Chapter 6 – Fiscal Measures Adopted in Other Economies

Overview

6.1 Population ageing is a global phenomenon that is affecting many developed economies. The global financial crisis at the turn of the decade has also left many economies in deep budgetary troubles, with debts reaching unprecedented heights, and governments being forced to seriously trim back on expenditure.

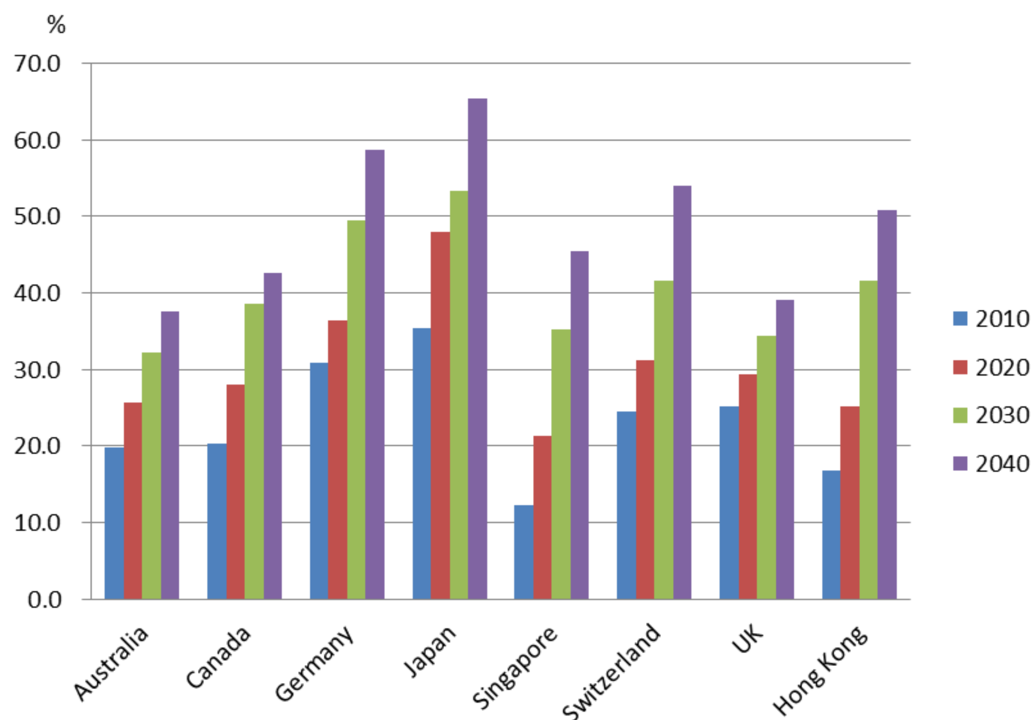
6.2 Whilst the population in Hong Kong is still relatively energetic, and whilst fiscal prudence has offered cushion for Hong Kong against global shocks, there is no room for complacency.

6.3 The Working Group has chosen a sample of seven economies for review, focusing particularly on the budget measures they have adopted to consolidate their budgetary positions. These economies are Australia, Canada, Germany, Japan, Singapore, Switzerland and the United Kingdom. The Working Group has also made reference to the publications issued by the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD). The research findings are set out in this Chapter.

Impact of population ageing on the economies

6.4 Population ageing poses pressures on the fiscal system of many economies. The chart below illustrates how the elderly dependency ratio will change in the coming 30 years.

Chart 6.1 – Projection on the elderly dependency ratio of the seven selected economies and Hong Kong



6.5 The extent of the fiscal pressures experienced by the seven selected economies will be briefly described in the ensuing paragraphs.

6.6 For Australia, while there is a positive growth in the size of all age groups and growth in the size of the labour force, the working-age ratio is projected to fall at the same time as the elderly dependency ratio rises. Population ageing and health pressures are projected to result in an increase in total government spending from 22.4% of GDP in 2015-16 to 27.1% of GDP by 2049-50. As a consequence, spending is projected to exceed revenue by 2.75% of GDP in 40 years. (2010 Intergenerational Report, The Treasury, Australian Government, 2010)

6.7 For Canada, long-term demographic trends imply lower per capita GDP growth and increase in spending pressure for health care and income support for elderly. OECD projects that Canada's spending on the Old Age Security, an important pillar of the pension system, will rise from the current level of 2.2% of GDP to 2.7% of GDP in 2040.

6.8 For Germany, the total population is projected to decrease from the current level of 82 million to 79 million in 2030 and 75 million in 2050. The working age group is expected to decrease by 15.4% by 2030 whereas people from aged 65 and above will increase by 35.8%. (United Nations, 2012) According to the European Commission, strictly aged-related payment items (including expenditure on pensions, health, long-term care and education) in Germany account for 24.2% of its GDP in 2010. This percentage share is expected to increase by 0.5 percentage point by 2020 and 5.5 percentage points by 2060 if only demographic developments are taken into account. (European Commission, 2012)

6.9 For Japan, the OECD measure of public social spending shows an increase from 11% of GDP in 1980 to 22% in 2009. Pension and health spending accounted for 9 percentage points of the increase. The upward trend is likely to continue. Japan expects total public social spending to rise further to 23.6% of GDP in 2020. (OECD, OECD Economic Surveys: Japan, 2013)

6.10 For Singapore, the Singapore Government has pointed out that a shrinking and ageing population and workforce will make it more difficult to sustain public finances over the longer term, especially when this is coupled with increasing needs for higher expenditure to support a much larger elderly population. Government revenue comes mostly from income taxes, consumption taxes and asset taxes, all of which are dependent on economic growth. Singapore may need to cut expenditure in some areas, or find new sources of revenue to balance the budget. (National Population and Talent Division, Prime Minister's Office, Government of Singapore, 2012-2013.) As the social spending increases significantly, sooner or later the taxes must go up. (Lee Hsien Loong, Prime Minister of Singapore, 2012)

6.11 For Switzerland, expenditure on old-age and disability insurance is projected to increase from 9.6% of GDP in 2009 to 11% of GDP by 2060 (Source - 2012 Report on the Long-Term Sustainability of Public Finances in Switzerland issued by the Swiss Federal Department of Finance). Expenditure on healthcare and long-term care will also increase by 1.0 and 1.3 percentage points to 3.5% and 1.9% of GDP in the same period. Together with a slight increase of 0.3 percentage points in Education, the total demographic-dependent expenditure is expected to increase by 3.9% to 22.3% of GDP by 2060.

6.12 For the United Kingdom (UK), age-related government expenditure, including expenditure on health, long-term care, education and pensions, is projected to rise by 4.4% of GDP between the fiscal years 2017-18 and 2062-63 (Source - 2013 Fiscal Sustainability Report). As a result, the net public debt in the UK is expected to rise by some 24% of GDP by 2062-63 on the basis of unchanged government policy.

Fiscal discipline

6.13 As more and more economies encounter serious fiscal problems and become debt-ridden, strengthening fiscal framework has emerged as the only logical response. Fiscal rules have been introduced or tightened to reinstate budget discipline and ensure fiscal responsibility and debt sustainability.

6.14 According to an IMF Working Paper[1], there are four main types of fiscal rules that economies have adopted or have strengthened in response to the mounting fiscal pressures –

(a) **Budget balance rules** – These can be specified as "overall balance", "structural or cyclically adjusted balance", and balance "over the cycle". In an inter-governmental treaty signed by 25 members of the European Council in March 2012 (so-called Fiscal Pact), there is a requirement for the European Union (EU) members to adopt in legislation national rules that limit annual structural deficits to a maximum of 0.5% of GDP (1% of GDP for countries with debt levels below 60% and with low sustainability risks).

(b) **Expenditure rules** – Expenditure limits are typically set in absolute terms or growth rates, or in percentage of GDP with a time horizon often between three to five years. Quite a number of EU members, such as Bulgaria, Denmark, France, Luxembourg, Netherlands and Slovenia, have introduced various rules constraining expenditure in real and nominal growth rate (e.g. France: Central government expenditure is frozen in nominal terms, except interest payments on debt and pensions of civil servants) and as % of GDP (e.g. Bulgaria: 40% of GDP).

[1] Andrea Schaechter, Tidiane Kinda, Nina Budina, and Anke Weber. (2012). Fiscal Rules in Response to the Crisis—Toward the "Next-Generation" Rules. A New Dataset. IMF.

(c) **Revenue rules** – These set ceilings or floors on revenues and are aimed at boosting revenue collection and/or preventing an excessive tax burden. For example, France introduced in 2011 a requirement that the impact of new additional fiscal revenue measures should reach a minimum level of €11 billion in 2011 and €3 billion in 2012. Denmark introduced a tax freeze on direct and indirect tax (i.e. taxes cannot be raised whether in percentage or dollar terms) in 2001 (which was in force until 2010) (EU Fiscal rules database).

(d) **Debt rules** – These set an explicit limit or target for public debt as a percentage of GDP. For instance, the Fiscal Pact referred to above includes, amongst other things, a commitment to continuously reduce the public-debt-to-GDP ratio to the 60% of GDP threshold.

6.15 Fiscal rules aim at correcting distorted incentives and containing pressures to overspend, in particular in good times, so as to ensure fiscal responsibility and debt sustainability. The presence of many competing interest groups usually results in the "voracity effect" where different groups compete and push for overspending windfalls in good years, which leaves no room for counter-cyclical response in bad years.

6.16 According to an IMF Working Paper[1] –

(a) Effective implementation and monitoring of fiscal rules often require a number of supporting arrangements and good institutional capacity. For example, reliable data availability and technical forecasting capacity is needed to ensure sufficient degree of accuracy in budgetary aggregates forecasting to avoid the risk that large deviations from the announced fiscal policy stance undermine rules credibility.

(b) Fiscal rules should be underpinned by a set of institutional arrangements to convert the intent of the fiscal rule into the reality of budget policy and execution. For example, medium-term budget frameworks prioritize, present and manage both revenue and expenditure over a multi-year framework, and can help demonstrate the impact of current and proposed policies over the course of several years, and ultimately achieve better control over public expenditure.

(c) Fiscal rules can be supported by fiscal responsibility laws which typically set out procedural and transparency requirements and in some cases also numerical rules.

(d) An increasing number of advanced and some emerging economies are using independent bodies to further enhance the credibility of their fiscal rules. Independent Fiscal Councils, i.e. institutions with a specific mandate to assess and monitor the implementation and impacts of fiscal policy, play a specific role in enforcing rules by providing an independent voice on their implementation.

6.17 The Working Group noted the international trend towards more rigorous application of fiscal rules and considers that room exists for Hong Kong to learn from the experience of other economies. The Working Group appreciates that rules cannot be too rigid; but if escape provisions are too readily invoked, the *raison d'etre* for the original fiscal rule would be undermined. When designing fiscal rules, policy makers would need to strike a balance between allowing flexibility and upholding fiscal discipline, and between coping with immediate community needs and preserving longer term fiscal sustainability.

Saving for the future

6.18 According to the research of the Working Group, some economies use the resources available to plan for the future through saving up part of their fiscal surplus or other receipts and assets. The notable examples are set out below.

Australia

6.19 The Future Fund was established by the Australian Government under the Future Fund Act 2006. The object of the fund is to strengthen the Australian Government's long term financial position by making provision for unfunded Commonwealth superannuation liabilities. These liabilities will become payable at a time when an ageing population is likely to place significant pressure on the Australian Government's finances.

6.20 The Future Fund received an initial injection of A$18 billion and proceeds from the sale of the Australian Government's holding of Telstra (a telecommunications company originating as a government department). The Australian Government may also make contributions to the Fund in accordance with the Act. A Board of Guardians responsible for investing the Fund's assets was established. As at 30 September 2013, the Future Fund balance stood at A$91.7 billion.

6.21 Withdrawals from the Future Fund may only occur once the superannuation liability is fully offset or from 1 July 2020, whichever is the earlier. The Australian Government Actuary periodically projects the Commonwealth's unfunded superannuation liability and declares the target asset level. In March 2010, the declared target asset level was A$99.7 billion for 2009-10, rising to A$114 billion for 2013-14.

Singapore

6.22 A constitutional safeguard exists in Singapore that would not allow the Government of the day to draw on past reserves accumulated by previous governments unless with the approval of the President. Besides, only up to 50% of the net investment return, on a real basis, on past reserves could be deployed as government spending every year. These safeguards create an effective savings mechanism that allow reserves to be saved and invested for the future.

Other economies

6.23 Many resource-producing economies have created natural resource funds for stabilization and saving purposes. Some of the funds are managed off-budget with the purpose of insulating resource revenues from spending pressures from the legislature. A few examples of funds with savings objectives are listed below –

(a) Norway's Government Pension Fund Global

It was set up in 1990 as a fiscal policy tool to support long-term management of Norway's petroleum revenue. The Fund is an instrument for general saving and does not have clearly defined future liabilities. It is fully integrated with the state budget and that net allocations to the fund reflect the total budget surplus, including petroleum revenue. Fiscal policy is based on the guideline that over time the structural, non-oil budget deficit shall correspond to the real return on the fund, estimated at 4%. Capital may only be used for transfer to the budget pursuant to a resolution by the parliament to cover the oil-adjusted budget deficit.

(b) Funds for Future Generations (FFGs)

Several countries, including Gabon and Kuwait, have created FFGs financed by a fraction of annual oil revenue (between 10% and 25%). The use of the funds' resources is relatively general, including for discretionary transfers to the budget.

(c) Chile's Pension Reserve Fund

It was established in 2006 to meet future pension costs. It receives annual contributions from the budget of 0.2% of GDP irrespective of the fiscal balance, and up to 0.5% of GDP if fiscal surpluses exceed 0.2% of GDP.

Fiscal measures of the selected overseas economies

6.24 An overview of the economic and fiscal background of the seven selected economies, along with the fiscal measures they adopted to cope with future economic challenges including population ageing, is set out below. The Working Group noted that the seven economies have also introduced various reforms on their healthcare and pension systems. Nevertheless, since healthcare and pension reforms are not the focus of the Working Group, these two areas are not included in the findings of this Chapter.

6.25 For comparison, the overall economic and fiscal position of Hong Kong is at the **Annex G**.

Australia

6.26 The Australian economy has experienced continuous growth and features low unemployment, contained inflation, low public debt, and a stable financial system. By 2012, Australia had experienced more than 20 years of continued economic growth, averaging 3.4% a year.

Chart 6.2 – Australia: Government revenue, expenditure and surplus/ deficits (1989 – 2012)

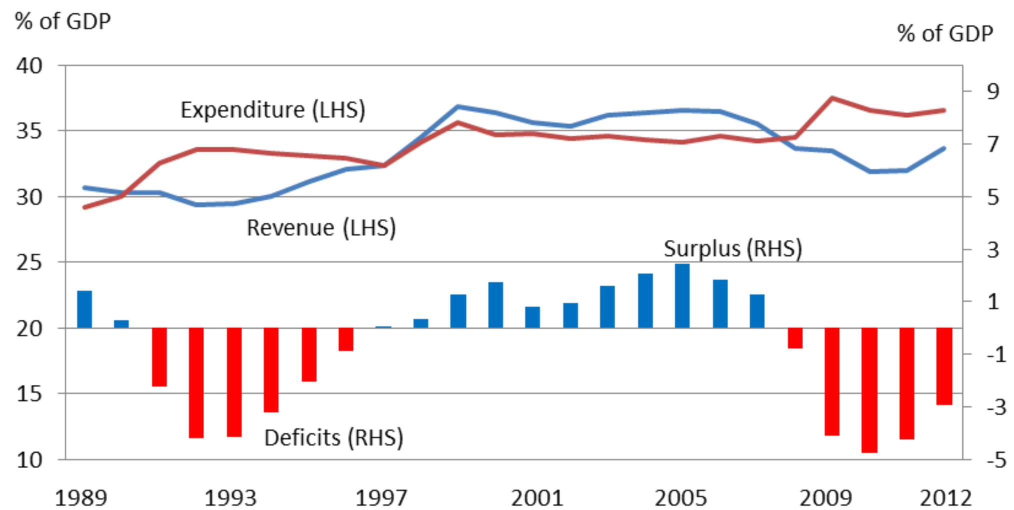
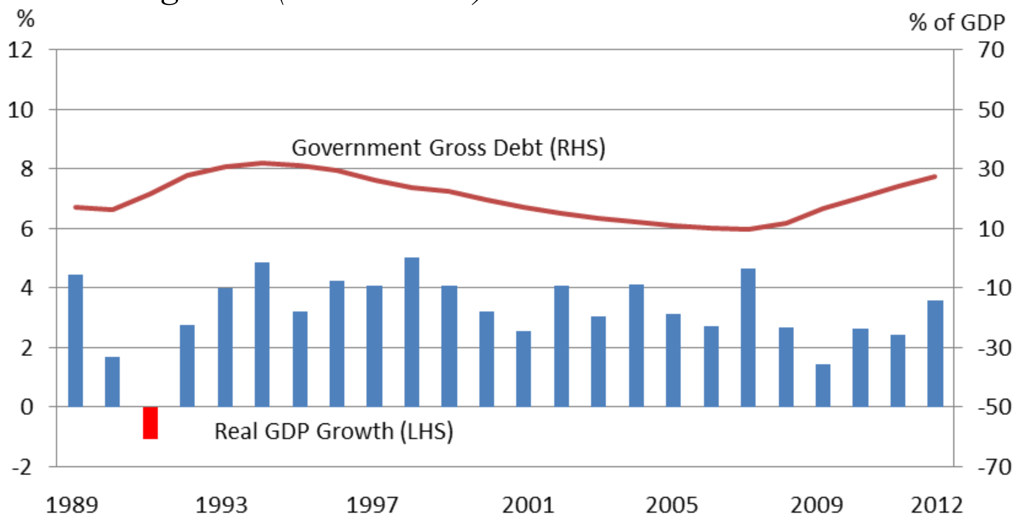


Chart 6.3 – Australia: Government gross debt and real GDP growth (1989 – 2012)



6.27 Demand for resources and energy from Asia and especially China has grown rapidly, creating a channel for resources investments and growth in commodity exports. The high Australian dollar has hurt the manufacturing sector while the services sector is the largest part of the Australian economy, accounting for about 74% of Gross Value Added and 78% of jobs.

6.28 While Australia was adversely affected by the global financial crisis, the impact of the crisis was considerably less than many other countries. Australian banks continued to be profitable and did not require any capital injections from the Government. Inflation was also kept under control. However, growth in the economy did decline while unemployment rates rose.

6.29 Australia has benefited from a dramatic surge in its terms of trade in recent years, stemming from rising global commodity prices. Australia is a significant exporter of natural resources, energy, and food. Australia's abundant and diverse natural resources attract high levels of foreign investment and include extensive reserves of coal, iron, copper, gold, natural gas, uranium, and renewable energy sources.

6.30 The fiscal measures undertaken by the Australian Government in recent years can be broadly divided into budget consolidation measures and tax measures as highlighted below –

(a) Budget consolidation measures

(i) To protect the corporate tax base, the Australian Government will tighten the rules to prevent profit shifting, remove the immediate deductibility for expenditure on exploration rights and information, improve the integrity of the consolidation regime and improve the operation of the Offshore Banking Unit regime.

(b) Tax measures

(i) Tax receipts as a proportion of GDP have moved in a relatively small range over the last two decades. Sales taxes have expanded with the introduction of Goods and Services Tax in 1999-2000 while total individuals' income taxes fell. Taxes as a proportion of GDP steadily increased from the early 1990s peaking in 2010 at 25.6%. The tax-to-GDP ratio declined as the global financial crisis reduced receipts sharply. Tax receipts are expected to rebound steadily relative to GDP to average 22.8% over 2012-13 to 2014-15.

(ii) In recent years, the Australian Government announced the following measures to increase tax revenue:

- introducing the Minerals Resource Rent Tax in July 2012, which collect taxes from the coal and iron ore minerals sector;
- taking action to close loopholes and protect the corporate tax base from erosion.

(iii) On the other hand, the Government also announced in 2013 Budget that there would be personal tax cuts (for all taxpayers with incomes up to A$80,000) and the tripling of the tax free threshold (from A$6,000 to A$18,200).

Canada

6.31 Due to the global economic crisis, the economy dropped into a sharp recession in the final months of 2008, and resulted in fiscal deficit for the year after 11 years of surplus. Canada achieved economic growth in 2010 to 2012 and plans to balance the budget by 2015.

Chart 6.4 – Canada: Government revenue, expenditure and surplus/ deficits (1989 – 2012)

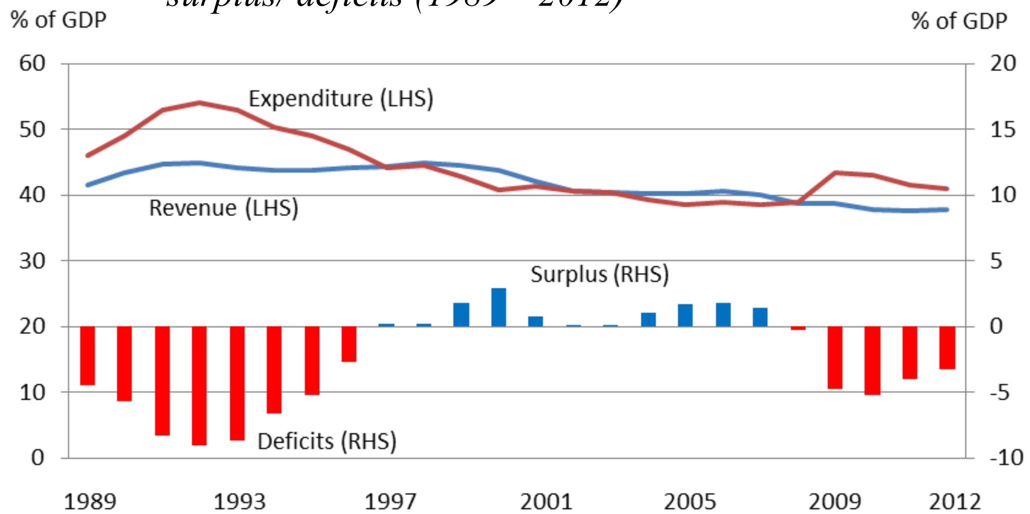
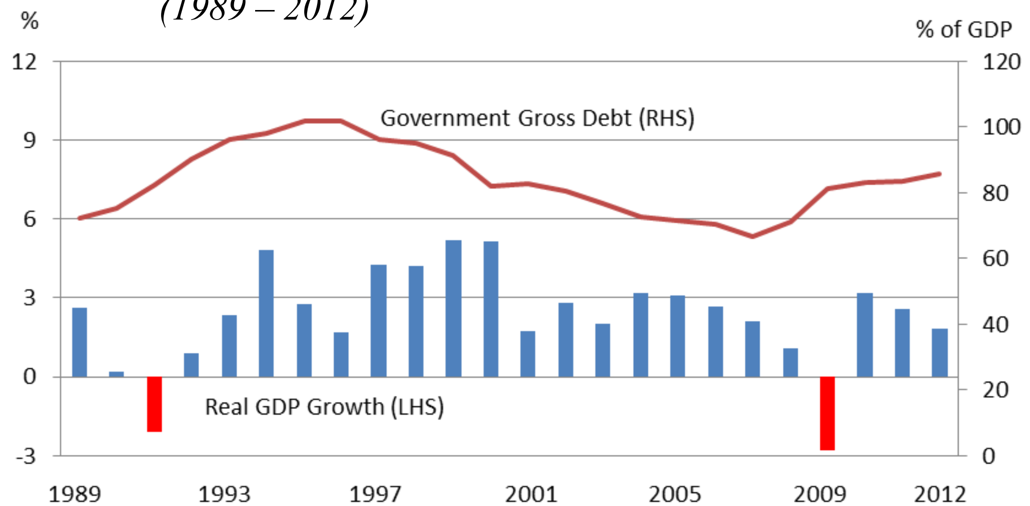


Chart 6.5 – Canada: Government gross debt and real GDP growth (1989 – 2012)



6.32 Canada enjoys a substantial trade surplus with the US, which absorbs about three-fourths of Canadian exports each year. Canada is the US' largest foreign supplier of energy, including oil, gas, uranium, and electric power. Given its great natural resources, highly skilled labor force, and modern capital plant, Canada enjoyed solid economic growth from 1993 through 2007.

6.33 According to the OECD, Canada weathered the 2008 global economic crisis well, mainly reflecting sustained growth in domestic spending and the economy is continuing to grow despite the persistence of international turbulence. One of the favourable factors contributing to this was that Canada's fiscal plans are seen by markets as credible, leading to low borrowing costs.

6.34 The IMF has commented that although Canada is in a stronger fiscal position than many other advanced economies, the ongoing consolidation effect is important to rebuild the fiscal buffer against future adverse shocks.

6.35 The fiscal measures undertaken by the Canadian Government in recent years are highlighted below –

(a) Budget consolidation measures

(i) The Canadian Government aims to returning to balanced budgets by 2015-16. It introduced measures mainly to control expenditure, e.g. restrained the growth in defense spending and limited the increase in wages of public administration.

(ii) Departmental budgets and salaries of all Members of Parliament and Senators were freezed for two years until 2013. The increase in annual wages for the federal public administration was also limited to 1.5% per year.

(iii) The Government will conduct major review of departmental budget. It will standardise, consolidate and transform the way the Government doing business. It aims to improve government administration and service delivery and reduce costs, examples are reducing travel costs through the use of technology, modernise and standardise information technology and transforming how Canadians obtain Government information and services.

(b) Tax measures

(i) In Canada, at federal level, income tax on individuals is the most significant sources of revenue, accounting for about 50% of total tax revenue in 2012-13. The income tax is progressive with tax rates start at 15% to the highest level of 29%. At provincial/territorial level, different provinces or territories impose their own income taxes with rates starting from 4%-16% to the highest level of 11.5%-25.75%. Apart from personal income tax, other major sources of revenue at federal level include corporate income tax and Goods and Services Tax.

(ii) The Canadian Government initiated the following in the 2013 Budget to improve integrity and close tax loopholes :

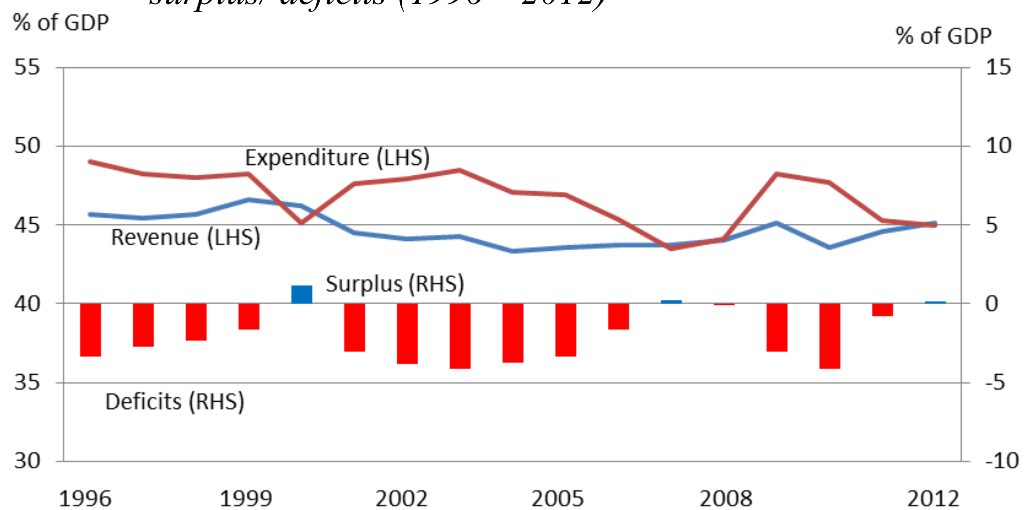
- introducing new administrative monetary penalties and criminal offences to deter the use, possession, sale and development of electronic suppression of sales software that is designed to falsify records for the purpose of tax evasion;

- announcing a new Stop International Tax Evasion Program, which will enable the Canada Revenue Agency to pay individuals with knowledge of major international tax non-compliance a percentage of tax collected as a result of information provided.

Germany

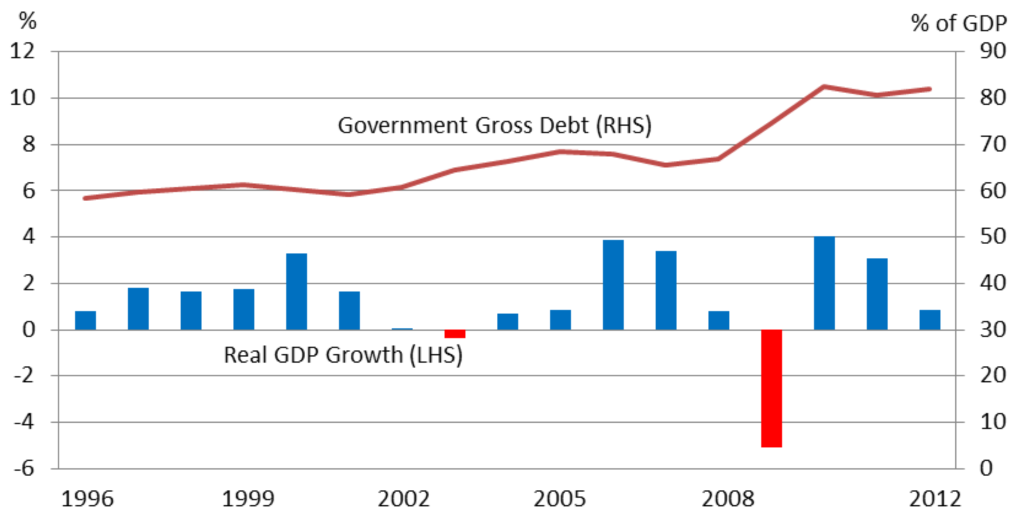
6.36 During the 2008-09 financial and economic crisis, the stimulus and stabilisation efforts initiated and a crisis-induced decline in tax revenue increased Germany's total budget deficit to 4.1% of GDP in 2010, but lower spending in % of GDP and higher tax revenues reduced the deficit to 0.8% in 2011. In 2012, Germany reached a budget surplus of 0.1%. The effects of the crises also caused a sharp soar in public debt to over 80% of the GDP.

Chart 6.6 – Germany: Government revenue, expenditure and surplus/ deficits (1996 – 2012)



Source: IMF WEO Database

Chart 6.7 – Germany: Government gross debt and real GDP growth (1996 – 2012)



Source: IMF WEO Database

6.37 The German economy is the fifth largest economy in the world and ranked first in Europe. It is the world's fourth largest exporter in 2012. It is a leading exporter of machinery, vehicles, chemicals, and household equipment and benefits from a highly skilled labor force.

6.38 GDP growth rate averaged almost 1.5% from 1991 until 2013, reaching an all-time high in 2010 and a record low in 2009. After decelerating throughout 2012 and turning negative in the fourth quarter, GDP growth is expected to strengthen gradually during 2013 and could reach 1.75% in 2014. While subdued activity in the euro area will hold back the recovery, the pick-up of world trade is projected to increase export growth.

6.39 The fiscal measures undertaken by the German authorities in recent years are highlighted below –

(a) Budget consolidation measures

(i) Germany introduced a balanced-budget requirement, the "debt brake" as from 2011. Under the new rule, neither spending increases nor tax cuts may be financed by new borrowing. The new budget rule makes an important contribution towards effectively limiting government debt.

(ii) Since 2011, the federal budget and financial plan were drafted in a top-down procedure, enabling the budget and financial planning to pay greater attention to policy priorities at an earlier stage. The primary focus is no longer on the presumed needs of each ministry but on setting policy priorities while safeguarding the necessary budgetary consolidation.

(iii) A Stability Council was set up in 2010 to monitor federal and Länder (state) budgets and to offer early warning against budget crises. If the Council identifies an impending budget crisis, a budget rehabilitation

programme must be agreed with the budget authority concerned.

(iv) Besides, the Federal Government conducts sustainability analyses periodically to examine the long-term development of public finances (currently up to 2060) and identify long-term fiscal gaps and the need for early actions.

(v) The Federal Government pursues a growth-friendly (or growth-oriented) consolidation strategy. The emphasis is on limiting government consumption, increasing performance incentives, encouraging growth through targeted investments in education, training, research, development and infrastructure and to ensure that social security systems are financed in a way that can withstand the effects of demographic change.

(b) Tax measures

(i) Income tax (including corporate taxes) and value-added tax (i.e. in general 19% and reduced rate of 7% for certain foods, books and magazines, flowers and transports) are two major tax collections in Germany.

(ii) The personal income tax is progressive and ranges with a basic allowance of more than 8 000 euro from 14% to 45%. The corporation tax rate is currently at 15%. Since 1991, a supplementary tax, called solidarity surcharge, has been added to income tax and corporate tax. The current solidarity surcharge rate is 5.5%.

(iii) Germany will impose restriction on tax planning models. It is estimated that these models cause tax revenue losses in the hundreds of millions of euros every year.

Japan

6.40 Japan has experienced two decades of budget deficits. Gross public debt rose from 70% of GDP in 1992 to some 230% in 2012, leaving Japan increasingly vulnerable to a loss of market confidence in the sustainability of its public finances.

6.41 Persistent deficits were mainly driven by social security outlays which expanded by 10.4% of GDP between 1992 and 2010, reflecting rapid population ageing. Total revenue declined by 1.7% of GDP during the period, primarily due to the fall in taxes on personal and corporate income from 12% of GDP to 8%. Budget deficit is projected to be around 10% of GDP in 2013, further pushing up gross public debt.

Chart 6.8 – Japan: Government revenue, expenditure and surplus/ deficits (1989 – 2012)

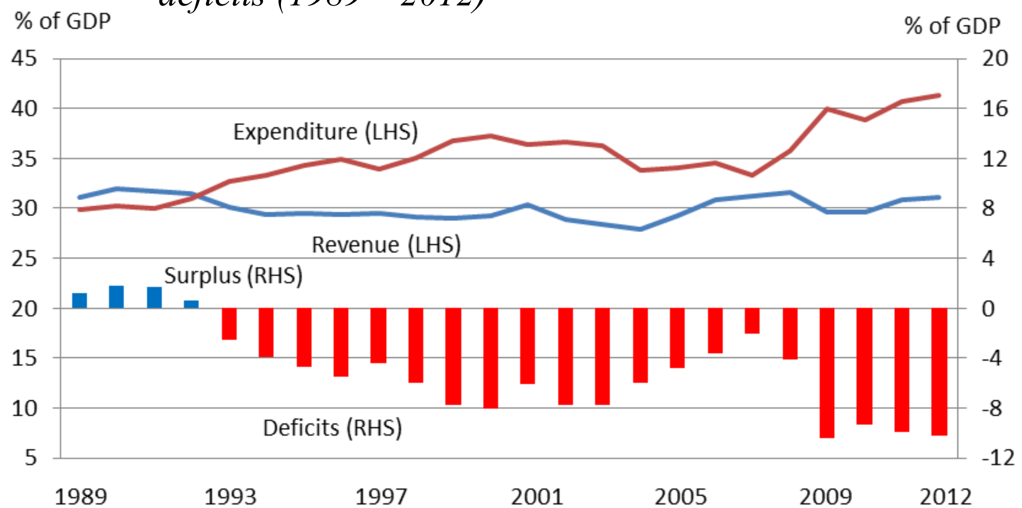
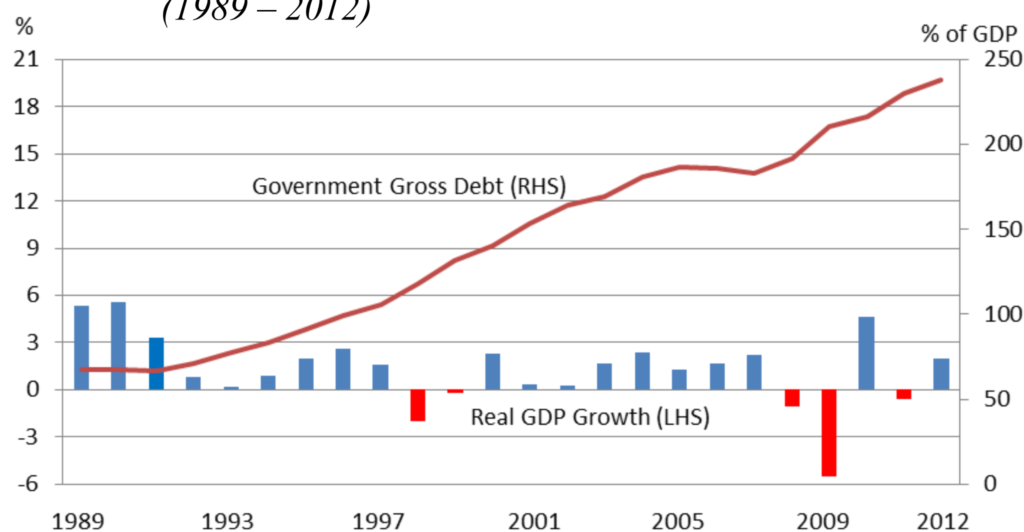


Chart 6.9 – Japan: Government gross debt and real GDP growth (1989 – 2012)



Source: IMF WEO Database

6.42 For three decades, Japan's overall real economic growth had been spectacular – a 10% average in the 1960s, a 5% average in the 1970s, and a 4% average in the 1980s. Growth slowed markedly in the 1990s, averaging just 1.7%, largely because of the after effects of inefficient investment and an asset price bubble in the late 1980s that required a protracted period of time for firms to reduce excess debt, capital, and labour.

6.43 Modest economic growth continued after 2000, but the economy has fallen into recession three times since 2008. A sharp downturn in business investment and global demand for Japan's exports in late 2008 pushed Japan into recession. Government stimulus spending helped the economy recover in late 2009 and 2010, but the economy contracted again in 2011 as the massive 9.0 magnitude earthquake and the ensuing tsunami in March disrupted manufacturing. The economy has largely recovered in the two years since the disaster.

6.44 Japan in 2012 stood as the fourth-largest economy in the world after USA, China and India. The government continued a longstanding debate on restructuring the economy and reining in Japan's huge government debt. Persistent deflation, reliance on exports to drive growth, and an ageing and shrinking population are other major long-term challenges for the economy.

6.45 The fiscal measures undertaken by the Japanese Government in recent years are highlighted below –

(a) Budget consolidation measures

The Japanese Government implemented headcount control and measures to reduce payroll costs. For instance, the number of new graduates hired by the central government in 2013 is to be halved compared to 2009 while salaries are to be cut by about 8% in both 2012 and 2013. However, the Japanese cabinet has agreed in March 2013 that the cap for recruiting civil servant would be taken away. Besides, the retirement allowances for central government officials are to be reduced by 15% by 2014.

(b) Tax measures

(i) Taxes in Japan are paid on income, property and consumption on the national, prefectural and municipal levels. In 2009, taxes on income and profits and taxes on goods and services contributing around 30% and 19% of total tax revenue respectively.

(ii) Recently, the following measures were introduced to boost tax revenue :

- The Japan legislature passed legislation in August 2012 to increase the consumption tax rate in two stages, from the current 5% to 8% in April 2014 and 10% in October 2015. The increased revenue is to be used to finance additional social security spending in childcare, health and long-term care and pension.

- The 2013 Tax Reform Proposal included an increase in taxes for the wealthiest taxpayers by introducing a new 45% personal income tax rate band for those earning over JPY40 million (HKD 3.1 million). The current highest marginal income tax rate is 40% on taxable income over JPY18 million (HKD 1.4 million). There will be also an increase in inheritance taxes by reducing the basic deduction by 40%[2] and raising the top tax rate from 50% to 55%.

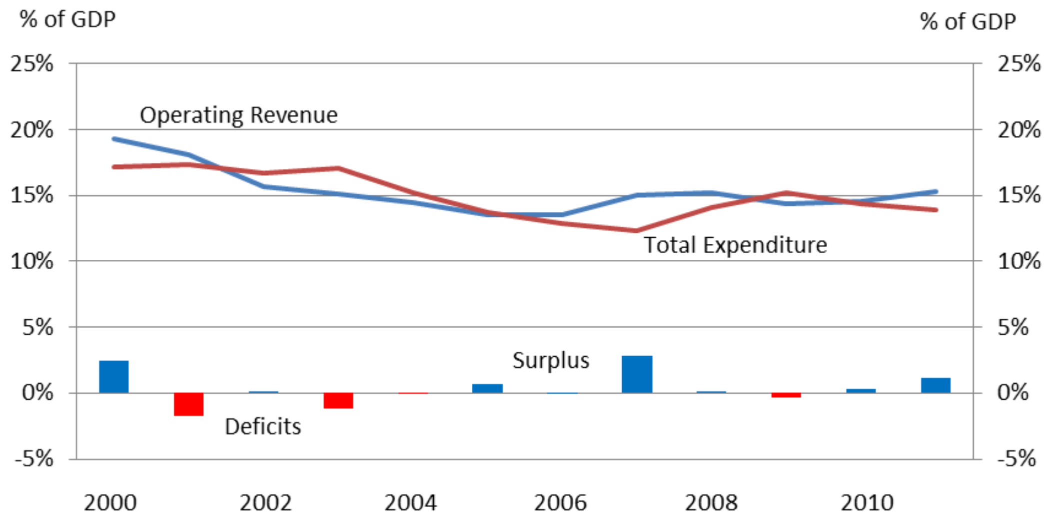
- The separate tax rate on capital gains and dividend income on listed stock has reverted back to 20%, after the expiry of a temporary tax rate of 10% by the end of 2013.

[2] The deduction amount will be changed from "JPY50 million plus JPY10 million multiplied by the number of statutory heirs" to "JPY30 million plus JPY6 million multiplied by the number of statutory heirs".

Singapore

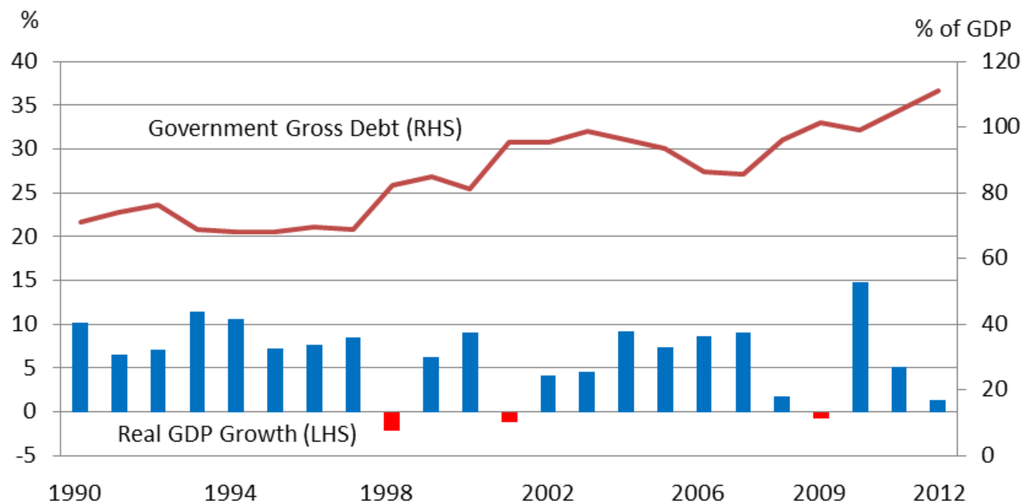
6.46 Singapore has run a balanced budget in the past decade. On average, the Overall Budget Balance was close to 0% of GDP[3].

Chart 6.10 – Singapore: Government revenue, expenditure and surplus/deficits (2000 – 2011)



Source: Ministry of Finance, Singapore Government

Chart 6.11 – Singapore: Government gross debt and real GDP growth (1990 – 2012)



Source: IMF WEO Database

[3] The average Overall Budget Balance from 2001 to 2011 was 0.2% of GDP.

6.47 Singapore enjoys an open environment, stable prices, and a per capita GDP higher than that of most developed countries. The top five industries contributing to about 75% of Singapore's GDP are manufacturing, wholesale and retail trade, finance and insurance, business services, and other service industries.

6.48 Real GDP growth averaged 8.3% between 2004 and 2007. The economy contracted 0.8% in 2009 as a result of the global financial crisis, but rebounded 14.8% in 2010, on the strength of renewed exports, before slowing to 5.2% in 2011 and 1.3% in 2012, largely a result of soft demand for exports during the second European recession.

6.49 Singapore has run a balanced budget in the past decade. The major government expenditure items are defense (23%), education (22%), transport (12%) and health (11%). Singapore undertook a major restructuring of its tax system in the early 1990s, including the introduction of the Goods and Services Tax (GST). The GST was introduced in April 1994 at 3%. It was increased to 4% in January 2003 and 5% in January 2004 and then to the current rate of 7% in July 2007. Each increase was accompanied by an offset package and direct tax rates were also reduced correspondingly.

6.50 Singapore's current public debt amounts to some 114% of GDP. However, the debt consists largely of Special Singapore Government Securities (SSGS) issued to meet the investment needs of the Central Provident Fund (CPF) Board, which administers Singapore's defined contribution pension fund. SSGS are held by the CPF, and are non-tradable. All proceeds from government borrowings are invested and are not used to finance government spending. The Government has not borrowed to finance expenditure since the 1980s. It operates on a balanced budget over each term of Government.

6.51 The fiscal measures undertaken by the Singaporean Government in recent years are highlighted below –

(a) Tax measures

(i) The personal income tax for Singapore residents is progressive, with rates ranging from 2% to 20%. Non-residents are taxed at the higher of 15% or the resident rate. Corporate income is taxed at 17%. The standard rate for Goods and Services Tax (GST) is 7%. In 2012, income tax and GST is estimated to contribute to 44% and 18% of government tax revenue in 2012.

(ii) Singapore announced the following measures in the 2013 Budget:

- From Year of Assessment (YA) 2015, housing and hotel accommodation provided to employees will be taxed based on the annual value of the premises, less rent paid by the employee and the actual cost of the hotel stay benefit provided to the employee respectively. In addition, the taxable value of furniture and fittings will be based on a percentage of the annual value of the housing accommodation.

- The concession of allowing property tax refunds on vacant properties was removed with effect from 2014.

(iii) On the other hand, the Government will provide a three-year Corporate Income Tax rebate of 30% (capped at $30,000 per year) from YA 2013 to YA 2015.

Switzerland

6.52 Switzerland experienced a positive growth in GDP over the past two decades, except 2009. Fiscal balance has been maintained since 2006 and government debt is on a decreasing trend.

Chart 6.12 – Switzerland: Government revenue, expenditure and surplus/deficits (1989 – 2012)

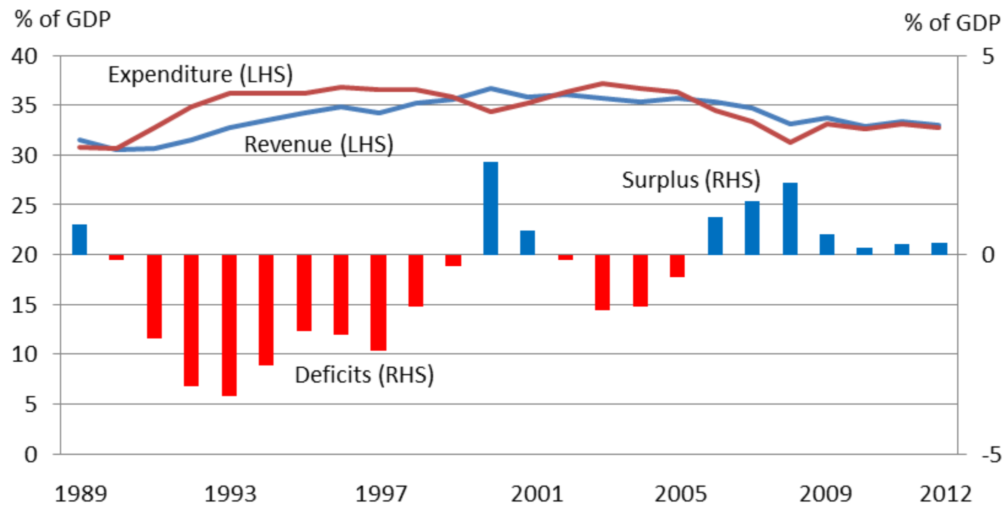
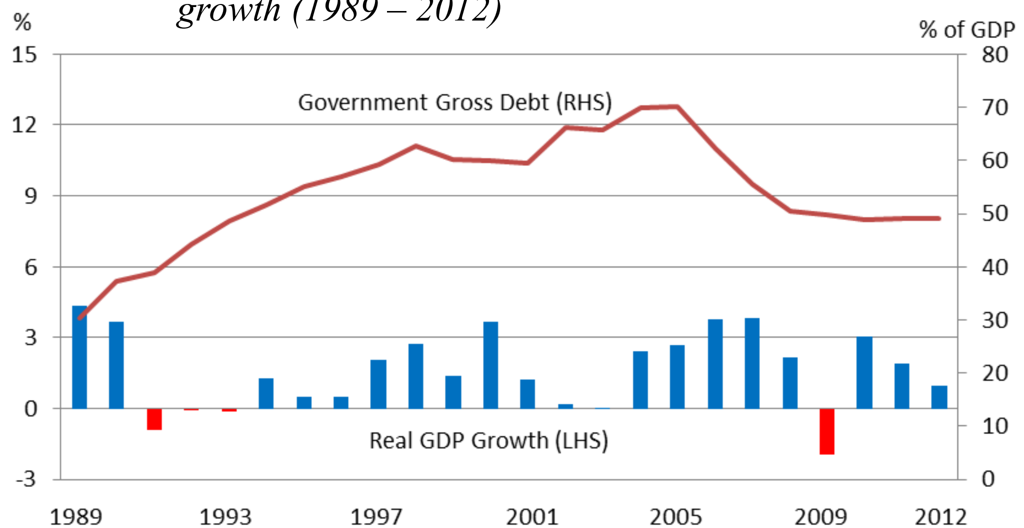


Chart 6.13 – Switzerland: Government gross debt and real GDP growth (1989 – 2012)



6.53 Switzerland's economy benefits from a highly developed service sector, led by financial services, and a manufacturing industry that specialises in high-technology, knowledge-based production. Its major industrial and services sectors are machinery, chemicals, watches, textiles, precision instruments, tourism, banking and insurance.

6.54 The top three major expenditures at general government level are spending for social security, education, and transportation and telecommunications. In 2011, the corresponding expenditures were around 38%, 17% and 9% of total budgeted expenditure.

6.55 The fiscal measures undertaken by the Swiss Government in recent years are highlighted below –

(a) Budget consolidation measures

(i) In 2001, 85% of Swiss voters approved the constitutional provision on the "debt brake", to ensure that the Confederation maintain its income and expenditure in balance at all times. The debt brake introduces a ceiling for total expenditure based on the expected income after taking account of the economic situation. In the medium term, the federal budget is balanced by using the debt brake, such that surpluses have to be managed in boom periods so as to compensate for deficits in subsequent recessions. Hence, there is no need for new borrowing.

(ii) Under the debt brake arrangement and in order to gain control over expenditure growth on a sustainable basis, task priorities will be examined from a medium-term perspective.

(b) Tax measures

(i) The Value Added Tax (i.e. standard rate of 8% and reduced rate of 2.5% for daily consumables) and direct federal tax (i.e. income tax and profit tax etc.) were around 35% and 29% of total government income in 2012. To finance disability insurance, the Swiss Government raised the standard Value Added Tax rate from 7.6% to 8% from 2011 to 2018.

United Kingdom

6.56 The UK has experienced a budget deficit since 2002. As a result, the government debt grows more than a double from 37.5% to 90.3% of the GDP in the period of 2002 – 2012.

Chart 6.14 – United Kingdom: Government revenue, expenditure and surplus/deficits (1989 – 2012)

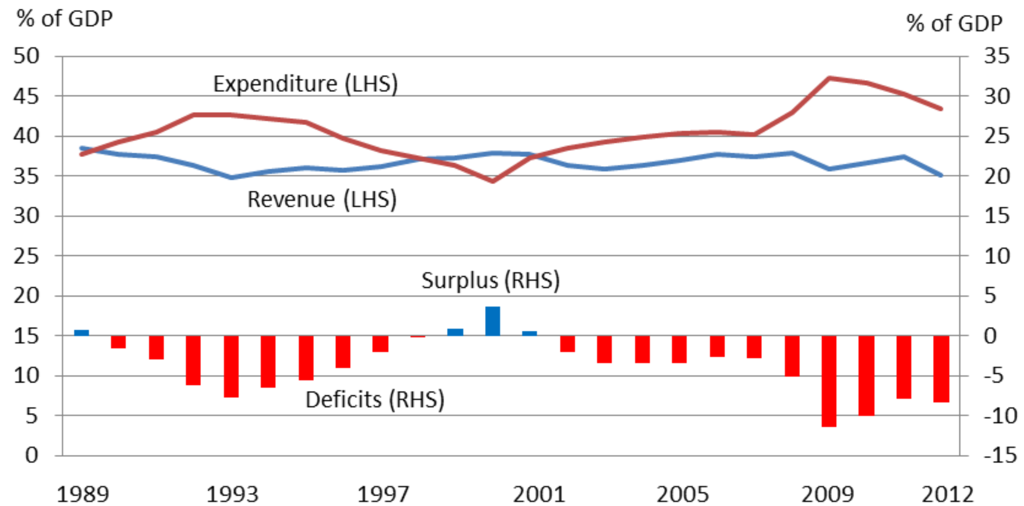
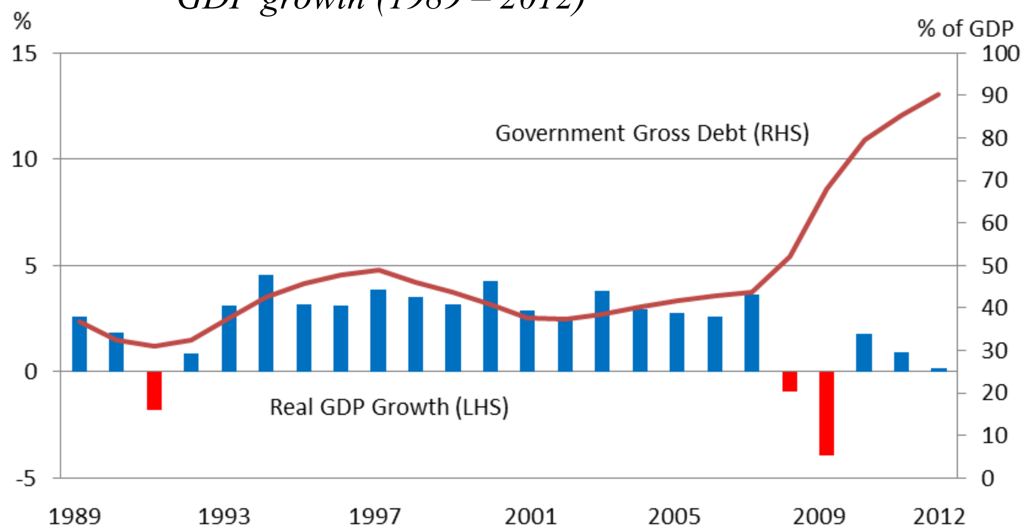


Chart 6.15 – United Kingdom: Government gross debt and real GDP growth (1989 – 2012)



6.57 The UK is the second largest economy in Europe after Germany. Services, particularly banking, insurance, and business services, account by far for the largest proportion of GDP while industry continues to decline in importance. Agriculture is intensive, highly mechanised, and efficient by European standards, producing about 60% of food needs with less than 2% of the labour force. The UK has large coal, natural gas, and oil resources, but its oil and natural gas reserves are declining and the UK became a net importer of energy in 2005. Over the past two decades, the Government has greatly reduced public ownership and contained the growth of social welfare programs.

6.58 After emerging from recession in 1992, the UK's economy enjoyed the longest period of expansion on record during which time growth outpaced most of Western Europe. In 2008, however, the global financial crisis hit the economy particularly hard, due to the importance of its financial sector. Sharply declining home prices, high consumer debt and the global economic slowdown compounded the UK's economic problems, pushing the economy into recession in the latter half of 2008 and prompting the then Government to implement a number of measures to stimulate the economy and stabilise the financial markets. The measures included nationalising parts of the banking system, temporarily cutting taxes, suspending public sector borrowing rules, and moving forward public spending on capital projects.

6.59 The UK currently has a large primary budget deficit, as non-interest spending far exceeds non-interest receipts. Major government expenditure items are social protection and personal social services (£251 billion; 35%), health (£137 billion; 19%), and education (£97 billion; 13%).

6.60 The fiscal measures undertaken by the UK Government in recent years are highlighted below –

(a) Budget consolidation measures

(i) In the face of rising public deficits and debt levels, the UK Government initiated in 2010 a five-year austerity programme, which aimed to lower the budget deficit from over 10% of GDP in 2010 to nearly 1% by 2015. In November 2011, the Chancellor of the Exchequer announced additional austerity measures through 2017 because of slower-than-expected economic growth and the impact of the euro-zone debt crisis.

(ii) The Budget 2013 reinforced the UK Government's commitment to deficit reduction and announced further details on the deficit reduction plans, primarily through spending consolidation. In gist, the Budget 2013:

- announced a reduction in departmental recurrent expenditure budget by £1.1 billion (or 0.3%) in 2013-14 and £1.2 billion in 2014-15. The schools and health budgets remain unchanged;

- fixed the total government expenditure for 2015-16. Health, schools and Official Development Assistance will be protected;

- confirmed the path of future fiscal consolidation, expressed as an assumption that total government expenditure in 2016-17 and 2017-18 will continue to fall at the same rate as over the Spending Review 2010 period; and

- announced that the Government would strengthen the public spending framework by introducing a firm limit on a significant proportion of centre-funded expenditure, including areas of welfare expenditure. This will be designed in a way that allows the

automatic stabilisers to operate to support the economy.

(b) Tax measures

(i) In the UK, personal income tax is progressive and ranges from 20% to 45%. The personal income tax is expected to be the largest portion of government revenue, amounting to 25% of government revenue in 2013-14.

(ii) Value Added Tax (at 20%) and corporate tax (at 23%) are two other major sources of government income. As the principal indirect tax in the UK, Value Added Tax is expected to be 17% of government revenue in 2013-14. Meanwhile, the corporation tax is expected to be 6% of government revenue in 2013-14.

(iii) The UK Government has increased the standard rate of Value Added Tax from 17.5% to 20% from 2011 to reduce its budget deficit.

(iv) On the other hand, the following measures were also introduced in recent years to lessen tax burdens of the public :

- reducing the main rate of corporation tax from 28% in 2010 to 23% in 2013, and to 20% by 2015, cutting the rate of corporation tax for companies with small profits from 21% to 20%;

- increasing personal tax allowance by £560 to £10,000 in 2014; and

- changing the way the UK taxes overseas profits to concentrate on taxing profits from UK activities

Conclusion

6.61 The Working Group noted that in preparation for an ageing population, a few governments have established savings schemes with or without designated purposes to hedge against known commitments in future. As a response to the global financial crisis, there is growing recognition that fiscal discipline should be tightened. As a result, fiscal rules have been imposed and independent fiscal oversight authorities established. The Working Group has reflected on the findings and developed recommendations in the following chapter.