SINGAPORE'S 2004 BUDGET:

Narrowing The Deficit, Encouraging Business

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S U M M A R Y

Senior Singapore officials underline that the main focus of Singapore's FY2004 budget is on improving Singapore's competitiveness, fostering new business activities for local and foreign investors, and ultimately, creating new jobs for Singaporeans. The budget contains few new initiatives. Rather, its centerpiece – a further two percentage point cut in corporate tax (to 20%) – fulfills a key recommendation of the Economic Review Committee, set up in late 2001 to restructure the economy in the face of recession and high unemployment. A promised simultaneous reduction in the personal income tax rate to 20% was postponed, on grounds of "unexpectedly difficult economic conditions." The budget also contains tax exemptions and concessions for MNCs, companies in the financial sector, and start-up enterprises. There were few handouts to individuals compared to the budgets of the last three years.

Looking at the numbers, the Government expects to incur a deficit of S$1.35 billion (US$798 million, or about 0.8% of GDP) in FY2004, its second consecutive budget deficit. Although this is half the deficit of FY2003, Deputy Prime Minister and Minister of Finance Lee Hsien Loong reiterated that the Government aims to return to a surplus budget in FY2005, stressing that the Government "must never fall into the trap of structural budget deficits, with a permanent shortfall of revenue." In keeping with the conservative budget, Lee announced a permanent 2% cut in budget allocations in FY2004 for all ministries, except the Ministry of Defense, and a further 2% reduction in FY2005.

Initial FY2004 budget estimates, made before Lee announced the tax cuts, forecast revenue at S$28.31 billion (US$16.9 billion) and expenditure at S$30.44 billion (US$18.2 billion). Singapore's government accounting system, however, does not include income on the government's sizable investments as revenue; the budget assumes an FY2004 income contribution of $2.29 billion (US$1.38 billion). Looking at where the money goes, security and homeland security continue to account for the largest share of spending (36%), with education second (21%). Transport receives the largest increase in spending, due to ongoing subway and road projects. Total government spending is equivalent to 18% of GDP. Detailed information on the FY2004 budget can be found at the following Internet site: http://www.budget2004.gov.sg/.

(Note: Exchange Rate - S$1.674/US$ as of April 1, 2004)

Fiscal Incentives for Business

Business fares well under the FY2004 budget (Singapore's fiscal year runs from April 1 to March 31), in line with government initiatives to reduce business costs and enhance Singapore's competitiveness. In his budget speech before Parliament on February 27, DPM Lee said a key element of the Government's efforts to remake Singapore is a globally competitive tax regime. The centerpiece is the two percentage point cut in corporate income tax rate, from 22% to 20%, in line with the ERC's recommendation in 2002 to reduce the then rate of 24.5% to a target of 20% within three years. As an initial step, the corporate and personal income tax rates were reduced in 2002 to 22%.

Many observers had expected the personal tax rate to also be cut from 22% to 20% this year, but DPM Lee said a deferral in the cut was necessary given the tight fiscal situation. Even with the corporate tax rate reduction to 20%, Singapore still lags behind Hong Kong which has a tax rate of 16%. Lee said the 20% rate is not a sacred cow, and that the government will consider lowering it further should other countries keep lowering their own rates.

Given concerns that Singapore may be losing ground to regional competitors offering more attractive tax perks to MNC investors, the FY2004 budget extends and sweetens a number of existing incentives:

Regional HQ Incentive

Extend the maximum duration of the existing Regional HQ incentive from three to five years, with immediate effect.

Pioneer Incentive

Extend the maximum duration for the pioneer incentive from 10 to 15 years to enhance Singapore's attractiveness to new MNC manufacturing investments.

Withholding Taxes on Royalty Payments

Lower the withholding tax on royalty payments to non-residents from 15% to 10%

Promoting Financial Services

In his budget speech, DPM Lee asserted that Singapore has a unique opportunity to become a center for private wealth management in Asia, as there are 1.8 million high net worth individuals in the Asia-Pacific region, with private wealth totaling US$5.7 trillion. He noted that employment in the wealth management industry has nearly doubled over the past three years. Lee also announced measures to promote the short-term debt market, the structured finance market, processing services for foreign institutions, commodity derivatives trading, and secondary loans trading. The FY2004 budget introduces the following incentives:

- Concessionary tax rate of 5% on income derived by companies providing high value-added processing services to financial institutions.

- Tax exemption of foreign-sourced income received in Singapore by resident individuals.

- Tax exemption of Singapore-sourced investment income derived by individuals from financial instruments.

- Tax exemption on discount income derived from qualifying debt securities by non-residents.

- Concessionary tax rate of 10% on discount income derived by companies and groups of persons in Singapore.

- Exemption from Singapore income tax for designated investment income derived by assets managed by fund managers in Singapore, or foreign trusts managed by trustees in Singapore.

- Concessionary tax treatment for special purpose vehicles engaged in asset securitization.

- Concessionary tax rate of 5% for income derived from trading in commodity derivatives.

- Inclusion of secondary loan trading as a qualifying activity under the Financial Sector Incentive Scheme.

- Tax exemption for payments on over-the-counter financial derivative contracts made by financial institutions to non-residents.

- Extension of the current concessionary tax rates for Singapore Exchange members with new products to products denominated in Singapore dollars.

Encouraging Entrepreneurship

DPM Lee stated that "new companies represent our hopes for a more entrepreneurial economy, and the Government will give these start-ups every opportunity to thrive and succeed". Measures included in the FY2004 budget to encourage entrepreneurship include:

- Full tax exemption for new companies on the first S$100,000 of their normal chargeable income, except for Singapore dividend income.

- Replacing the Technopreneur Investment Incentive, with Enterprise Investment Incentive, which will include all forms of start-ups. Investors in start-ups awarded the EII will receive tax deductions for losses incurred if these companies fail or if they have to sell their shares at a loss.

Other Tax Changes

The FY2004 budget includes a range of other tax changes, including incentives targeted at other priority sectors, as well as changes to excise taxes:

- Tax exemption for all onshore charter income received by an 'approved international shipping' company.

- Reduction of the Additional Registration Fees of motor vehicles by 20 percentage points, from 130% to 110% of its Open Market Value. The measure is intended to reduce (marginally) the cost of car ownership in Singapore.

- Increase in taxes on tobacco, both to discourage smoking and to raise revenue.

- Rationalization of liquor taxes to align with WTO obligations.

- Increase in skilled foreign worker levy from S$30 to S$50 per worker per month.

Where are the Goodies?

To the disappointment of many Singaporeans, including some labor leaders, the FY2004 budget contains almost none of the rebates, special transfers or other entitlements for individual Singaporeans that have characterized Singapore budgets in recent years. The only significant measure is the release of the second tranche of "Economic Restructuring Shares", intended to help low-income families adjust to a one-percentage point increase in the Goods and Services Tax (GST), introduced on January 1, 2004. Analysts see the disbursement (which at S$814 million is equal to the whole corporate income tax cut for 2004) as a sweetener to the lower income group, which will not benefit from any of the proposed tax exemptions for individuals. Some observers have noted favorably the restraint shown by the government in not augmenting entitlements, saying that the more focused approach on those who really need help is to be welcomed. As it stands, some 90% of households gain more in subsidies than they pay in taxes, if they do not own a car.

The FY2004 budget contains a few measures that move toward reducing some entitlements. For example, the government is raising university fees (currently students pay only 35% of tuition costs, with the remainder picked up by the Government). The Government said the savings from the reduced subsidy would provide more resources for primary and secondary education. The Government has also proposed introducing greater means testing for health care subsidies.

As with most Singapore budgets, the FY2004 budget contains measures intended to influence personal behavior. In line with policy objectives to encourage Singaporeans to put more money into their Central Provident Fund (CPF, a social security system) retirement accounts, the budget raises the ceiling for tax relief on annual contributions. There was widespread surprise that the budget did not expand financial incentives to encourage Singaporeans to have more babies, given the Government's alarm at the drop in the total country's fertility rate to a historic low of 1.26 in 2003. DPM Lee instead announced that an inter-ministry committee on population will propose specific measures before August 9, the country's independence day.

Budget: The Numbers

The tax cuts and other incentives outlined by DPM Lee will cost around S$1 billion (US$597 million). This will raise the budget deficit to an estimated S$1.35 billion (US$806 million, or 0.8% of GDP) from the initial estimate of S$750 million (US$448 million); this is below the FY2003 deficit of S$1.76 million (US$1.05 million). Ministry of Finance budget materials are based on initial FY2004 estimates presented to Parliament, as outlined in the table below, and do not incorporate the fiscal effects of the measures announced by DPM Lee in his budget speech on February 27. Those measures will result in lower revenues and slightly higher expenditures than shown in the table. Unlike the overall budget itself, the tax and other fiscal measures outlined by Lee do not require approval by Parliament.

Table: FY2004 Budget

	Actual FY2002	(S$ Billion) Revised FY2003	Estimate FY2004	% Change over Revised FY 2003
Operating Revenue	25.47	25.61	28.31	10.5
Tax Revenue	21.50	21.59	24.57	13.8
Fees & Charges	3.81	3.76	3.61	-4.0
Others	0.16	0.25	0.13	-49.0
Operating Expenditure	19.36	19.99	20.86	4.4
Total Expenditure	27.15	28.81	30.44	5.6
Operating Expenditure	19.36	19.99	20.86	4.4
Development Expenditure	7.79	8.83	9.58	8.5
Operating Surplus (Operating Revenue less Operating Expenditure)	6.11	5.62	7.45	32.6
Surplus/Deficit (Operating Revenue less Total Expenditure)	-1.68	-3.21	-2.13	-33.6
Less:				
Special Transfers	1.80	0.60	0.91	50.7
Economic Restructuring Shares	1.20	0.60	0.90	50.7
Utilities Save Scheme	0.00	0.00	0.01	n.a.
Lifelong Learning	0.50	0.00	0.00	0.0
Endowment Fund				
Medical Endowment Fund	0.10	0.00	0.00	0.0
Add:				
Net Investment Income Contribution	3.68	2.05	2.29	11.7
BUDGET SURPLUS/DEFICIT	**0.19**	**-1.76**	**-0.75**	**-57.4**

Without the special transfers and net investment income, the initial estimated budget deficit for FY2004 would reach S$2.13 billion (US$1.27 billion); as noted above, the tax cuts announced by DPM Lee will augment that figure higher. According to the Ministry of Finance, the deficit results from higher development spending – S$9.58 billion (US$5.72 billion, or 8.5% higher than FY2003) – and also higher special transfers of S$910 million (US$543.6 million, or about double that of FY2003). Analysts also highlighted that the SARS Off-Budget Relief provided in FY2003, mainly for SMEs, tourism, transportation sectors and the low-income group, had cost the Singapore Government S$1.0 billion (US$597 million). As such the special transfers in FY2004 was minimal compared to those of previous years.

The Singapore Government remains fiscally conservative and uneasy about running budget deficits. In his budget speech, Lee said, "fiscal prudence has been a hallmark of Singapore's economic management. We must never fall into the trap of structural budget deficits, as Hong Kong has done, because that would undermine investor confidence, crowd out the private sector, and dampen growth and weaken the Singapore dollar." Officials point to the expected FY2004 deficit as the third in a row; yet many analysts contend that Singapore in fact is not running much of a deficit, noting that Singapore does not record investment income as government revenue. Other analysts note that much of the deficit spending is attributed to development expenditure, for infrastructure, public housing, capital investments and grants.

Revenue

Preliminary estimates presented to Parliament, which do not incorporate the fiscal effects of the measures announced by DPM Lee in the budget speech, peg FY2004 operating revenue at S$28.31 billion (US$16.91 billion), 10.5% higher than that of FY2003 (revised). Tax revenue, accounting for 87% of operating revenue, was projected to increase by 13.8% compared to the revised FY2003 collection, although the tax cuts announced by Lee will mean that increase is likely to be much smaller. The budget continues the Government's overall approach of shifting the tax regime to rely less on direct (income) taxes and more on indirect taxes. Presently, only a third of working adults in Singapore are subject to income tax (and the top 20% of the working population pays 93% of the net income tax assessed); the government wants to boost the share of indirect taxes in overall revenue to over 50%.

Other than improved economic conditions contributing to higher collections, much of the gain comes from the one percentage point increase (from 4% to 5%) in the Goods and Services Tax (GST), implemented January 1, 2004, which is expected to generate an additional S$700 million (US$418 million). A previous one-percentage point increase (from 3% to 4%) in 2003 generated an extra S$1.0 billion (US$597 million) for the Government. Contributions by Government statutory boards in lieu of tax are also projected to rise. Revenue from fees/charges, the other component of operating revenue, is projected to fall 4% from the level in FY2003 due to lower collections from sales of Certificates of Entitlement (COE, i.e., permits to own a motor vehicle), which makes up about 40% of this revenue source.

While not considered by the Singapore Government to be operating revenue, net investment income (income from accumulated surpluses invested by the Government of Singapore Investment Corporation) is expected to increase by 12% to S$2.29 billion (US$1.37 billion) in FY2004.

Composition of estimated tax revenue for FY2004

	S$ Billion		% Share Of Tax Revenue
	Revised FY2003	FY 2004	FY 2004
Direct Tax	11.12	12.21	49.6
Corporate/Personal	9.66	10.41	42.3
Assets Tax	1.46	1.86	7.3
Indirect Tax	9.53	10.78	43.8
Goods & Services Tax	3.10	3.80	15.4
Customs & Excise Tax	1.84	1.70	6.9
Motor Vehicle Tax	1.86	2.15	8.7
Betting Taxes	1.49	1.50	6.1
Stamp Duty	0.60	0.63	2.6
Others	0.64	1.00	4.1
Total	21.59	24.60	100.0

Looking back at FY2003, estimated tax and fee revenue is expected to have come in about S$1 billion under initial estimates, but slightly higher than in FY2002. Income tax revenue was down 8.2% in 2003, but the overall decline was much less, thanks to higher contributions from other taxes, such as GST (thanks in part to the one percentage point increase in January 2003).

Expenditure

The estimated expenditure of S$30.44 billion (US$18.18 billion) for FY2004 is 5.6% higher than that of FY2003. Total government spending is equal to about 18% of GDP, up from 14% in 1995 but still well below developed country norms. About 70% of the budget goes to what the Government terms "operating expenditure" (S$20.86 billion/US$12.46 billion), while the remaining 30% (S$9.58 billion/US$5.72 billion) goes toward "development expenditure". Major ministries and their budget allocations follow:

- Defense: At 28.3% of the FY2004 budget, the Ministry of Defense (MINDEF) remains the largest budget allocation, with defense spending equal to 5.4% of the country's 2003 nominal GDP (S$159 billion/US$95 billion). The FY2004 allocation represents a 4.5% increase from 2003. The Government states that it is prepared to spend up to 6% of GDP to provide the peace and security that it says are essential to ensure economic progress.

- Education: 20.9% of the budget, representing 4.0% of FY2003 nominal GDP, goes to financing 680,000 students from primary school through university. Nearly half of the allocation will be spent on students in the 7-16 age group.

- Home Affairs: 7.7% of the budget, mainly on police, homeland security, and the rehabilitation of prisoners.

- Health: 7.4% of the budget, representing 4.7% of FY2003 nominal GDP, goes to spending on healthcare. As noted above, the Government intends to implement a means-testing formula for subsidies for hospital patients so that only the most needy ones will receive a full subsidy. Presently, patients are subsidized according to the class of hospital ward they stay in.

- Transport: 7.3% of the budget, mainly for rapid transit and road development projects.

- Environment: 5.7% of the budget, of which 72% will be spent on the on-going deep tunnel sewerage system project, refurbishing water reclamation plants, and Singapore's famous hawker centers (i.e., outdoor food courts).

- Trade & Industry: 5.2% of the budget, of which 63% will go to trade and investment promotion efforts.

Table: FY2004 Expenditure By Sector and Ministry

	S$ Billion	% Share	% Change from FY2003
TOTAL EXPENDITURE	30.44	100.0	5.6
Social Development	13.40	44.0	1.9
Education	6.36	20.9	3.7
National Development	1.76	5.8	-25.7
Health	2.24	7.4	9.6
Environment	1.72	5.7	18.7
Community Development & Sports	0.83	2.7	14.0
Information, Communications & the Arts	0.49	1.6	16.0
Security/External Relations	11.26	37.0	5.4
Defense	8.62	28.3	4.5
Home Affairs	2.35	7.7	9.0
Foreign Affairs	0.29	0.9	2.9
Economic Development	4.08	13.4	11.7
Transport	2.21	7.3	55.9
Trade & Industry	1.60	5.2	-18.6
Manpower	0.21	0.7	-0.9
Info-Communications Technology	0.06	0.2	6.4
Government Administration	1.70	5.6	27.6
Finance	0.70	2.3	16.1
Law	0.43	1.4	53.0
Organs of State	0.37	1.2	55.6
Prime Minister's Office	0.20	0.7	-4.4

Reaction to Budget

The baby bust took center stage in the Parliamentary debate on the budget and in media reports. Members of Parliament (MPs) who normally focus on the interests of labor and low income Singaporeans joined government ministers to devote considerable time to discussions about the need to address the declining birth rate. *(Comment: The governing Peoples Action Party controls 82 out of 84 elected seats in Singapore's Parliament; therefore, while there is a "debate" on the budget, passage of the budget is never in doubt. The annual budget debate is more of an opportunity for backbench MPs to discuss long-term policy directions than an argument about funding levels.)*

From an economic perspective, most analysts opine that the budget does little to address the problem of weak domestic demand. The FY2003 budget had been criticized as providing little stimulus for domestic demand, and the FY2004 budget, with fewer incentives for individuals, has even less of an impact on domestic demand. Responding, DPM Lee commented that since momentum behind the economic recovery appears strong, there is no need for a larger fiscal stimulus. Some observers express disappointment that the budget did not cut personal tax rates further, and reduce the level of mandatory employer and employee contributions to the CPF. However, analysts understand the Government's priority to address the rising unemployment rate; as the economy remains heavily dependent on foreign investors as the major employers, the Government had to offer more carrots to them.

On the whole, the budget advances the Government's immediate goals. It is pro-business, although more focused on the big players; small local manufacturing firms have been critical about what they see as minimal support. Feedback to MPs included comments of "cautious", "conservative", and "unattractive". And overall, some analysts assert that the Government has still not done enough to lower costs for both foreign and domestic investors, especially land costs and employment taxes.