**Content Teaching – Inflation**

**1. Meaning of Macroeconomic aims**

### Economic Growth

* + - Economic growth refers to the growth of the actual or potential production capacity.

### Full Employment

* + - Full employment would refer to the full utilization of resources for the production capacity which is measured in term of employment rate.

### Price Stability

* + - Price stability is measured by the consumer price index which will indicate whether there is inflation or deflation.
		- With price stability, the economy is able to maintain the cost of living and cost of production and thus avoid the detrimental impact of deflation and inflation

### BOP Equilibrium

* + - At BOP equilibrium, there is no excessive deficit and surplus of the balance of payment and trade which will affect the flow of the currency and thus affect the exchange rate.

### Equal Income Distribution

* + - Income distribution is measured by the Gini coefficient and Wage to GDP ratio.
		- The lower the Gini co-efficient and higher wage to GDP ratio, the less income disparity.

### Jobless Growth

* + - Situation where there is economic growth without the increasing labour to increase production
		- This can happen with the improvement of technology and factors of production.

**Inclusive growth** – sustainable economic growth with dimensional distribution of economic gain to diverse income group.

Have greater economic prosperity and share the economic prosperity with the population.

* 1) sustainable economic growth / 2) equal distribution of income and wealth to distribute economic benefits to the population

**Scope of Discussion**

ο 4 Aims

ο Definition

ο How it is measured

ο Characteristics

* **Explain the aims of government (definition and main features)**

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.

**Question 1**

**What are the internal and external factors that contribute to inflation? [10]**

Introduction

 Inflation is the sustained increase in general price level. There are two primary causes of inflation: cost-push inflation and demand-pull inflation. Demand-pull inflation occurs as a result of the rise in aggregate demand, leading to an excess demand condition and a rise in general price level, only when the economy is experiencing rising cost condition or full employment condition. Cost-push inflation is caused by a rise in cost of production, which can be due to an increase in unit labour cost or an increase in cost of raw materials. The increase in cost of production will lead to a reduction in aggregate supply, contributing to a shortage leading to increase in general price level.

Main Body



 As seen from Diagram 1, the rise in AD from AD₀ to AD₃ will lead to inflation (rise in price level) when the economy is experiencing rising cost condition from Y₁ to Y₂ or it is at full employment at Y₂=YF.

 

 As seen from Diagram 2, the rise in cost of production will lead to a fall in aggregate supply from AS0 to AS1 which will create an excess demand condition at P0 which will prompt the rise in price from P0 to P1.

 There are internal factors that contribute to cost-push inflation. Wage-cost inflation happens when powerful union demands for higher wages but is not matched by a corresponding higher increase in productivity. It leads to higher prices and inflationary pressures. Higher prices then lead the unions to again demand higher wages, and this spiral continues.

 A rigid structure is another internal factor that leads to cost-push inflation. It restrains the mobility of resources causing shortage and rising cost conditions. The increase in cost of production may be passed onto the consumers as an increase in price level. Structural rigidities are the result of the change in the nature of the economy when it experiences a change in the production method or focus of the industries. Shortage of workers will increase as there are not enough workers to fulfil the demand of the industries as workers lack the skills. Shortage of resources can also occur when the economy fails to provide the industries the necessary infrastructures to enable the transport of resources for production. Thus, cost of production increases, leading to inflation.

Besides structural rigidities and wage cost inflation, asset-based inflation is another source of internal inflation. Asset-based inflation is caused by the rise in the price of assets and luxury goods as it will cause the individuals to raise the price of their factor services as they peg their factor cost to the price of the luxury goods. This will lead to the rise in the price of asset and raise the value of mortgage and cost of payment, inducing a rise in rental cost. Thus, cost of production will increase and there will be a reduction in aggregate supply, contributing to inflation.

 As for demand-pull inflation, the internal factor of inflation is due to the increase in consumption, investment and government expenditure will lead to an increase in AD. This will lead to an excess demand condition and a rise in price level only when the economy is experiencing a rising cost condition or full employment.

 Not only that, there are also external factors that lead to inflation. The rise in global price of certain essential goods or global boom will cause the price of imports to rise which will lead to a rise in cost of living and cost of production, contributing to cost-push inflation. This is a dominant source of inflation for countries with few natural endowments and thus, relies heavily on the imports of materials for production and consumption.

 When there is an increase in export demand, this will generate more revenue for the country. This will then lead to an increase in AD, causing demand-pull inflation. There will also be an increase in AD when there is an inflow of foreign direct investment (FDI) thus increasing investment. AD increases and there will be demand-pull inflation.

 External influences such as the excessive rise in inflow of hot money will contribute indirectly to the internal cause of inflation like asset-based inflation. Excessive inflow of hot money will contribute to excessive liquidity in the local money market which will lower cost of borrowing and thus, encourages speculation in property market will cause asset-based inflation which will spiral into inflationary condition.

Conclusion

 In conclusion, inflation is caused by internal and external factors. However the primary causes of inflation are demand-pull inflation and cost-push inflation that will contribute to inflationary condition.

**Question 2**

 **"In 2004, higher global oil prices pushed up inflation in developed countries, which should result in a moderation of economic growth in 2005,"**

 **(a) Explain the possible impact of rising global oil prices on the Singapore economy. [10]**

Singapore being a small, open and oil-import reliant economy, will be affected both internally and externally due to rising global oil prices.

**Internal impact:**

**On prices and employment**

As crude oil is an essential resource for many industries and products, for example transportation, utilities, petrochemicals and plastic products, higher global oil prices will eventually raise overall costs of production. This will lead to cost push inflation shifting aggregate supply to the left leading to an increase in the general price level and a fall in employment as firms lay off workers or may even shut-down. Unemployment will increase (with reference to the diagram from Y1 to Y3).

**Diagram**

In the case of Singapore, rising global oil prices has a significant impact on our economy due to our being an oil refinery centre. The higher cost of oil would imply higher cost of production which affects the revenue earned. On the other hand, as she has the comparative advantage and economies of scale in refining oil, she benefited from selling refined oil overseas. This in turn benefited her in terms of higher revenue.

On economic growth and equity

Besides AS, surging oil prices may also affect the various components of aggregate demand.

Consumption falls as consumers are cautious about economic outlook and increase precautionary savings. Investment falls as with lower expected profitability from higher oil prices, firms invest less. Economic growth will fall due to falls in aggregate demand and supply.

Surging oil prices leads to increases in prices and unemployment which may widen income disparity between low income earners and high income earners and hence reduce equity.

External impact

The most significant concern of higher oil prices for Singapore is its implications for global economic growth. The Singapore economy is highly dependent on external demand, which contributed an average about 80% of total demand growth. Lower growth of the economies of its major export markets could lead to weaker demand for Singapore's exports and lower its real GDP growth.

The volume of oil exports from Singapore, a major oil refining centre, would be especially affected. The higher cost of oil could encourage consumers to cut their direct usage of the commodity as well as reduce demand for goods and services that are energy intensive. Substitution to alternative sources of energy such as coal, natural gas or nuclear power could weaken oil demand.

The Impact on Singapore's non-oil domestic exports would be indirect but of greater importance, due to the heavy economic contribution of such exports. Higher oil prices effectively transfers income from oil-importing countries to oil-exporting countries. Consumers in the formed group are known to have significantly higher propensities to consume than those in the latter group. The effect of higher oil prices would, therefore, reduce global demand.

Singapore service exports is also hit as her major export markets such as developing Asian economies are adversely hit by higher oil prices due their higher dependence on imported oil as well as higher oil intensity of economic activities.

Hence in the short run, may go into a deficit current account is likely to deteriorate and if the oil price continues it

Together with a fall in inflow of investment, balance of payment may worsen and the Sing dollar depreciates. However this is unlikely to happen in the initial years of oil price increase since the MAS has substantial foreign reserves to strengthen the Sing dollar. Also, as Singapore current account and balance of payment have posted strong surpluses for many years they are unlikely to go into a deficit at least in the initial years of oil price increases.

Overall in the long run, if the increase in oil prices continues, there will be increase pressure on the Sing dollar and the continued intervention of the MAS may lead to an eventual depletion of the country foreign reserves.

In conclusion, an increase in global oil prices brings about inflationary pressure not only in Singapore but also in developed countries such as\the United States. This may forced her to increase interest rates which may lead to an overall increase in interest rates worldwide and a fall in US demand for Asia's exports. Singapore's export would be hit as well.

**Question 3**

**April 2016 marked 18 consecutive months of negative inflation for Singapore arising from lower global crude oil prices and cheaper housing, utilities as well as transport costs. Faced with a challenging external environment, the Singapore economy will also see a slowdown of growth between 1% and 3% this year.**

 ***Source: Singapore Business Review 24 May 2016***

**(a) Explain the internal and external factors that are likely to have contributed to deflation in Singapore. [10]**

Introduction:

Deflation is a period of sustained and inordinate fall in the general price level of final goods and services in a country.

Direction: This essay aims to explain factors caused by domestic and international changes which lead to a persistent fall in GPL.

Body:

P1: External factors like lower global crude oil prices are likely to have caused a deflation in Singapore.

E1: Singapore has limited resources and thus, is very dependent on imported inputs such as oil to produce fuel and other related goods and services. A fall in global crude oil price means a lower price of imported oil in Singapore which lowers cost of producing final goods and services by large extent, assuming revenue remains unchanged, profits will be higher. Profit maximizing producers increase SRAS of final goods and services significantly. Huge surplus created will exert downward pressure on GPL causing deflation.

P2: Singapore’s deflation can also be caused by external factors like the challenges from the external environment.

E2: The challenges from the external environment can include economic slowdown of trade partners. When trade partners have a fall in real national income, their purchasing power falls. There will be a fall in demand for Singapore’s exports causing a fall in export revenue. As Singapore is trade reliant, export is a significant component of GDP. Any fall in export revenue, assuming import expenditure unchanged, there will be a large fall in (X-M). When (X-M) falls, AD will fall causing GPL to fall persistently resulting in deflation.

P3: Internal factors like cheaper housing, transport costs and utilities are also likely to cause deflation in Singapore.

E3: Cheaper housing, transport costs and utilities would mean that expenditure on these goods and fall since PED is less than one due to housing and utilities being necessities. When price falls, quantity demanded rises less than proportionately, ceteris paribus, leading to a fall in total expenditure. As housing, transport costs and utilities in total take up a relatively large proportion of household’s income, it is significant enough to cause a fall in consumption expenditure in the country. When C falls, AD falls as C is a component of AD. Surplus created exerts downward pressure on GPL causing persistent fall in GPL which caused deflation in Singapore.

Conclusion:

It is worth noting that these factors are happening simultaneously which means that both fall in AD and rise in SRAS reinforce each other causing a large persistent fall in GPL. Given Singapore’s open nature and highly reliant on trade, it is more likely that external factors have a stronger influence in causing deflation in Singapore compared to internal factors.

**(b) Discuss whether fiscal policy is the most effective way to manage the Singapore economy when faced with deflation and slow economic growth. [15]**

Introduction:

Slow economic growth is a concern as a small rise in real national income may deter investors and households from spending which can in turn cause a fall in employment and economic growth eventually.

While deflation may seem desirable, severe deflation can create a contractionary effect on the economy as the households and investors hold back spending in anticipation of a future price fall and the rise in real debt may also deter borrowing causing further fall in spending leading to a fall in employment and economic growth.

Direction: This essay aims to explain how expansionary fiscal policy can help to raise general price level and real national output, taking into consideration the relative effectiveness, ability to tackle root cause of problems as well as sustainability in comparison with other policies.

Body:

P1: Expansionary fiscal policy can help to raise GPL and real national output when faced with deflation and slow economic growth.

E1: Expansionary fiscal policy involves deliberate increase in government expenditure and/or reduction in tax rate. When government increased spending on infrastructural facilities such as MRT Downtown Line, there will be a rise in AD leading to a rise in real national income. This rise in income will trigger a further rise in induced consumption causing a further rise in AD due to the effects of spending and re-spending causing multiple rise in real national output, boosting economic growth. When more resources are increasingly utilised due to greater production of goods and services, there will be a shortage of final goods and services exerting upward pressure on GPL leading to a rise in GPL, hence, reducing deflation.

Expansionary fiscal policy also involves cut in tax rate such as personal and corporate income tax. Reduction in personal income tax rate can increase the households’ disposable income which enables them to increase their consumption expenditure C. The cut in corporate income tax can raise firms’ after-tax profits allowing them to spend more on capital goods which increases investment expenditure I. This rise in AD due to rise in C and I will generate similar multiplied effects as explained earlier to boost real national output and GPL.

This policy is especially effective in tackling root cause when dealing with deflation problem brought about by fall in C and I.

P2: Given that Singapore has a small multiplier size, expansionary fiscal policy has limited effectiveness on boosting employment and economic growth.

E2: Singapore has small multiplier size due to her high dependency on imports and large savings which leads to large leakage. Being highly dependent on imported inputs to produce most of her final goods and services as she has limited resources, there is a large leakage of imports. Being small, the government has also mandated a compulsory saving scheme, Central Provident Fund, which is a social security system to get the citizens to set aside savings to be self-sufficient so that the country will not be overly reliant on the working population to fund them through tax. As such, for every additional income earned, a large proportion is leaked out, resulting in a small amount of income available to be re-spent to generate income and another round of spending. As such, the multiplier effect reaches an equilibrium quickly. This means the multiple rise in real national income is limited causing the expansionary fiscal policy to not be very effective in generating growth. In such a case, the government will combine expansionary fiscal policy with exchange rate policy to boost economic growth to a larger extent.

P3: Adopting a zero-appreciation exchange rate policy is another way to manage the economy during slow economic growth and deflation.

E3: In a zero-appreciation exchange rate policy which is equivalent to a depreciation, Singapore’s exports will be cheaper in foreign currency and imports will be more expensive in domestic currency. Assuming PEDx and PEDm is greater than 1 due to many close substitutes available, quantity demanded for exports will rise more than proportionately and quantity demanded for imports will fall more than proportionately. As such, there will be a rise in export revenue and a fall in import expenditure causing a rise in net export revenue (X-M). A rise in (X-M) will cause AD to rise and as explained earlier, it can boost both real national output and GPL managing both slow economic growth and deflation problem.

This is especially effective when dealing with deflation and slow growth problem stemming from challenging external environment which caused Singapore’s (X-M) to fall as it tackles the root cause of the problem.

Evaluation:

During a slow economic growth, it is quite likely that the Singapore government will face some budget constraint since there will be a decline in the rate of increase in tax revenue collected and a small fall in spending on welfare benefits. Should the government decide to borrow from the bank to finance its spending through expansionary fiscal policy, the demand for loanable funds will rise driving up interest rate. When interest rate on loans rise, cost of borrowing will also increase which will then deter investors and households from borrowing and spending on capital goods and big ticketing items respectively. The fall in investment I and consumption C expenditure will negate the effect of the rise in G. As a result, the rise in AD is a small extent causing small in real national output and general price level. In this context, due to crowding-out effect, expansionary fiscal policy is relatively less effective than zero-appreciation in managing the economy. This is especially so since Singapore being trade dependent has her (X-M) as a very significant component of GDP which means any rise in (X-M) due to zero-appreciation will lead to a larger rise in real national output and GPL, making it a more effective policy than expansionary fiscal policy.

Having said that, zero-appreciation is relatively less sustainable than expansionary fiscal policy for the same reason of Singapore being highly dependent on trade. As Singapore is highly dependent on imported inputs, a zero-appreciation will lead to a large rise in cost of production as the price of her imported inputs such as steel and oil rises in domestic currency. This will cause her SRAS to fall by a large extent which may accelerate the effects of rising GPL brought about by a rise in AD as the effects reinforce each other causing a large shortage. At the moment it is not such a serious concern as there is global fall in crude oil prices which means the fall in cost of production can negate this rise in cost to negate the impact of fall in SRAS. While a rise in GPL during deflation is required, the extent of the rise and the cause of the rise has to be monitored. A large rise in GPL which is a sign of high inflation is also not desirable for Singapore since she needs to keep her exports competitively priced to generate external demand and also keep her cost of production low to attract investors. In addition, a rise in GPL due to fall in SRAS is not desirable because at the same time, real national output falls reducing the purchasing power of the people to a large extent. As such, expansionary fiscal policy is more sustainable than zero-appreciation since rise in I can help to increase the productive capacity of the economy as quantity of resources rises. This leads to a rise in LRAS which will negate the rise in GPL due to rise in AD, keeping inflation under control.

P4: Singapore government also manages the economy through interventionist supply side policy to boost potential economic growth and manage deflation in the long run.

E4: Interventionist supply-side policies such as training and retraining is ideal during slow economic growth. The government sets up a Workforce Development Agency to roll out programmes such as Skills Redevelopment Programme and Skills Future to upgrade the skills of the people. During slow economic growth, there can be a cut down in production activities in some sectors and some workers may be left idle. During this period, government will encourage firms to send them for training courses to equip them with relevant skills for new job opportunities when the economy picks up. By enhancing their productivity as they become more proficient at their jobs, for example, being able to use technology to speed up the production process and hence increase output per unit time, the quality of resources increase. This leads to a higher productive capacity which can lead to a rise in LRAS. When this happens, full employment output level rises increasing the country’s potential economic growth. The rise in LRAS also can keep the inflation rate under control when AD rises.

Evaluation:

Expansionary fiscal policy is more effective than supply-side policies involving training/retraining as the latter has a time lag effect. It takes time for workers to pick up skills before they can apply them in their jobs. This is especially for Singapore which is currently facing ageing population issues and the large proportion of elderly in the workforce may tend to be relatively slower in their ability to pick up new skills. In contrast, spending on infrastructural facilities or reducing tax rate has a relatively more immediate effect in generating spending and boosting AD. In 2009, when the Singapore government embarked on expansionary fiscal policy, the real GDP growth rose by 14.7% in 2010. This means that expansionary fiscal policy can tackle the problems of slow economic growth and deflation more immediately.

Having said that, training is a more sustainable policy than expansionary fiscal policy as Singapore has a limited land space so there is only so much government can do in developing and re-developing its infrastructure and it cannot keep reducing tax rate as it will have an adverse consequence on its budget. Yet with ageing population, should the labour skills not match with the new job opportunities created, it may give rise to another set of economic problems such as inflation and structural unemployment.

In my opinion, expansionary fiscal policy is definitely the most effective way to boost real national output and GPL in the short run moderately but it cannot be used on its own as it has its limitations which can only be mitigated by the strengths of other policies. In Singapore’s context, while there is a need to manage deflation and slow growth, it is trickier to deal with deflation problems as Singapore cannot afford to have rising GPL to a large extent given her nature of high dependence on exports and investment. It is also important to consider the root cause of the slow economic growth and deflation problem before deciding on appropriate policies to manage the economy effectively.

**Essay Question 1**

**Discuss why governments are concerned to keep up the rate of inflation at a low level. (13)** *(What are the advantages of low rate inflation?)*

**Introduction**

 Inflation is a situation where there is a sustained and inordinate increase in the general price level when there is excess demand without or with an inadequate increase in supply. As the occurrence of high rate of inflation may bring about adverse effects on the economy but a mild rate of inflation may be beneficial to the economy, it is natural for the government to seek maintain the rate of inflation at a low rate.

**Main Body**

 One such benefit of low rate of inflation is the positive stimulation it has on the level of investment and employment. When price level increases at a low rate, it will mean an increase in the total revenue, provided that the demand for goods is; inelastic. This implies that profitability will increase and induce producers to produce more and hence, there will be an increase in investment and subsequently increase the level of employment.

 Low rate inflation will also help to prevent extensive unequal distribution of income since a large proportion of the population is fixed income earners. Fixed income earners will not be marginalized by the effects of excessive inflation and thus erode their purchasing in favour of those who are receiving their income pegged to price movement

 Low rate of inflation will also mean that the purchasing power of the people is maintained and this will also mean that their ability and willingness to save is maintained. Consequently, there will be a considerable level of saving, enabling the economy a constant source of fund for investment.

 Low rate of inflation can also help to prevent excessive rise in cost of livings enabling the workers to maintain their purchasing power and standard of living. The trade union will less likely to ask for excessive wage increase, which help to stabilize our cost of production.

 Without excessive price change, there will be lesser wastage of resources since speculative activities are minimized. Investors with source of fund will not direct their investment on goods with speculative appreciation but instead on goods with production activities that will enhance the economic development of the economy.

 Externally, a low rate of inflation is also beneficial, as it will help the country maintain its international competitiveness as an exporter and as a country for foreign investment. Lower rate price increase will mean that the cost of production can be maintained at considerable level, easily counteract by a rise in productivity. It will also mean the cost of business operation is kept low and competitive.

 Low rate of inflation will enable the nation to maintain its export price and hence ensure that export demand will grow. At the same time, import expenditure will not rise excessive since local goods are still reasonably low and attractive to the -consumers. This will mean that a deficit balance of trade will not surface.

 Without high rate of inflation, there will be no need of a corresponding contractionary monetary policy to curb inflation. This means that increase interest rate will not rise creating the influx of hot money and instability to the foreign exchange market. This will lead to excessive speculation dampening the economic development to the economy.

**Conclusion**

 In conclusion, the occurrence of high rate of inflation is not desirable and the government will seek to maintain the inflation at a low rate as It has certain beneficial effect of the economy.

**Essay Question 15**

**Singapore’s unemployment rates have been ranging from 3.4% to 2.1% while inflation rate was around 2.1% to 0.5% from 2004 to 2007. However, inflation rate shot up 7.5% while unemployment rate hovered at 2.3% for the first half of 2008.**

 **Singapore Department of Statistics**

**Explain why low unemployment and inflation rates are aims of any government and discuss whether the Singapore government should be concerned over the above-mentioned scenarios. [25]**

1. **Benefits of low inflation rate and low unemployment rate**
2. **The government should be concerned of the adverse effects of inflation and unemployment – how it will undermine Singapore’s economy**

Introduction Inflation is defined as the inordinate and sustained rise in price level while unemployment refers to the extent of utilization of labour resources in an economy. Any government would seek to maintain low inflation and unemployment as these aims promotes price stability and efficient utilization of labour resources which will create extensive beneficial impact for the economy. Thus, it is a concern for Singapore with regards the above condition, when they expect inflation and unemployment to rise in the first half of 2008.

Main Body

Inflation reflects the extent of price stability in an economy which is measured by the consumer price index on a year-on-year basis or base year comparison approach. It is important for the government to set it as the main aim as it will affect the internal and external aspects of the economy if price stability is not achieved where there will be low inflation or deflation.

Low inflation will ensure that the cost of living and cost of production is kept low. Internally, low inflation ensures cost of living is low to prevent unequal distribution of income as price increases for basic necessities will undermine the purchasing power of the lower income group while it raises the wealth of the rich when the price of assets appreciates. Low inflation can also help to maintain level of savings which is a critical source of funding for investment when the purchasing power and future value of money is maintained and thus, encourages the ability and willingness to save. Most importantly, low inflation will ensure that there will be improvement in standard of living, given that any percentage in GDP will be greater than percentage increase in price level, holding population growth constant, to induce a rise in Real GDP per capita.

Externally, low inflation is an important aim of the government as it maintains cost of production to ensure the country is able to develop competitiveness in the export market and in attracting Foreign Direct Investment (FDI). By keeping the cost of production low, the price of export in foreign value and the cost of FDI will be low to induce rise in export demand and FDI, critical to any economy that is export dependent. If the export demand and FDI have not been reduced, there will be no depreciation of the local currency which will affect the flow of fund into an economy that will affect the economy which has a financial centre for economic development.

As for low unemployment, this is measured by the unemployment rate which is the ratio of the number of unemployed to the total labour force which will determine the rate of utilization of labour resources in an economy. It is rational for government to set low unemployment as the main aims of the government since employment determines actual production capacity and low unemployment rate will mean high rate of production capacity that will raise the level of real output or national income. This will provide more tax revenue for the government to expand its expenditure to enhance economic development and improvement in well-being of the population. Furthermore, it will reduce the need of more government spending since there will be lesser unemployment benefits to be allocated if unemployment rate is low and such saving will reduce the opportunity cost of resources used to solve the adverse effects of unemployment which can be used for other aspects of a country’s development.

More direct implication of the need to see low unemployment rate as the main aim of the government since it has strong impact on the extent of unequal distribution of income and standard of living as those who are unemployed will have no income and will be undermined by a low purchasing power which will indicate a lower standard of living.

Thus, it can be noted why low inflation and unemployment are aims of the government and it is natural for the government of Singapore to place great concern over the above inflationary and unemployment condition.

Mathematically, the slight rise in unemployment rate is still considered low as it is slightly above the natural rate of unemployment of 2% for a small economy like Singapore and therefore, this is not a panic condition to worry. But if we examine closer, it can be noted that the unemployment condition is mainly in the form of structural unemployment and this form of unemployment is detrimental for Singapore since its effect is entrenched and prolonged. Workers who are unemployed due to skills incompatibility and displacement of workers due to use of machinery will take a long time period to retrain and adapt to the new industries. Very often, these workers may not be suitable for the new service-based industries if the workers have set skills for manufacturing-based type of industries. Thus, it may take a longer time and incur higher training cost for Singapore to eradicate the lack of skills for these workers to improve their employability.

In Singapore, the number of workers whose educational level is below ‘O’ level still occupies a high percentage of the working population and this may create a problem for the government in converting sufficient workers for high-valued industries and thus, the issue of structural unemployment is entrenched for some of the workers. In recent years, the government has seen a rise in the employment level of PMETs (Professionals, Managers, Engineers and Technicians) and the group of older PMETs is taking longer time period to find employment due to technological advancement that undermines the skill level of PMETs.

Furthermore, structural unemployment will aggravate the social life of the people, especially the lower income group. It will also mean that the government may need to spend more government subsidy in helping those who are unemployed and this may be difficult for the workers in Singapore as we do not have unemployment benefits for these unemployed workers. Consequently, the country will have a higher degree of unequal distribution of income and lower standard of living as a significant group of population is unemployed, thus, this will be a serious problem for Singapore, which has a high Gini-coefficient ratio. Also, the existing level of unequal distribution of income is quite high and may create social dissatisfaction, which explains why the government needs to ensure this form of structural unemployment will not prevail as it is a serious concern Singapore needs to pay attention to.

As for inflation, the sharp rise in inflation rate from a mild rate around 2% to 7.5% in the first half of 2008 is of great concern due to its magnitude of increase and the nature of inflation and its impact on Singapore’s economy. Inflation will be a serious concern as it affects the price and cost competitiveness in the export and our capacity to attract FDI. As our cost of production rises as the cost of import rises due to rise in global price of resources like oil and steel, we have to raise our price of export in foreign value which will lead to a fall in export demand. As export demand to GDP ratio is around 2.5 times of our GDP, Singapore’s reduction in export demand will contribute to a large fall in the GDP which subsequently leads to a reduction in production and employment.

As our economy is a price-taker in the global resource market, the rise in global prices of resource will definitely raise our cost of import, implying that such imported inflation is inevitable. Although some may argue that our exchange rate management policy is a gradual and modest appreciation strategy which can help to dampen the cost of imports, it is not a feasible measure in the long run when the owner of resources in the global market persists to raise price of their resources. Furthermore, the impact of rising inflation will affect the cost of living, making it difficult for industries to lessen excessive wage increment as real wage of local or foreign workers in Singapore will be lowered. This demand for wage increment will bring about a wage-price spiral which can be quite detrimental even for Singapore which is known for her capacity to control wage increment within the level of productivity.

Although the cost of managing inflationary impact is less than the cost of managing unemployment, the adverse impact it has on unequal distribution of income will still be a problem for Singapore as inflationary condition will seriously aggravate this problem since the price of assets will rise excessively to raise the wealth of the rich while the purchasing power of the low income group will be lowered. This high degree of income disparity will counter the aim of the government to set up an inclusive growth which will spread the benefit of economic growth to all spectrums of the people.

Conclusion

In view of all these development of higher unemployment and inflation rate, it can be understood that it is understandable and rational for governments like Singapore to place concern on these aims to prevent the detrimental effects.