neglect the deleterious impact that economic development has had on the environment and the stock of "natural capital": clean water, air, forests and minerals.

Now that climate change casts a long shadow over planetary health and human welfare, the true costs of climate mitigation and adaptation are finally becoming apparent.

A study published in *Nature* in 2022 estimated the social cost of carbon at US$185 per tonne of carbon dioxide (tCO2). The Intergovernmental Panel on Climate Change suggested that a carbon price of US$100 / tCO2 would be needed to cut global greenhouse gas emissions by at least half the 2019 level by 2030. However, most countries have yet to price carbon at rates reflecting its true social cost.

Meanwhile, forces of deglobalisation threaten to reverse decades of gains from trade liberalisation, and the risk of technological bifurcation is growing. Geopolitical tensions are fuelling increased defence spending, eliminating the "peace dividend" the world has largely enjoyed since the end of the Cold War.

Adding population ageing into the mix, it is no longer a certainty that prosperity and living standards will continue to rise.

On the other hand, technological advances such as artificial intelligence (AI) have the potential to vastly increase productivity across various domains. If the ill effects of such technology, such as cyberthreats and disinformation, can be contained, the AI revolution could be a significant offsetting boon for humanity.

Ensuring intergenerational fairness in Singapore

Since independence in 1965, Singapore's policies have been geared towards the long term, with budget planning always future-orientated. High savings rates and strict fiscal discipline over decades have swelled state coffers, and constitutional protection is accorded to the nation's accumulated reserves.

However, with an ageing population and higher social spending needs, balancing the budget has become much more challenging today.

Intergenerational fairness was no doubt a consideration when the Pioneer and Merdeka Generation packages comprising healthcare support were devised for Singaporeans who had contributed much to the nation's development and reserves but who did not themselves benefit as much as subsequent generations from better education, income and savings.

The question of fairness should also inform how much is appropriate to draw on the investment returns on past reserves to fund current spending. Drawing more today would mean a slower growth of the reserves and less for future generations, as well as lower capacity to deal with crises and contingencies that may strike in future.

Weighed against these are the many pressing social needs and investments in need of funding even as the government aims to keep the tax burden low. It could be argued that certain economic and social investments may yield better returns to society than returns on financial assets.

With the enactment of the Significant Infrastructure Government Loan Act in 2021, the government is now permitted to borrow to fund long-term infrastructure, rather than having to fund such investments from current revenue.

This tempering of fiscal conservatism, besides easing constraints on current spending, also allows for the cost of such infrastructure to be spread more equitably across the generations who will benefit from it.

Nevertheless, prudence and intergenerational equity suggest that we need to set aside enough resources for the future, factoring in the costs and risks of climate change, as well as a more fractured and dangerous world.

Besides spending on immediate needs, we will also need to invest – adequately and efficiently – in the knowledge, skills, technology to secure a better future. This means education, lifelong learning, economic infrastructure, as well as research, innovation and enterprise.

Ultimately, it is technology and innovation that will push out the production possibility frontier to the benefit of future generations in Singapore and around the world.

> Besides spending on immediate needs, we will also need to invest – adequately and efficiently – in the knowledge, skills, technology to secure a better future.

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