ARTICLE FOR THE EDGE

SINGAPORE BUDGET 2022: A HIGHLY CONSEQUENTIAL BUDGET

As Finance Minister Lawrence Wong prepares to present his first budget on 18th February, the economy is in much better shape than a year ago. Nevertheless, preparing the budget remains a demanding task. Judgements have to be made on revenues and the potential demands on spending in the midst of great uncertainty over how the pandemic will impact the economy and society. At the same time, there is an intensifying urgency to tackle structural challenges such as how emerging new technologies could affect workers and businesses, rising inequality, climate change and a troubled global environment.

A few themes emerge as we think about the budget. First, on reasonable assumptions, we expect the economy to sizzle this year. That will generate substantial revenues for the government while also allowing it to re-focus on long term issues rather than on near-term crisis management as was the case in 2020 and 2021 when we were in the worst phases of the covid pandemic. Second, although this is the most likely scenario, there is much uncertainty over important factors shaping the economy. That means that fiscal policy must be flexible and easily adjustable in case things turn out much worse than expected. Third, the government has already clearly signalled what the broad changes in fiscal policy are likely to be. The question is the appropriate timing for these changes and the supporting measures needed to ensure that the changes being planned do not cause collateral damage.

## The economic context: we could have a blow-out year for growth

Yes, the pandemic has lasted a longer time than many of us had expected and there is always some possibility of nasty variants and so on. But, after weighing the probabilities, our view is that the most likely scenario is that the downside risks can be mostly contained while the upside may have been under-estimated:

First, there has been enough progress in vaccines, new drugs to treat covid and clinical management to help us cope better with the covid pandemic. Economies in Singapore and elsewhere can therefore be progressively opened up: limits on activity can be eased and border restrictions relaxed. There may well be new variants from time to time but these are likely to cause episodic problems at worst. By and large, the pandemic will exert much less drag on the economy than last year.

This scenario will allow sectors that are still operating below pre-pandemic levels of output to recover. As border restrictions are eased, migrant workers can return to work in areas such as construction and food & beverage. Supply chain disruptions will be less likely as well. As cross-border travel becomes easier with quarantine conditions being liberalised, tourism and aviation-related activities can also bounce back. And, as restraints on group activities such as dining, weddings, conference and other corporate activities are lessened, restaurants and entertainment activities will also rebound. In this more upbeat atmosphere, pent-up demand will be released as people spend the money that they have been saving in the past two years.

Second, Singapore will also be able to leverage off some secular changes that favour it.

- The Economic Development Board has brought in substantially more investments in high-value manufacturing. New factories will be adding to industrial production and hiring more Singaporeans as the year progresses. In addition, the start-up scene has burgeoned, attracting more funding for new ventures here and creating a buzz of entrepreneurship that will carry us far.

- There is also more evidence that some activity is shifting out of Hong Kong in favour of Singapore. Anecdotes point to wealth management and regional business operations of large global corporations being increasingly placed in Singapore.

- Singapore's hinterland in Southeast Asia is set to turn around. Rising commodity prices and a cyclical rebound from the pandemic will boost the region's growth. The region is also beginning to gain more foreign investor attention as a result of reforms and improved stability in countries such as Indonesia and Vietnam. Data from UNCTAD show foreign investment pouring into the region in 2021 despite the waves of covid infection. All this will expand demand for Singapore's hub services.

In short, virtually all our engines of growth will be firing strongly. Economic growth could easily exceed 5% this year, building on the recovery in 2021.

### Uncertainty remains, so we need to ensure that fiscal policy is flexible

While there is a high likelihood that the economy will perform well, downside risks exist. That means that fiscal policy has to be formulated in such a way as to allow it to respond to unfavourable developments and unexpected stresses.

One area to watch is inflation. Global price pressures have clearly increased. And, if we are right about Singapore's growth being much stronger than expected, then domestic inflationary pressures will also grow as tighter labour markets push up wages and as rentals and other costs rise as well. The Monetary Authority of Singapore has already acted to tighten monetary policy to contain these risks but there is still a risk that inflation could be higher than expected. Ideally, fiscal policy therefore should play its part in cooling demand and stabilising inflation expectations. With strong growth likely, it will be appropriate for fiscal policy to be moderately contractionary.

The global economy will benefit from the easing of the pandemic but other risks are becoming more salient. Major central banks, led by the US Federal Reserve Bank, are tightening monetary policy after two years of extraordinarily low interest rates and easy liquidity. This is bound to trigger financial market ructions - sharp corrections in equity and bond valuations are possible as well as abrupt outflows of capital from emerging markets which could generate volatility in currencies around our region. At the same time, we expect US-China trade tensions to emerge again, after a year of relative quiet. If these risks are not managed well then there would be ill-effects on global and regional demand and Singapore could suffer. It would make sense for the fiscal powder to be kept dry in case things turn out worse than hoped and we need to bolster demand later.

**Fiscal policy can now re-focus on secular trends not crisis management**

The structural challenges that Singapore faces have intensified over time, so it is good that policy makers can now devote more attention, including fiscal resources to addressing them.

First, fiscal policy will have to address Singapore citizens' growing yearning for economic security. The pandemic has reminded ordinary folks about their vulnerability to sudden and wholly unexpected shocks. Beyond the pandemic, we should expect a surge in adoption of new technologies. This will generate many good things such as higher productivity from the adoption of artificial intelligence and robotics, snazzy new consumer gadgets and services, better healthcare treatments and cheaper energy from renewable sources. But there will almost certainly be dislocations – incumbent industries could shrink and small businesses and their workers lose their ability to earn a decent living. We are also going to see a reconfiguration of supply chains as countries such as the US, China, Europe and Japan seek to bring home the production of strategic goods.

Government will be expected to help people and local companies adapt to these difficulties. Social safety nets will need to be strengthened and more aid given to re-skilling workers. New schemes will also be required to make it easier for small businesses to remain viable. Remember also that our society is ageing and citizens are seeking more support for healthcare and eldercare.

Second, there is a growing sense that inequality in wealth and income has reached a point where more government intervention is needed to ensure a fair society. Where fiscal policy is concerned, this can be done in two ways. Taxes can be increased on the rich and more can be spent to help the poorer segments of the population.

Third, Singapore has to accept that the global community will probably not act in time to mitigate climate change. What governments across the world have promised in terms of mitigation measures will not be enough to prevent Singapore from suffering from rises in sea levels, higher temperatures and much more extremes in weather generally. The government has indicated that it will spend roughly $100 billion over the next few decades to buffer Singapore against these very serious climate-related dangers. Some of this may have to be front-loaded as the speed of climate change could accelerate.

**Main changes in fiscal policy have been signalled**

Government leaders have prepared the ground for some important changes in fiscal policy – a hike in the GST rate, higher carbon prices and some form of wealth tax. It is likely that government will carefully phase in the increased carbon price so it is unlikely to create a problem for companies here. On wealth taxes, official statements hint that the government will proceed cautiously, so as to not undermine our wealth management hub. A modest tweak in property taxes may be favoured rather than a totally new tax such as an inheritance tax.

This leaves the GST rate hike as the main issue. On balance, we do not see a pressing need to implement the GST change right away.

- Inflationary pressures have surprised all of us by their ferocity. This is not the time to add to those pressures with higher taxes on consumer purchases. If consumers sense that living costs are rising faster than expected, they will press for higher wages. If wages and prices chase each other, inflation would be much worse and much harder to manage.

- The revenue position is currently very strong. For the first nine months of the current fiscal year – April to December 2021 – revenue growth was extraordinarily high, and well above the estimates provided in last year's budget. There is no urgent need for an immediate increase in revenues.

- Government leaders have explained that rising demands on the public purse are inevitable and will need to be funded. This is true, as explained above. However, we have yet to see projections made by government of the likely increase over time in government spending on healthcare, eldercare, education, social safety nets and climate change. We do not have a good sense of how revenues – including those from investment income – will grow as there are no projections available either. Only with these numbers – even if they are rough estimates – can we get a sense of what the gap between spending and revenues will be. And only after that can we decide on the best way to close the gap. After all, higher GST rates are not the only option available. Corporate and personal income taxes could be raised, for instance. Or, government could take a higher share of the net investment returns rather than the 50% share it currently assumes.

**Conclusion: this budget will set the stage for Singapore's future development**

Singapore enters the new fiscal year with strong momentum. This budget statement is a great opportunity for Singapore to show that it can move nimbly from crisis management to formulating sound policies for the long term. The broad directions for fiscal policy are more or less clear, the challenge is to calibrate the tax and spending changes finely, so that the welfare of Singapore citizens is truly improved.

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