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OPINION

An economist's viewpoint on the Budget

Surplus bonus to boost consumption; infrastructure spending to draw private investments; while BSD hike will have macro prudential effect on higher end housing

By Sumit Agarwal

PRESENTING the Singapore budget on Monday, Finance Minister Heng Swee Keat said that with the economy doing well and growing at a faster than expected pace, real wages and output have risen.

He also outlined key measures to keep Singapore on the growth trajectory with emphasis on technological growth, environment sustainability and fiscal responsibility. Specifically he outlined key measures including (1) the Goods and Sales Tax (GST) hike to be imposed between 2021 and 2025; (2) the budget surplus to be used for infrastructure investments and bonus payments to the adult Singaporean population; (3) an additional 1 per cent stamp duty on houses above S$1 million; (4) carbon tax; (5) corporate income tax rebate of 40 per cent capped at S$15,000; and (6) an increase in maid levy.

As an economist and a finance professor, I want to share my views on key aspects of the budget. Broadly, this is a well-balanced budget. I commend the government for putting forward a budget that is not only inclusive and equitable but also progressive. It fares favourably compared to the one proposed by the largest economy in the world that is very likely to take on an additional US$1.5 trillion in deficit, is non-inclusive and regressive, and will lead to a massive government debt with inflation and increased stock market volatility in tow.

Now, back to the specifics of the Singapore budget. Like it or not, the 2-percentage point GST hike will hurt the pockets of the average consumer. The last GST hike was a decade ago when it was raised from 5 to 7 per cent in 2007. Unfortunately, we do not have clean measures of its impact on consumption.

Consumption impact

That said, I anticipate that the upcoming GST hike may slow down consumption growth and impact Gross Domestic Product (GDP). But it is likely that the effects of the GST hike will be mitigated by the stimulating effects of the other budget measures – carbon tax, the corporate tax rebates or infrastructure investments, which can spur entrepreneurship and/or may raise tax revenues. All of these may render the effects of a GST hike moot.

The FY2017 budget surplus of S$9.6 billion is to be used towards infrastructure investment in rail lines, subsidies and other support programmes, as well as a one-time bonus payment to adult Singaporeans. Generally, the economist view is that government investments tend to crowd out private investments. A crowding-out occurs when a situation leads to a reduction in private investment spending such that it dampens the initial increase of total investment spending.

However, both empirical and theoretical research has shown that certain government infrastructure investments, particularly those in roads and rails, do not have the same crowding-out effects. Rather, it may lead to crowding-in of private investments by corporations and the development of new public and private housing, leading to small business creation. So, we are likely to reap the benefits of such infrastructure investments as proposed in the Singapore budget in the medium term.

Free money

Now, let's turn to the one-time bonus payment of S$100 to S$300 to adult Singaporeans. This bonus is progressive and provides the largest of S$300 to those with assessable income below S$28,000; S$200 to those with assessable income between S$28,000 and S$100,000; and S$100 to the top earners with assessable income above S$100,000 or who own multiple properties.

Everybody loves free money, especially when it comes from the government. We all wish there's a helicopter dropping free money on a regular basis. However, in reality we only get free money very rarely. So the interesting question is what do we do with this free money. Do we spend it or save it?

I anticipate that the vast majority of the money will be spent by consumers. This is especially true as most of the bonus is going to lower-income individuals who are liquidity constrained.

I can say this with some high level of confidence because my NUS Business School colleague Qian Wenlan and I conducted a thorough empirical analysis of the 2011 Growth Dividend bonus package, much like the SG bonus announced in this budget, and found that consumers' consumption rose significantly after the fiscal policy announcement.

Specifically, for each dollar received, consumers on average spent 80 cents in the months prior to and after the announcement. We also documented a modest decrease in credit card debt. More interestingly, we found that consumption response varied across spending categories and across individuals. Consumption rose primarily in the non-food, discretionary category and for low-income households. Hence, the bonus is likely to stimulate the economy.

The budget also announced a 1 per cent additional stamp duty on houses over S$1 million. This is a progressive tax as it will not impact public housing, but rather will have an impact on most of the private property market.

The one-time increase in the stamp duty payment is unlikely to have any measurable impact on the demand and/or supply of private housing in Singapore. If anything, this will reduce the market value of the private housing stock by 0.5 to 1 per cent as buyers will be willing to pay slightly less to buy the house now because they have to pay the additional 1 per cent stamp duty; effectively causing sellers to absorb part of the stamp duty tax. Overall, this policy will serve as a macro prudential policy to correct house price growth on the higher end of the housing market.

Finally, the budget also recommended changes to the corporate income tax rebate and maid levy. These policies will raise government revenue and encourage small business growth. Such revenue growth from these taxes and small business creation can be used to offset the impact of GST hikes.

Overall, the budget is balanced, inclusive, and most importantly progressive. It will surely keep economists like me busy for years to come analysing the various aspects of the budget and its costs and benefits.

The corporate income tax rebate will lift small business growth.

BT PHOTO: YEN MENG JIIN

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