FOR AGENDA

SM/05/22
Correction 1

February 4, 2005

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Singapore—Selected Issues**

The attached factual corrections to SM/05/22 (1/24/05) have been provided by the staff:

Page 20, para. 6, lines 8 and 9: for "represents the surpluses of the Central Provident Fund (CPF)"
read "represents Central Provident Fund (CPF) members' balances"

para. 8, lines 7 and 8: for "the development of life insurance and asset management sectors"
read "the enhancement of members' retirement savings"

Page 23, footnote 11: for "About one third of the labor force is not covered by the CPF. A replacement rate of 30 percent of per-capita income is assumed."
read "The analysis assumed that about one third of the labor force is not covered by the CPF, with a replacement rate of 30 percent of per-capita income. The coverage of the CPF is currently estimated to have increased to about three fourths of the labor force."

Questions may be referred to Mr. Aziz (ext. 37693) and Mr. Jang (ext. 37916) in APD.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (2)

Other Distribution:
Department Heads

- infrastructure development and public housing, these items are about 7 percentage points of GDP higher than the OECD countries' median. Much of net lending goes to finance one statutory board, the Housing and Development Board (HDB); there are nearly 70 statutory boards.[6] However, net lending has declined in recent years, reflecting lower new loans and higher repayments.

- *Relative to its level of development, social spending is strikingly low.* Total social spending in Singapore is just about one third of the OECD countries' median. High levels of expenditure on education and housing reflect the government's priorities, which aim at providing high levels of accessibility and affordability in education and public housing.

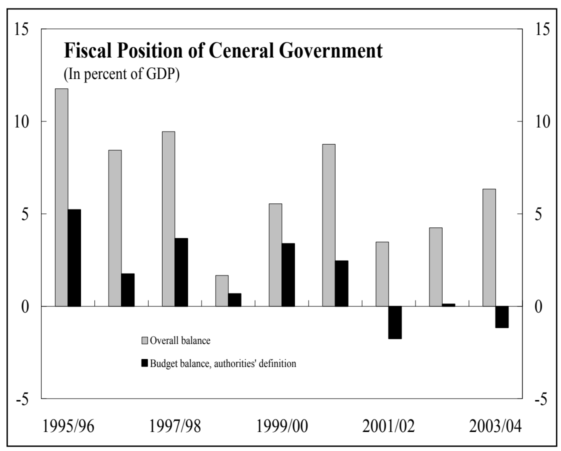
Comparative Central Government Social Spending, 1990-2001
(In percent of GDP; average)

	Singapore	OECD (median)	Japan	Korea	Malaysia 1/	Thailand	Indonesia	Philippines	Hong Kong SAR 4/
Government Expenditures on									
Education 2/	3.8	4.7	3.5	4.3	5.1	3.6	1.4	3.4	4.3
Health 3/	1.2	6.4	6.4	3.2	1.4	1.3	0.4	0.6	2.7
Social security and welfare	0.8	12.7	8.1	1.6	1.4	0.7	0.7	0.6	2.6
Housing and community amenities	1.6	0.5	2.4	0.3	1.5	0.7	1.7	0.2	2.3
Total Social Spending	7.4	24.4	20.4	9.4	9.4	6.4	4.3	4.7	11.9

Source: IMF, Government Finance Statistics; and OECD, OECD in Figures.

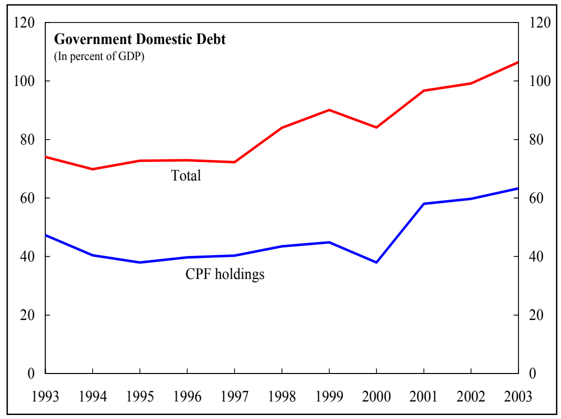
1/ Data for 1990-97.
2/ Public expenditure data for 2000 for OECD, Japan and Korea.
3/ Public expenditure data for OECD (2002), Japan (2001) and Korea (2001).
4/ Data for 2002.

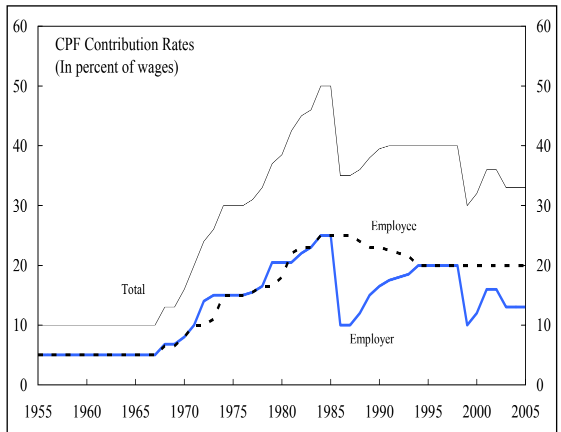
5. **Prudence has been the hallmark of Singapore's fiscal policy**. Except once, the overall fiscal balance has been in surplus throughout the last two decades. The overall surplus averaged 10½ percent of GDP during 1990–2001, compared with a deficit of 3½ percent of GDP in the OECD countries. However, the government's definition of the budget balance underestimates the strength of Singapore's fiscal position as operating revenue excludes substantial portion of investment income and earnings from land leases.



[6] The HDB, which is financed directly by the Ministry of Finance and through bond issuances, was established in 1960 as a statutory board of the Ministry of National Development to develop public housing. About 85 percent of Singaporeans currently live in HDB housing, compared with 9 percent in 1960. The HDB also provides housing loans at a concessionary interest rate (currently 2.6 percent), which is set at 0.1 percentage point above the rate on CPF ordinary account balances.

6. **With a large net asset position, government securities have been issued mainly to develop Singapore's capital market**. Government securities have provided a liquid and risk-free instrument that has served as a benchmark for the corporate debt securities market. The bulk of domestic debt represents Central Provident Fund (CPF) members' balances, which are invested overseas by the GIC.





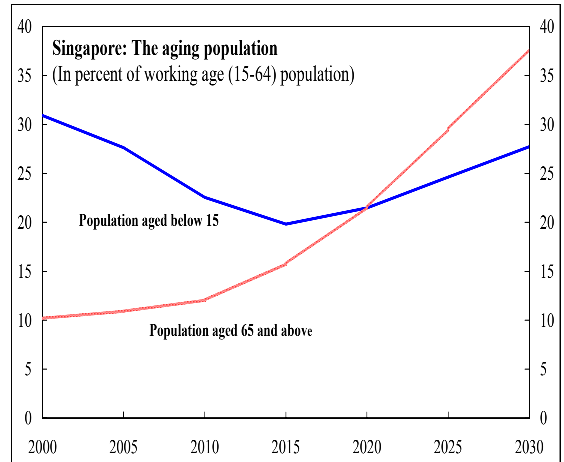
Source: CPF Board.

7. **In the absence of any defined-benefit social security program, for most Singaporeans, balances held with the CPF form the mainstay of retirement savings**. The CPF was established in 1955 as a mandatory, fully funded, defined contribution, individual account system to provide financial security for workers in their old age.[7] Over time, the CPF has evolved into a scheme that has come to be used for various public policy objectives, including macroeconomic management through changes in employer contribution rates as a means of reducing business costs (Box 1).

8. Net **contribution to the CPF is relatively low**. Gross contributions to the CPF in Singapore averaged 10½ percent of GDP during 1993-2003, well above the median of the OECD countries' social security contribution and those in Asian countries. However, net CPF contributions in Singapore amounted to only 3¼ percent of GDP a year during the same period, well below 8½ percent of GDP, the median of the OECD countries. The high level of withdrawals reflects the use of CPF to further various government objectives, including universal home ownership, and the enhancement of members' retirement savings through the liberalization of the CPF investment schemes. Indeed, the withdrawal for

[7] Each member has four accounts: (i) Ordinary Account—savings in this account are available for pre-retirement withdrawals for home purchases, education, and investment; (ii) Special Account, which is reserved for old age, contingency purposes, and investment in retirement-related financial products and can only be withdrawn at age 55; (iii) Medisave Account, which can be used for hospitalization expenses and to pay premiums for approved medical insurance schemes such as MediShield (designed to help meet the cost of catastrophic illnesses); and (iv) Retirement Account—at age 55, a member can withdraw the remaining balance in the Ordinary Account and the balance in the Special Account as a tax exempt lump sum after setting aside a minimum sum in this account.

- *An aging population will raise demands on the healthcare system*. Total health expenditure in Singapore is estimated at around 3 percent of GDP, which is low compared to that in the OECD countries. Moreover, the share of public health expenditure is only around 25 percent (Lim, 2004). Healthcare costs have also risen by 3–4 percent a year, faster than CPI inflation. It is anticipated that over the next two decades the share of the public sector in healthcare expenditure will need to be increased significantly to provide adequate healthcare service to the aging population. Thus if government's share of public health is increased to 50 percent, still lower than the current OECD country average, budgetary expenditure could increase to around 2.4 percent of GDP, which would be only one-third of public health spending in OECD countries.[10]



Source: World Bank, World Development Indicators.

Health Expenditure and Resources in 2002

	Total expenditure as % of GDP	Public expenditure as % of total expenditure on health
Finland	7.3	75.7
Japan 1/	7.8	81.7
Korea 1/	5.9	54.4
United Kingdom	7.7	83.4
United States	14.6	44.9
OECD (median)	7.2	65.6

Source: OECD in Figures (2004)
1/ Data for 2001

- *Singapore's social security system is almost entirely based on a mandatory savings scheme (CPF), which is unusual among advanced economies*. As compared to a multi-pillar social security framework, reliance on a single pillar is quite risky (Asher, 2004). Given experiences of OECD countries, it is likely that a multi-pillar framework that incorporates some form of social insurance may be needed to address the needs of the poor. Heller (1999) estimates that it would cost about 1¼ percent of GDP by 2010 for the government to provide pensions to the elderly population not covered by the CPF.[11] Singapore government's spending on social security is just

[10] The government has increased spending on public health on an ad hoc basis. For example, in 2004 the government topped up the Medisave Accounts of individuals aged 50 and above by about 0.06 percent of GDP. Moreover, an additional 0.06 percent of GDP was provided to the government's medical fund to help needy patients. The authorities are currently considering revamping CPF's medical insurance scheme to provide better coverage.

[11] The analysis assumed that about one third of the labor force is not covered by the CPF, with a replacement rate of 30 percent of per-capita income. The coverage of the CPF is currently estimated to have increased to about three fourths of the labor force.

6 percent (or 15 percent, including CPF withdrawals) of the median OECD country. Given increasing structural unemployment among the less skilled, provision of additional social safety to the unemployed is worth considering, in addition to job training programs.

11. **Looking forward, Singapore's fiscal position is likely to remain strong**. There are good reasons—primarily the need to prepare for the ageing of the population and the desire to build up a sizable "rainy day" reserve given the lack of natural resources in Singapore—underlying the government's cautious approach to fiscal policy. Given that Singapore has already joined the ranks of advanced economies in light of rapid growth since its independence in 1965, the government could consider expanding its social safety net as the country faces the challenges of an aging population and rising structural unemployment, as well as to enhance medium-term growth prospects through higher human capital. Although information on government's net asset position is limited, it appears that the government could afford additional social spending by 2–3 percent of GDP over the medium term without impairing the strength of its reserves position.[12]

12. **The authorities are fully cognizant of these challenges and have taken several measures in response**. Among these measures is targeted assistance to low-income earners for health care and retirement. On unemployment, the authorities have strengthened a number of retraining and job-matching schemes. At present, they consider such programs better suited to provide social insurance by enhancing employment opportunities rather than introducing any entitlement program.

[12] In the FY2003 budget the government used about one third (1¼ percent of GDP) of the net investment income included in the fiscal data, and plans to do the same in the FY2004 budget.