**Essay Question 8**

**Chinese consumption decreased from 51% of Gross Domestic Product in 1985 to 43% in 1995, 38% in 2005, and 34% in 2013. By comparison, consumption is around 61% in Japan and 69% in the United States. Regardless of its relative percentage of GDP, China’s consumption has been growing faster than any other economy’s in absolute terms.**

**Discuss whether raising domestic consumption as percentage of GDP is the best approach to achieve sustainable economic growth. [15]**

**must explain other policies**

1. **Why domestic consumption can lead to sustained economic growth**
2. **Why it cannot?**
3. **Limitations of policies like FP**
4. **What are other ways to achieve EG?**

Question Analysis

* ‘Discuss whether’ – examine closely taking account of the benefits and costs for and against
* ‘best approach’ – need to compare at least 3 approaches
* **Thesis –** Raising domestic consumption as percentage of GDP is the best approach to achieve sustainable economic growth
* **Anti-Thesis** – There are other better approaches to achieve sustainable economic growth -
* Judgement – Give reasoned judgement to which is the best approach to achieve sustainable economic growth, given the contextual circumstance

Introduction

Sustainable economic growth ensures growth without creating further problems such as BOP imbalances, high inflation rate and environment damage that will otherwise suppress it. Given the increasingly volatile and uncertain world brought about by globalisation, raising domestic consumption as percentage of GDP would be the best approach for big consumer markets in the quest for sustainable growth. However, this is not ideal for economies with small domestic markets and facing an aging population, and hence other approaches such as increasing productivity and investing in Research and Development to look for new areas of comparative advantages would be better approaches.

Main Body

**Thesis 1 – Internal Factors**

Raising domestic consumption as percentage of GDP allows economies with large domestic market to increase real national income via multiplier effect, leading to actual and sustainable economic growth. The high demand for goods and services from large domestic market induce employment opportunities in the retail and service sectors.

Comparing consumption and service - led economies and capital- led industries, consumption and service - led economies like US and Japan tend to create more jobs per unit of investment, accompanied by higher wages per dollar invested. Hence economies like US and Japan will benefit the most from this approach.

**(large population to induce greater consumption which leads to a higher value of increase in AD)**

P2

 Y1 Yf

General Price Level

Real National Income

0

P1

AD1

AS

AD2

Increase in private consumption causes aggregate demand (AD) to increase from AD0 to AD1, leading to increase in real national income via multiplier effect (Fig 1) and actual economic growth, with a positive spillover effects on internal economic health such as induced employment and higher standard of living for consumers (higher quality products in the case of Korean cosmetics). Hence, actual economic growth is sustainable and can be achieved with the approach of rising domestic demand and consumption.

**Thesis 2 – External Factors**

In addition, raising private consumption as percentage GDP eliminates the reliance on trade to achieve sustainable economic growth, thus, reducing susceptibility to external shocks for large economies such as China and hence is the best approach.

The increase in real national income obtained from raising private consumption contributes to the national official reserves and diminishes the need to build up foreign reserves through reducing import expenditure. This allows China to narrow her trade surplus and reduce conflicts arising from global trade imbalances with her trading partners. Moreover, by turning towards producing consumption goods, China is able to reduce excessive usage of natural resources such as fossil fuels, water and land required to produce capital goods (industrial parks) and mitigate mounting environmental pressures, therefore achieving sustainable economic growth.

Being one of the world’s greatest producers of greenhouse gases and the world’s largest coal consumer, China needs to adopt a more efficient use of resources in order to achieve sustainable economic growth. Hence, a rebalancing of China’s growth toward production of goods and services would help boost the country’s already – commendable efforts to put the economy on a more environmentally sustainable footing.

In addition to a lesser reliance on international trade, consumption spending in general simply tends to be much less volatile than either investment or exports. Investment can be postponed according to the cyclical needs of businesses, but consumers tend to prefer a smoother and permanent consumption trend over their lifetimes and at least some portion of consumption spending goes on non-optional basic necessities. .

Thus, raising domestic consumption as percentage of GDP is the best approach to achieve sustainable economic growth for economies with big domestic markets like China and the US.

**Anti-Thesis 1**

However, raising private consumption can be a challenge for developed economies facing aging population in a rapidly changing global economic environment like European economies and Singapore due to the necessary quantity and quality of labour required for potential economic growth, which then leads to cost–push inflation as these economies reach full employment level. Therefore, an approach that anchors on productivity–led growth will deliver sustainable economic growth for these economies.

An increase in labour productivity will lead to lower per unit labour cost and hence lower unit cost of production. This means higher rate of expected returns from investment, which attracts FDI into the economy and improve the economy’s capital and financial account. The inflow of FDI also improves employment by creating employment opportunities for the locals. Additionally, advanced technologies, machines, skilled labour and expertise that FDI bring in can expand productive capacity of the economy and contribute to higher potential economic growth. Therefore, scarcity of resources that otherwise hinders sustainable economic growth can now be addressing following this productivity–led growth approach.

General Price Level

Real National Income

0

AD0

LRAS1

LRAS2

Y1 Y2

P1

P2

Furthermore, Using AD-AS framework, labour productivity growth can reduce inflationary pressure caused by actual economic growth of economies operating at/near full employment level. An increase in labour productivity leads to rightward shift of LRAS from LRAS1 to LRAS2. Hence, general price level will decrease from P1 to P2 in response to an increase in real national income from Y1 to Y2 via multiplier effect. Hence, actual economic growth can be achieved without trade–offs with high inflation.

Improving labour productivity also help improve an economy’s BOP through price competitiveness and product differentiation. Labour productivity growth lowers unit cost of production and price of exports in foreign currencies, thus boosting international export competitiveness.

As demand for exports is price elastic, lower exports price leads to more than proportionate increase in quantity demanded for exports. Total export revenues R = P x Q thus increases and BOP in current account increases. This leads to a significant actual economic growth for small and open economies like Singapore where exports revenues take up 326% GDP. Moreover, improvement in process and product innovation (as part of labour productivity growth) such as improving users’ experiences in connectivity between consumers and electronics, as well as products/services improvement and differentiation through smart phones apps, wearable devices, data and media may lead to the development of consumer preferences to domestic products and form brand loyalty. This makes demand for domestic exports even more inelastic and price competitive with higher BOP surplus, contributing to sustainable economic growth.

Also, to mitigate the negative impact of an ageing labour force on labour productivity growth, it is important for the government to continue to focus on lifelong learning and retraining of older and less educated workers, as it will help the workers to remain relevant and productive in the domestic economy. Hence, enhancing labour force’s productivity and employability for older workers will be the key to help economies achieve sustainable economic growth and high employment levels.

**Anti-Thesis 2**

Another approach to sustainable economic growth is to seek new areas for comparative advantage and build up sunrise industries to improve attractiveness of investment climate. The economy is able to benefit from potential economic growth and increased spare capacity. In Singapore, the government has identified 4 pillars of growth as they hold significant growth potential, namely the water processing, tourism, biomedical and pharmaceutical industries.

With capabilities of high and advanced technology, Singapore also have found comparative advantage in water treatment plants(e.g NEWater). As a result of government focus on these industries, productive capacity in the country will rise as technology and expertise can be passed on to Singapore companies. This ensures sustainability as economic growth is supported with increase in workers’ skills and knowledge, thereby ensuring vibrant economic environment for investment and provides opportunities for employment.

However, there are also some adverse effects on citizens of lower income groups and skills. Such rapid industrialization and structural change might bring about increased income inequality and structural unemployment. Then again, the government needs to ensure lifelong learning through training programmes and workshops. One such example would be SkillsFuture, a philosophy led initiative in which the government provides opportunities to maximise one’s potential and develop a mastery of skills. This policy encourages Singaporeans, young or old, to achieve success through the growth mindset, charting our own paths and skills mastery. Hence, an approach to sustainable economic growth is to seek new areas for comparative advantage and build up sunrise industries to improve attractiveness of investment climate.

Conclusion

In conclusion, raising domestic consumption as percentage is the most appropriate for countries with large domestic markets and when there are external shocks as countries are able to rely on their factor endowments to achieve sustained economic growth. However, when countries rely on one another to boost economic growth due to small domestic markets, other approaches like boosting productivity and research on comparative advantages to attract investors would be more appropriate in sustaining all aspects of economies.