**Chapter**

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**1. Macroeconomic Aims**

Define and explain the four main aims and their importance or benefits. (8-10)

(definition/measurement/characteristics/importance)

The aims of the government are seen in terms of price stability, low unemployment, economic growth and external equilibrium. In striving to attain price stability, the Singapore government seeks to attain low inflation rate which can be measured by the consumer price index on a year-on-year basis or base year comparison approach. To do so, the government is trying to maintain low cost of living and cost of production to sustain the livelihood for the workers and maintain her external competitiveness. As for low unemployment rate which is measured by the ratio of the unemployed workers to the total working population, it will enable the economy to have higher level of production and thus, raise the rate of utilization of resources.

In achieving these two aims, the economy of Singapore will be able to attain economic growth at a sustainable and stable growth rate when real Gross Domestic Product (GDP) grows without experiencing inflationary condition. In achieving this, the government needs to raise the actual growth which is measured in terms of the growth of the real GDP which is the total monetary value of goods and services produced by the nation within its territory, usually measured in a year and raise the potential growth of the economy by expanding the availability of resources through the outward shift of the long-run supply curve. (BOP equilibrium – affect exchange rate fluctuation)

As for the external equilibrium, this will refer the flow condition of the economic activities that the country will engage with other countries, seen in terms of trade, flow of investment, fund and equity transactions, reflected by the balance of payment. These economic activities will affect the flow of currency which will affect exchange rate that may create adverse effects like asset-based inflation or imported inflation.

**2. Macroeconomic Policies**

**2.1 Fiscal Policy**

- uses government expenditure and taxation - influence AD so as to achieve aims of government

**2.1.1 Expansionary Fiscal Policy**

- It is used to solve recession or curb unemployment by raising aggregate demand

- Increase in government expenditure → increase aggregate expenditure directly through infrastructural development and provision of public services

- Tax reduction → increase disposable income → raise consumption and increase return on investment, (lower tax on corporate earnings) contributing borrowing from the public through the issues of government bond the rise in investment expenditure → rise in aggregate expenditure/national income (multiplier effect)

- This will close up the deflationary gap and thus curb recession.

**Evaluation**

* Low multiplier → reduces effectiveness of policy (High MPS/High MPM)
* Crowding out effect – If the government expenditure is financed through borrowing through the issue of government bond -increase in demand of loan – increase in interest rate → increase in cost of borrowing-discourage private investment as there is deprivation of fund for private investment and higher cost of borrowing due to high interest rate [contractionary effect that undermines the impact of expansionary FP] – crowd out the fund available for pte investment
* Fiscal drag - income increases (expansionary policy) → public in a higher tax bracket → slower growth in disposable income → slower increase in C → reduces effectiveness of FP. This is the result of automatic stabilizers that are in place in the fiscal system
* Time lag
* High cost of financing
* Saturation of infrastructural development will lead to under-utilization of public facilities

**2.1.2 Contractionary FP**

- It is used to curb demand-pull inflation by lowering aggregate demand

- Decrease in government expenditure will decrease aggregate expenditure directly.

- Tax increment will reduce disposable income and thus lower consumption while the return on investment decrease due to higher tax on corporate earnings, contributing the fall in investment expenditure

- The effect will lead to the fall in aggregate expenditure which will decrease national income via the reverse multiplying effect. This will close up the inflationary gap and thus curb inflation.

**Evaluation**

* Low multiplier- reduces effectiveness of policy
* Time lag
* Expenditure on public works projects already happening cannot be cut. Reductions in expenditure may be minimal. (SOL/undermine efficiency of industries)
* tax is politically unfavourable
* cannot be used to solve cost-push inflation (tax to AD will lead to tax-based inflation) and imported inflation

**2.1.3 Explain why Singapore introduces fiscal policy for its supply-side implications rather than the demand-side implications**

a. FP → affect AD → Demand-side implication

-depending factors –time period

–impact on resource (AS) or production capacity (AD)

b. FP → affect resource / production capacity → affect potential growth (SS-side implication) – outward shift of the LRAS

-infrastructural development and manpower development will enhance mobility of resource, which will expand availability of resources – shift LRAS to the right – lower cost of production to reduce price → ↑AD on a quantity basis, ↑ real GDP (achieving sustainable EG)

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**2.1.4 Assess the extent of the effectiveness of the fiscal policy in Singapore**

- Effective as a policy to help to reduce unemployment as it can create direct and indirect impact on the issue of employment

a)Productions induce employment with direct provision of goods and service by government (more teaching staff)

b) Can train the workers to help them adapt to structural changes and imperfect market information (solve skill incompatibility)

c) The increase in employment will have significant benefits to a large economy – more labour intensive forms of jobs

- Can help to generate growth as it will expand production capacity with infrastructural development to reduce immobility of resources like expressways and MRT transit link (↑FDI →↑production→↑N+)

- Fiscal policy can also be used to raise the efficiency of industries through manpower development and infrastructural development

- Use as a policy eliminate disparity of income as subsidies are to lower income group and infrastructural development will raise the standard of living as it provides convenience and comfort to the people

**Evaluation**

* Government expenditure is inadequate to compensate the loss from external demand (17% Govt exp of GDP compared to 250% XD to GDP)
* Time lag
* Efficiency and Effectiveness depends on the public administrative body
* Small k effect in Singapore – high MPS/MPM
* high cost of financing – need to raise tax burden for future generation / may need to raise in public debt (need to tax more in the future)

**2.2 Monetary Policy**

It involves the variation of money supply and interest rate to influence AD components so as to attain the aims of government

**2.2.1 Expansionary MP**

- To raise AD to solve recession and unemployment

- When expansionary monetary policy is conducted, the government will increase the money supply which will lower interest rate. This will lower the cost of credit consumption and reduces the reward for saving which will encourage more consumption and reduce willingness to save. Also, the level of investment will be raised as the level of profitability is raised since the cost of investment is lowered as lowering interest rates lowered the cost of borrowing. Consequently, there will be a rise in consumption and investment which will raise the aggregate demand, via the multiplier effect and thus raises the real GDP, production and employment.

- Qualitative MP (direction of money supply)→ provide more liquidity to firms to prevent business failure→ prevent retrenchment

control of credit cards – influence consumption – areas of spending

- Fall in interest rate → outflow of hot money (→depreciation of currency of the country ↓ Px/↑Pm increase in (X-M), assuming demand for X and M is price-elastic

(Exchange Rate Monetary Policy →↓ Px → ↑Xd→ ↑AD)

Not adopted by Singapore (No use of interest rate to affect exchange rate

Use interest to influence the exchange rate to control imported inflation – capital control (prevent short term change of local currency into forex)

**Evaluation of Expansionary Monetary Policy**

Advantages

* Can create a more market-oriented impact on the economy which is more permanent as it induces private investment
* Market-based economic activities will be more effective as the production may be more innovative and efficient (more diversified form of investment → dynamic for economic development → more sources of growth of NY and greater variety of employment opportunities
* liquidity provided by the government will induce stability for the economy (more money supply will enable higher level of consumption/more fund for business operation) – more cash flow

Disadvantages

* Inability of the central bank in controlling money supply due to liberalization of the banking sector
* Inelastic MEI – Investment is based on FDI and low local interest rate cannot affect FDI/Market pessimism may not induce borrowing
* Small multiplying effect-undermining the MP from expanding the economy(high MPS and MPT)
* Increase in local investment may not be able to compensate the loss in production due to fall in external demand

Qn: Why expansionary MP cannot raise AD to solve recession?

- Cannot compensate the loss of external demand (global economic recession due to sub-prime crisis cannot be reverted by the expansionary MP)

- Market pessimism will not induce ↑AD even if i/r is lowered

Qn: Why some governments may still need to lower i/r to raise AD?

- The economy is large with huge population and credit consumption is significant part of AD (US and Euronzome

- Avoid the dependency of external market demand/avoid the adverse effects of protectionism

**2.2.2 Contractionary MP**

- When contractionary monetary policy is conducted, the government will reduce the money supply which will raise interest rate. This will raise the cost of credit consumption and raise the reward for saving which will discourage consumption and raise willingness to save. Also, the level of investment is lowered as the level of profitability is reduced since the cost of investment is higher as rising interest rates raised the cost of borrowing. Consequently, there will be a fall in consumption and investment which will lower the aggregate demand, via the reverse multiplier effect and thus lower the real GDP, production and employment→ ↓P (curb inflation)

- Rise in interest rate →inflow of hot money → appreciation of currency of the country →↑dd for local $ →↑Px/↓Pmdecrease in (X-M), assuming demand for X and M is price-elastic

- Lower down Pm (temporary)-profit-taking (speculator will sell the local currency when it appreciates)

∴ Cannot curb imported inflation permanently

solution – introduce capital control – keep the local currency for a period of time

**Evaluation**

* Ineffective if the interest elasticity of capital/investment (MEC/MEI) is highly inelastic. E.g. due to positive business expectations (Investors are still willing to ↑ despite high cost of financing.)
* Effectiveness is reduced if the MPW in the country is high and k is small
* Unrestricted movement of short term capital (hot money) will reduce effectiveness- Appreciation of local $ will be dampened by profit-taking→ Appreciation is for very short period (speculator will sell local $ →↑ SS of local $ → exchange rate depreciates immediately

∴ Exchange rate MP is usually introduced along with capital control

* Higher interest rates may be politically unpopular as it increases cost of servicing mortgages on residential and industrial properties.

 (only countries like Vietnam, Indonesian, Malaysia)

Why MP is ineffective in Singapore?

- Singapore is an interest-rate taker in the international financial market

- lack of control of MS - liberalization of banking sector – commercial banks like DBS set their own interest rate

- MEI is interest-inelastic -small k

-Govt focuses on the control of exchange rate rather than interest rate – need to stabilize the exchange rate since external demand is 4.5 times of GDP

- Imported inflation is a significant source of inflation → use exchange rate management to control inflation

**2.3 Exchange Rate Policy**

**2.3.1 Strong Exchange Rate Policy** (Reduce imported inflation)

- Increase in exchange rate → imports cheaper in domestic currency → reduce imported inflation.

- This can be done through the manipulation of the FOREX market through direct buying of the local currency, implying an increase in demand for the currency which will appreciate the foreign value of the local currency

**Evaluation**

* Limit on how much exchange rate can be appreciated→ amount of forex available/extensive fluctuation in price of global resources
* Price of imported resources may rise excessively→ appreciation may be too extensive→ need to raise more forex but the country may have limited forex reserve (price of resources subjected to international market condition) SG is a price -taker in the international market)
* Resource owners may raise the price of resources as the value of US$ owned by the resource owners may be lowered, prompting them to raise the price of oil
* Exports would be more expensive in terms of foreign currency → fall in X, assuming Marshal-Lerner condition → unemployment in export industries (SR – Pedx + PEDm >1) appreciation – (decrease Pm - increase in import exp) > (increase in Px – decrease in export revenue - balance of trade deficit
* Government needs to set aside funds for intervention in forex market – Rise in opportunity cost – seen in terms of the usage of fund for other aspects of economic development.

Qn: Why Singapore government can maintain a strong exchange rate?

a. Pedx is price-inelasti→cAppreciation→↑Px in foreign value→↓Xd

-> TRx will still ↑ (Why Pedx is price-inelastic→Xd is high-value added – low degree of substitution) Pharmaceutical industries

b. Strong exchange rate→↓Pm→↓COP,↓Px/↓Xd→maintain export competitiveness

-> ↓Pm→↓COL→prevent wage increment→lower COP -> ↓Px

**2.3.2 Weak Exchange Rate Policy**

- (Increase employment and actual output) – SG – zero appreciation – allow it to stay strong without further rise (aim to curb imported inflation without further undermining export competitiveness)

- Fall in exchange rate → export becomes relatively cheaper in foreign value and imports relatively more expensive → rise in (X-M) assuming Marshal-Lerner condition is > 1 rise in AE, increases employment and growth. (export revenue increases)

- lower exchange rate – Px decreases – TRx increases as PEDx > 1

- This can be done through the manipulation of the FOREX market through direct selling of the local currency, implying an increase in supply for the currency which will depreciate the foreign value of the local currency

**Evaluation**

* Import prices would be higher in terms of domestic currency- imported inflation
* Government needs to set aside funds for intervention in forex market
* Exchange Rate Depreciation will not raise Xd or FDI if the world economy is in a recession as the fall in Xd/FDI is due to lower foreign NY

Price↓ in Xd will not raise Xd (e.g. sub-prime market crisis in 2009)

Qn: Why Singapore cannot conduct depreciation to solve the lack of XD/FDI?

a. Depreciation→↑Pm in local value →↑COL/↑COP→↓cost of competitiveness and increase the need to raise wages

b. Depreciation→↓real wage of foreign workers in terms of foreign value → will induce wage increment→↑COP

c. Depreciation may not ↑XD/↑FDI if the fall in XD/FDI is due to ↓NY of foreign nations

D. Need of a strong exchange rate to stabilize Singapore as a financial centre (must ensure foreigner savings, will be maintained in future value ) – encourage Singapore to become a wealth-management centre

**2.4 Supply-side policy**

- Through the implementation of the policies, the government can expand the availability of resources (supply of resources) and increase the utilization of resources (productivity of wage) thereby increasing the supply of the goods and services to raise actual and potential growth without incurring rising cost condition.

- It involves the implementation of policies to (1) increase the rate of utilization of resources so as to raise actual production capacity and (2) the expansion of the availability of resources to raise potential production capacity

- Expand the availability of resources – shift the LRAS to the right

- Lower the cost of production – raise SRAS and LRAS – shift to the right

**2.4.1 Manpower Development (Solve UN+)**

- raise the productivity of the workers with skills development through a constructive and efficient training system – overcome skill incompatibility and displacement of workers

- must be able to induce investment - creating new scope of production – SS – side policies must diversify the economy

**Evaluation**

* educational level of the workers must be at a certain level
* cost of training and availability of facilities and trainers
* difficulty in retaining training benefits

**2.4.2 Technological Development** – high valued production – accelerate economic growth – increase real GDP – higher tax revenue

- Raise the technological level of the economy through training and research and development (↑competitiveness – Raise EG) →will raise the efficiency of production

- Decrease cost of production but may create structural unemployment as technological advancement will contribute to skill incompatibly and displacement of workers due to greater use of machinery

**Evaluation**

* requires the facilities and pools of skilled labour
* problems of funding
* source of technological transfer – depends on the developed nations

**2.4.3 Capital accumulation**

- Creation of a financial centre for the creation of funding for investment (Raise EG) → cost of funds for I↓ (for low i/r)

**Evaluation**

* requires financial knowledge and expertise
* political stability

**2.4.4 Infrastructure Development**

- build up facilities to attract more investment and raise the productivity of the economy. This will lead the expansion of the PPC – widen the scope of economic growth

**Evaluation**

* source of funding - budget strain
* problem of white elephant and rise of corruption

**2.4.5 Significance of Supply-side Policy on Singapore**

- overcome the limited resource capacity due to small size of economy

- raise competitiveness by increasing productivity of the workers

- Use to contain LT issues→ E.g. Structural UN+/Sustainable EG (↑real GDP, suppress inflation)

- diversification of the economy to accommodate economic and systemic global changes

- reduce the vulnerability of the economy

- provide a greater variety of employment – high wage valued jobs with more labour intensive density

**2.4.6** **Disadvantages of Supply-side policies**

- Long time period – cannot contain short term issues

- Cost of financing – may raise public debt and budget strain

- Experience complexity in adjustment – change in legislation

- E.g. effectiveness greatly depends on the efficiency of public administration

- Cannot contain external impact directly -adjust current economic structure to accommodate long term growth

**3. Conflicting Aims**

**3.1 Conflict between inflation and unemployment (inflation vs growth)**

a. Explain the conflict using AD-AS

To curb unemployment, need to conduct expansionary demand management policy to increase AD, via multiplier will increase national income – production will increase – leading to higher demand for more labour and thus solve the unemployment level but such an expansionary policy will also raise the AD excessively, leading to increase in price level when the economy is operating under rising cost condition.

To curb inflation, need to conduct contractionary demand management policy to lower AD, via multiplier will decrease price level – but such a contractionary demand management policy will also lower the AD excessively, leading to decrease in national income and production which will lead to unemployment.

b. Relate to Singapore (assertion that these objectives cannot be achieved simultaneously is not relevant and why)

• Emphasis on expansion of production capacity, results in both AS and AD shifting outwards. Therefore employment is increased but there is low inflation. (to attain sustainable EG)

• CPF policy and strong Singapore dollar also keeps imported inflation rates low(provide funds for exchange rate management)

• Increase in employment may result in some mild inflation but it is an affordable trade off (Can provide more employment and loss in purchasing power can be compensated with subsidies.)

**3.2 Conflict between internal and external stability**

a. Explain the relationship

It is difficult for the economy to adjust the interest rate to achieve internal and external stability. Increase in interest rate will help to curb inflation but it will not solve balance of payment surplus as there will be increase in capital inflow, leading to further improvement in BOP. Decrease in interest rate will lead to reduction in unemployment as investment and consumption will increase which will contribute to rise in employment and national income but such a reduction in interest rate will lead to a fall in net capital flow and thus worsen the BOP deficit.

b. Relate to Singapore (assertion that these objectives cannot be achieved simultaneously is relevant for Singapore)

• Singapore will experience such situations as the economy relies extensively on the external demand for growth and its reliance on flow of capital as it is main financial centre which will be greatly influenced by the need to stabilize the exchange rate.

• Productivity increase, technology improvement, cost of cheap imported raw materials made possible by strong Singapore dollar and thus it is more likely to focus more on the need to stabilize the exchange rate (pre-requisite condition for the government to prevent the surface of economic problems like unemployment and to help to attain the main aim of economic growth)

(stable exchange rate – stable trading prices – promoting trading activities – increase prodn n N+)

**3.3 Conflict between economic growth and unemployme**nt

a. Explain jobless growth (high level of economic growth with low contribution to employment as the areas of growth confined to capital intensive industries)

b. Relate to Singapore (assertion that these objectives cannot be achieved simultaneously is relevant for Singapore in short run)

• Current unemployment is largely structural in nature

• Our emphasis on productivity is double-edged in effect – it will grow the economy but the economy is likely to lead to technological unemployment (less workers are needed and skill incompatibility will occur)

• The economy will constantly need to adjust the sectors of the economy to enhance its comparative advantage which will lead to sectoral unemployment as sunset and sunrise industries will occur

• Demand may come back but does not mean more workers are needed as worker does not have the skills to be employed (skill incompatibility and displacement of workers)

• Need to equip workers with new skills and also look for new demand which require the new skills

**4. "A RECESSION in the United States and Europe would badly hurt Asian economies, especially Singapore's, which still rely heavily on these two export markets for growth, according to economists."**

**Source: The Straits Times 23/01/2008**

**(a) Explain the effects of the US slowdown on the Singapore economy. [12]**

**(b) Assess the effectiveness of the current policies adopted by the Singapore government to improve the economic performance in this current downturn. [13]**

(a)

**Introduction:**

Define US slowdown: Recession or Falling economic growth rates.

Effects on the economy: Economic Growth, unemployment rate, inflation rate and balance of payments

**Body:**

Explain the effects on US slowdown in Singapore

- Recession in US - Falling national income - Falling incomes

- This will cause a fall in the demand for Singapore's exports - "rely heavily on these export markets for growth" - Link to factor affecting exports.

- This will also cause a fall m investments and FDI into the countries due a fall in export growth and weak business sentiments (link to factors affecting investments)

Fall in the demand for exports and investments will cause a fall in net exports and I – Fall in AD



Effects on the economy

- Economic Growth: Fall in AD will lead to a more than proportionate fall in NY through the reverse multiplier process as the reduction in aggregate demand leads to a fall m national income, and the fall in national income causes a further fall in aggregate demand.

- Unemployment: unemployment rate will increase as production falls and labour is a derived demand.

- Inflation: inflation rate will fall as the economy moves away from full employment level of national income - spare capacity in the economy.

- Balance of payments: Balance of trade will worsen as exports fall. Imports may also fall but the extent of fall will not be large.

- Exchange Rate: S$ will depreciate against other currencies as the demand of S$ falls.

**Conclusion**

Singapore will be negatively affected by the US slowdown. The extent of the detrimental effects will depend on the degree of the openness of the economy and reliance of US economy on the performance on the economy. Singapore will be adversely affected given the large export sector and US as a major trading partner

(b)

**Introduction**

Context: current downturn brought about by the global financial crisis.

Macroeconomic Problems: Negative Economic Growth and High unemployment

Identify the current policies adopted by the Singapore government demand side policies-expansionary fiscal policy, supply side policies

**Body**

1) Explain the workings of the policies used by the government:

Expansionary Fiscal Policy: government set a budget deficit through increasing G and reducing corporate taxes (taking effect only next year).

- Context: Government increased development expenditure (infrastructure - roads and

railwork; hospitals construction) and operating expenditure (education and security), special transfers (job credits scheme, loan programmes for businesses). Government reduced corporate taxes and give income tax rebates.

- Supply side implication - reduction of COP (through the Job credits scheme), building of infrastructure and investing in education and R&D increases the productive capacity of the economy.

- Expansionary FP and SS-side policies will lead to a more than proportionate increase in national income, prevent further job losses. (rise in Ad and AS )

- Illustrate the effects diagrammatically.

- Effective: short implementation lags, mat lead to redundancy in the development of public facilities, no trade-offs on long term objectives, no crowding out effect.

2) Exchange Rate Policy: Zero-appreciation policy stance (compared to previous gradual appreciating stance before the recession) – prevent the exchange rate from rising excessively to hurt export demand – (the condition of low export demand exists

- Explain the workings of Exchange rate policy: allow for depredation of S$ due to the fall in DD for SS.

- Depreciation of ER will cause prices of exports (in terms of foreign currency) to fall (improve the competitiveness of exports) and prices of imports (in terms of domestic currency) to increase.

- Assuming the Marshall-Lerner condition holds (PEDx + PEDm >1), this will lead to an increase in net exports.

- This will help to dampen the fall in net export brought about current downturn.

2) Explain the limitations of the current policies:

Fiscal Policy:

- Singapore has small multiplier and hence the impact of fiscal stimuli on the economy is small. (Evaluation: spending is targeted 4 will increase size of k)

- Fall in corporate taxes may not be effective as during recession due to pessimistic business sentiments and firms will not invest even if there is a fall in corporate tax. - Large export sector; increase in G will not be able to offset fall in X completely, (unless the world economy recovers, the increase in G is not sustainable)

- Burden on government budget (evaluate: measures are temporary and Singapore has sufficient reserves)

- Sustainability of the policies: will world economy recover soon?

Exchange Rate Policy:

- The policy is limited as the recession is caused by a global recession and not due to a fall in the country's competitiveness.

- Also, the policy will not be sustainable over time as Singapore is dependent on imported factor inputs and/or final goods, if currency depreciates, it will lead to imported inflation and hinder economic growth.

**Conclusion**

The current policies used by the Singapore government to improve the economic performance is effective to the extent that it dampens the fall in national Income brought about by fall in exports and improves business expectations. This will reduce the extent of unemployment which could prevent the worsening of the current recession.

However, as the root cause of the recession in Singapore is due to external factors, unless the world economy recovers, there's a limit to what the government can do to improve the economic situation.

Although the current policies are unlikely to prevent a recession, it does mitigate the impact and avert an even sharper downturn.

**5. (a) Explain the supply-side and trade policies the Singapore government could adopt to improve global competitiveness. [10]**

**(b) Discuss how pursuing global competitiveness could lead to conflicts in achieving Singapore’s economic goals. [15]**

(a)

**Introduction**

Define Global competitiveness: The development of comparative advantage or competitive advantage in terms of relatively lower cost/price of exports and better quality in order to reap more profits via expansion of global market share

**Main Body**

(A) Supply Side Policies

1. the shift to indirect tax & reduction of income and corporate tax

Increase in SS of labour & Investment to increase the productive capacity of the economy. Effects will be a fall in cost of production, making our exports more prices competitive. Firms will, have more after tax profits which enable them to invest in R&D, resulting in dynamic efficiency.

=> improve quality of exports of goods & services or reduce cost of production (with better technology)

2. have a strong Intellectual Property Right Law/ environment

This will attract skills & capital intensive FDI to Singapore to carry out R&D, since innovative products & ideas can be patented & protected.

=> Such innovative products goods/services/design/ideas can help Singapore to develop new comparative advantage as old ones (e.g. labour intensive) are competed away.

Singapore may also benefit from increased FDI inflows from non-members like U.S & EU, esp. in high- tech capital goods for which China currently does not have a CA. These countries may prefer to take advantage of Singapore's tariff-free access to the Chinese market instead of locating their plants in China for reasons such as China's weak IP laws, poor infrastructure & lack of skilled labour, as well the desire to diversify their risks. This will lead to transfers of technology and improvement in efficiency in Singapore, these will encourage potential growth.

3. Education & training: Subsidize education & skills upgrading/training/re-training for those who are structurally unemployed

Singapore is constantly restructuring her education system to be align to global demand e.g. new courses such as Information Technology, Future Schools, School of the Arts (SOTA) etc that specialize in niche areas are springing up to groom students to ride on their talents/giftedness/abilities/inclinations in certain line of specialist track in order to be able to compete globally in whatever field they may have chosen.

As technological cycle/wave is getting shorter, comparative advantage will be lost when demand changes as new innovative products are introduced frequently. Singapore government has been subsidizing workers who are retrenched & structurally unemployed so that they can fit into the vacancies in sunrise industries.

Government's SPUR Program in providing training & re-training enable workers that were retrenched from declining industries to be more occupational mobile in seeking employment in alternative line of production. By equipping workers in relevant skills needed in sunrise industries, will prepare the workforce to better fit into new job opportunities e.g. in the IRs, education, health, entertainment industries when the global economy recovers. => Hence improving global competitiveness in the exports of such services & goods.

4. Immigration policy - openness to foreign talent

This will supplement our limited pool of aging population in terms of both skilled & unskilled labour.

FDIs e.g. in the Media & Entertainment Industry e.g. Lucas Films, wiil not be attracted to invest in Singapore without a critical mass of labour with relevant skills available.

America is able to continuously re-invent itself & be a leader in cutting edge technology & innovation only because it has a "melting pot" culture where foreign talents are welcomed. Moreover, it is generous in offering scholarships to the bright & talented international students in its tertiary institutions such as Harvard, Princeton etc

Singapore is similarly generous in allocating adequate places in her Universities to foreign students.

Such attraction & inflow of global "brains & talents" to Singapore will help build up her comparative advantages in various fields

Openness to Unskilled labour e.g. domestic maids & construction workers will help to lower wage rate of blue collar workers as well as supplement shortages in manual workers (many Singaporeans shun, such jobs due to its low status & wage rates).

Labour & Talent Flows: help to reduce cost of production in Singapore

Outsourcing & Offshoring to lower cost countries

There are no restrictions to outflow of private & public investment overseas in search of countries with cheaper cost of production.

Globalization: To remain competitive: need to cut cost & improve quality. Hence, S'pore firms need to source for the cheapest cost of production: outsourcing & offshoring to lower cost countries

Greater Competition: Possible erosion of monopoly power in the domestic market. This promotes efficiency among the producers and prevents exploitation of consumers.

Public Investment - Building an external wing by outward investment

To compensate the lack of land and resources, government has invested our reserves in overseas projects e.g. joint-venture with China in planning & building the Suzhou Industrial & Residential Park (Suzhou-Project). This will sharpen our global competitiveness in exporting our expertise in Town

Planning & Building services (where we have a CA) & working on the relatively cheap & abundant natural resources of developing countries (where we do not have a CA).

The above policy will be more viable as there is a saturation of construction activities domestically due to our small land area.

(B) Trade Policy:

FTA

With preferential treatment from FTA: Reduce Tariff & non-tariff measures on Singapore's exports.

FTA will make foreign markets more accessible to domestic producers - helps to diversify our export markets (Trade Creation)

Improve global competitiveness as price of exports will be more competitive since no tariff is imposed.

Maintaining export competitiveness using exchange rate policy

Most countries would resort to depreciation in exchange rate to make their exports more prices competitive. However, due to the high import content of our exports, Singapore has been adopting a policy of gradual appreciation. To maintain the global competitiveness of our exports in the present recession, when most of her major trading partners' exchange rates are depreciating, Singapore has adopted a zero appreciation policy in order to avoid having our exports to be relatively too expensive in terms of foreign currencies.

Through the trade channel when one country devalues/depreciates currency in response to domestic shocks, it affects the economic fundamentals of other countries through terms of trade and income effects. It will affect the relative prices of goods and resources in different countries. The country with the devalued/depreciated currency will build up export price competitiveness in the same global export market.

6. TMJC 2019 H1 Econs Prelim Question 2

**What happened in the Eurozone and Singapore?**

**Extract 5: Eurozone grows at fastest pace for 10 years**

The Eurozone grew by 2.5 per cent in 2017, the fastest growth rate since a 3 per cent rise in 2007. Investec economist Ryan Djajasaputra said much of the growth had been driven by the Eurozone's core four economies: Germany, France, Italy and Spain. He attributed the strength of the Eurozone to the European Central Bank's (ECB) stimulus policies. The quantitative easing (QE) programme cut interest rates in the Eurozone to zero by expanding its money printing programme to revive the economy and fend off deflation. Also, he said confidence had been hitting record levels since the crisis years in the Eurozone and unemployment was down to pre-crisis levels.

Sarah Hewin, chief economist at Standard Chartered, said: "Activity is being supported by strong global growth, which is helping European exporters. In terms of domestic factors, rising wages, low inflation and record-level employment are driving consumer spending; meanwhile, investment is rising, helped by strong profitability and buoyant confidence." However, while she expected Eurozone economic growth to stay strong, “higher energy prices and a stronger euro may be headwinds to growth this year”.

*Source: www.bbc.com, 14 February 2018*

**Extract 6: Eurozone unemployment rate falls but youth unemployment rate remains high in some member countries**

The unemployment rate in the Eurozone has fallen to its lowest since February 2009. Last month, Greece has the highest rate of unemployment in the Eurozone at 21.7 per cent, and also the highest rate of youth unemployment at 45.5 per cent. The second highest unemployment rate was 17.1 per cent in Spain, which was down from 19.9 per cent a year earlier. Spain also had the second highest level of youth unemployment among 15-24 year olds at 39.2 per cent. Across the region, youth unemployment rates are higher for those who have less education. “The longer that somebody is unemployed, the more likely they are to become discouraged, miss out on opportunities to develop skills and drop out of the labour force,” said Jessica Hinds, European economist at Capital Economics.

*Sources: www.bbc.com, 31 July 2017, and Business Insider Singapore, 9 November 2017*

**Extract 7: European labour market reforms: A two-handed approach**

In 1985, European unemployment was double-digit, youth unemployment was high in many countries, and long-term unemployment was increasing. At that time, a group of distinguished economists advocated that policies to lower unemployment must be two-handed – they “must act on supply (on structure) at least as much as on demand; otherwise, gains will be temporary at best and may in fact worsen structural problems”.

Thirty years later, aggregate unemployment remains high (though lower than two years ago). Youth unemployment and long-term unemployment are alarmingly high in some countries. Is it time to revive the two-handed approach? And will it work in a world of economic and monetary union and greater global capital and labour integration?

*Source: Centre for Economic Policy Research, 5 December 2016*

**Extract 8: Technological disruption may push up unemployment rate**

Singapore's labour market faces challenging times ahead, and not just because of the slowing economy. The lacklustre sentiment has stunted job creation and prompted a wave of layoffs in the hardest-hit sectors. Also, the Monetary Authority of Singapore (MAS) said skills mismatches in the labour market are rising due to the unrelenting technological changes that leave old skills outmoded. The Singapore economy is increasingly moving towards higher value-added, niche sectors – such as medical technology and data analytics – in a bid to maintain its competitive edge. These provide good jobs, but require specialised skills that most retrenched PMETs (professional, managers, executives and technicians) do not have and may take a while to acquire.

More than just a loss of financial security, retrenchment can have a knock-on effect on mental health and well-being too. Middle-aged to older adults tend to be more susceptible to job-related anxiety as they worry that it is too late to start over or re-train themselves. To adapt, workers can keep a lookout for opportunities to deepen and extend their own skills, said SIM University economist Walter Theseira. “It is going to be very hard for the Government or employers to force workers down a particular skills pathway, because everyone has different abilities.” He also suggested that policymakers aim to ease this "adjustment burden" to the firms by subsidising wage costs.

*Source: The Straits Times, 28 October 2016*

**Extract 9: Singapore well-placed to weather uncertainties but government ready to step up support**

With a strong fiscal position and restructuring of the economy, Singapore is well-placed in the weakened global economy, said Trade and Industry Minister Chan Chun Sing. Nevertheless, the Government is closely monitoring all economic developments and stands ready to step up support for companies here, he said. Noting that the global economy has weakened, the minister pointed to the US-China trade dispute and Brexit as key uncertainties. Singapore’s open and trade-reliant economy logged its slowest growth in nearly a decade during the first quarter.

Given the external challenges, MAS said the Singapore economy will turn towards domestic drivers for growth such as higher government spending on research and technology. The country must constantly refresh its offerings to businesses and investors so as to seize new opportunities such as additive manufacturing which is being created in the field of advanced manufacturing. In addition, the Government tries to provide a skilled workforce that continues to take up training. As digital trade is also a key driver of Singapore’s future economic growth, Mr Chan said Singapore will keep advocating for an integrated and global digital economy by co-developing international trade rules in this area.

*Source: www.channelnewsasia.com, 8 July 2019*

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| Discuss the extent to which a government from the Eurozone should adopt the policies implemented by the Singapore government to achieve both economic growth and a low rate of unemployment. [12]  |

**Answers**

**Problems encountered by the Eurozone e.g. Greece and Spain:**

-sustained EG but expected to slow down due to “higher energy prices and a stronger euro” (Extract 5)

- high rate of unemployment (structural unemployment), especially youth unemployment

**Policies implemented by the SG govt (Extract 9):**

- SS-side policy (interventionist) → retraining: “provide a skilled workforce that continues to take up training”

-DD-mgmt policy (fiscal policy) → “higher government spending on research and technology”

- Trade policy → FTA: “integrated and global digital economy by co-developing international trade rules …” [Free Trade Agreements help to promote sales of exports in foreign countries hence X ↑ → AD ↑ → … (adjustment process) → real o/p ↑ → actual growth + ↓ demand-deficient unemployment]

**Explain how any 2 adopted policies work + strength(s) & limitation(s) (contextualised to the Eurozone) → must link to both EG (AG + PG) and/or unN+**

- **SS-side policy (interventionist) → retraining: “provide a skilled workforce that continues to take up training”**

What is it:

- Govt can provide subsidies for education and training. Education and training aim at increasing labour mobility and labour productivity.

How it works:

- With retraining, labour productivity increases, allowing workers to be more employable. Equipped with more relevant skills, this will help to reduce the mismatch of skills and thus, improve labour mobility across industries.

How well it works:

**Strength**

- able to deal with their structural unemployment + youth unemployment as it equips the youth with more skills to join the industries as the main cause of the high youth unemployment is due to lack of skills (Extract 5)



- Training increases the skills of labour, leading to increases in labour productivity. Workers will be able to produce more output per man hour. This increases individual market supply curves. If enough individual supply curves are impacted, total output that the economy can produce increases. Productive capacity of the economy increases. AS shifts right from AS1 to AS2, leading to potential economic growth.

- Assuming that there is a certain level of AD, real national output increases from OYf to OY1, resulting in actual economic growth.

- Able to boost both actual and potential growth by attracting more FDI

- May also help to achieve inclusive growth as the displaced workers now have the skilled to gain employment again.

**Limitation**

- Supply-side polices are costly, their outcomes seen only in long-term and often these outcomes are uncertain. Policies requiring education and training requires significant investments and have high opportunity cost. Since Greece and Spain were suffering from debt crisis, the government will not be able to finance the spending and if they do, they will need to divert spending from other developmental projects. Some other public amenities will have to be given up which may affect the standard of living of their people.

- Financing of the education and training subsidies might also require the government to raise taxes, which would result in unintended consequences. An increase in personal income tax would lead to lower disposable income and lower opportunity cost of leisure thereby creating a disincentive to work. Similarly, an increase in corporate tax could discourage investment as the after-tax profits would be lowered. All of these could lower the production capacity of the economy, thereby lowering national income and output, resulting in negative economic growth. As seen in Table 3, the Eurozone is already experiencing slowing growth so it might be possible that the growth might slow down even more if the govt finances it via raising taxes.

- It also takes time to improve literacy & numeracy skills, and to complete an apprentice or a degree! Hence, it will take several years before improvements in education and training result in higher labour productivity. In addition, the effectiveness of this measure is more uncertain. Thus this may not be an effective policy to deal with the pressing high youth unemployment in the short run and “very hard for the Government or employers to force workers down a particular skills pathway, because everyone has different abilities” [Extract 8] → workers may not be receptive to retraining

**DD-mgmt policy (fiscal policy) → “higher government spending on research and technology”**

What is it:

- Fiscal policy refers to the use of government spending and taxation to achieve the macroeconomic policy objectives such as high and sustained economic growth, low and stable inflation, full employment and a healthy balance of payments.

How it works:

- Expansionary fiscal policy may be employed to reduce demand deficient unemployment. This involves reducing taxation and/or increasing government expenditure.

- A rise in government spending on public projects like research and technology will raise AD directly via a rise in government expenditure.

- Hence, an expansionary fiscal policy raises AD via the increases in G. This increase in AD, from AD1 to AD2 as depicted in diagram 1a promotes actual economic growth via the multiplier process. Real national output increases from Y1 to Yf.

- Potential growth may also be realised in the long run as there is an increase in AS due to the improvement in quality of factors of production when there is innovation via R&D.



- Diagram 1b depicts demand deficient unemployment in an economy represented by the horizontal distance of LDLs due to sticky wages at W1. When the real output rises, firms produce more goods and services. As such, they need to hire more factors of production like labour to produce these goods and service. Since labour is a derived demand, the demand for labour rises. This is represented in diagram 1b by a rightward shift in aggregate demand for labour from ADL1 to ADL2 bringing about an increase in employment from Ld to Ls. Demand deficient unemployment is eliminated. Unemployment rate falls.



How well it works:

**Strength**

- Thus, expansionary fiscal policy shifts AD to the right, promoting actual economic growth. There is an inverse relationship between changes in real national output and unemployment rate. Increases in real output leads to falls in unemployment rate.

- Hence, expansionary fiscal policy reduces demand-deficient unemployment.

- Able to boost both actual and potential growth by attracting more FDI.

- If the R&D is in terms of green technology, it may help to achieve sustainable growth as the increase in output will not cause as much harm to the environment via lower emissions of pollutants or greenhouse gases. There may also be improved methods of production that make use of lesser raw materials thus leading to a slower rate of depletion of resources, allowing a more sustainable rate of growth.

**Limitation**

- If AD increases too fast such that AD is persistently greater than AS, demand-pull inflation will result. Demand–pull inflation is defined as a situation where AD is persistently greater than AS, close to or at full employment of all resources. The excess demand cannot be met because existing resources are fully or almost fully employed. This will bid up prices of real output, causing demand–pull inflation. This may be worrying for Eurozone as the inflation rate was already on the rise [Table 3].

- Another unintended consequence of using fiscal policy is the crowding out effect. If the increase in government spending is financed by borrowing, it will be competing with the private sector for funds. This increase in demand for funds creates an upward pressure on interest rate which rises. Higher interest means higher cost of borrowing, discouraging firms from investing (reducing I) and individuals from buying on credit (reducing C). Thus, we say government expenditure crowds out private expenditure. In the extreme case, the fall in consumption and investment may completely offset the rise in government expenditure, with the result that AD does not rise at all. Hence, government’s attempt to tackle negative growth may be rendered ineffective.

- If government increases spending and reduces tax rates, in an attempt to promote economic growth through increasing AD, there is a risk of government running into budget deficit. A budget deficit in any one year is where government’s expenditure (including benefits) exceeds its revenue from taxation. If the government runs persistent deficits over many years, these debts will accumulate. In order to finance these debts, government may resort to borrowing, which may further enlarge its national debt to service. The government may also need to increase the tax rate in future, which may result in the unintended consequences of disincentive effects on work. Thus, labour productivity rate may fall in the future and hinder potential growth. Too huge a government debt weakens investor confidence which may lead to capital flight. It also reduces credit rating of the country making it more difficult & expensive (may have to pay higher interest rates) for a country to borrow money to finance its expenditure. This slows down the progress of the economy.

**Evaluative conclusion: (Similarity to characteristics + Nature of issue)**

What policies a country should implement or adopt depends on the nature of the economy and the economic situation of the economy. Although the Eurozone may find that adopting the policies may help in their youth unemployment problem and in boosting growth, the policy decision to increase G might be constrained by a government’s fiscal position. The Eurozone is suffering from a slightly higher budget deficit as compared to SG (except for 2018) → some member states also suffering from budget deficit hence may not have sufficient funds to provide retraining or spend on research and technology which may worsen their budget deficit → may cause consumers and investors to lose confidence in the economy which they have managed to build up over time.

However, Extract 5 mentioned “confidence had been hitting record levels since the crisis years in the Eurozone and unemployment was down to pre-crisis levels” hence this shows that although the countries in Eurozone might have problem adopting the policies due to limited budget, the situation is improving hence the scale of implementation of the policies may not need to be so big. Hence the countries in Eurozone may still adopt the policies but to a limited extent, depending on the amount of funds they can afford to spend. They should be adapting where appropriate.