Economics

**Essays – Economic Growth**

**Essay Question 1**

**Inclusive growth is economic growth that creates opportunity for all segments of the population and distributes the dividends of increased prosperity, both in monetary and non-monetary terms, fairly across society.**

**Source: http://www.oecd.org, accessed on 10 July 2016**

**(a) Explain why a government might aim to achieve inclusive growth. [10]**

Introduction

definition and meaning of inclusive growth – refers to a condition where the benefits of economic growth is well distributed and extended to all segments of the citizens in the country

manifestation of inclusive growth – sustainable growth and well-distributed growth to different segments of population / maximization of economic benefits

measures – policies and directives that can be used to achieve sustainable EG and eradicate disparity of income

**benefits of growth to be distributed to more segments of the citizens**

* **sustainable economic growth (consistent rise in real GDP)**
* **equal distribution of the gain from economic growth**

**why must have inclusive growth**

* **raise SOL for more people**
* **reduce the negative effects of unequal distribution of income**
* **induce a more permanent and large base of consumption – pivot to growth**
* **more saving to generate more funding for investment**

**why inclusive growth is beneficial to the economy?**

* **A larger consumer base – wealthier and in larger volume – create more economic activities in terms of higher consumption**
* **Higher value of national income – (higher economic growth) - higher tax revenue – higher consumption (GST)**
* **A measurement of the state of governance – higher standard of living**

**How do measure the degree of inclusive**

* **Degree of equal distribution of income and wealth – Gini co-efficient**
* **Full employment condition**
* **Higher economic growth – increase in GDP**
* **Price stability – stable price – sustain real purchasing power**
* **Exchange rate stability – BOP stability or surplus – lower price of imports – stabilize price level**

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**(b) Evaluate the measures adopted by the Singapore government to achieve inclusive growth. [15]**

Analysis of the question:

definition and meaning of inclusive growth – manifestation of inclusive growth – sustainable growth and well-distributed growth to different segments of population

measures – policies and directives that can be used to achieve sustainable EG and eradicate disparity of income

Introduction

To achieve inclusive growth, the Singapore government emphasize on improving the productive capacity of individuals and creating conducive environment for employment and on income redistribution as a means of increasing incomes for excluded groups.

Main Body

Measures to achieve inclusive growth include:

* Fiscal Policy
* SS-side policies
* Progressive Tax system with capacity to induce rise in disposable income

**Fiscal Policy to achieve economic growth and reduce income gap**

* ↑ in G → ↑ in AD assuming economy operating below full employment level, via muitiplier → ↑actual growth, reduces demand deficient unemployment.
* For example, $8 billion Pioneer Generation Package. It helps citizens aged 65 and above in 2014 meet their healthcare costs for life, with further subsidies on healthcare services and medicines → ↑ affordability of healthcare services for senior citizens, reduce the effects of income inequality.
* Wage Credit Scheme launched in 2013, which has seen more than $2.2 billion handed out to help local businesses subsidise wage increases for low-income workers. This helps to maintain employment and prevents the increase in income gap between low income workers and high-income workers.



* ↓corporate tax rates from 20% to 17% → ↑in after tax profits → ↑ investment local business and foreign firms → ↑AD shifting to the right from AD1 to AD2 → ↑actual growth from Y1 to Y2.
* ↑ in investment→ ↑productivity → ↑LRAS shift to the right from AS 1 to AS2 → ↑potential growth from Yf1 to Yf2.

 **Appropriateness:**

* In view of an ageing population in Singapore, direct income redistribution as a means of increasing incomes for this group is an immediate solution.
* As Singapore is a small and open economy that is vulnerable to external shock, the wage scheme credit that mitigates the negative impact of business cycles is essential to prevent deskilling. Deskilling would reduce productivity level making it more challenging to achieve inclusive growth. As such, the wage credit scheme is much needed as it creates an incentive to stay in the workforce as compared to unemployment benefits. – prevent unemployment and reduce income inequality
* Corporate tax rate is one of the most important factor in attracting FDI in Singapore. FDI makes up a large proportion of GDP in Singapore given the nature of the economy. The move to reduce corporate tax rate is effective in attract foreign firms to invest in Singapore.

**Limitations:**

* Size of multiplier is small. As MPM is large (import reliant) in Singapore, MPS is large due to high CPF savings. Large leakages in the circular flow of income will result in a small increase in real national income.
* Strained government budget. In the long run, the Singapore government might have to adopt “growth at all cost” instead of inclusive growth to generate tax revenue in order to sustain her fiscal position.
* Singapore’s corporate tax rates are competitive, therefore, further cuts would need to be compensated by an increase in GST which is regressive by nature. This will limit the scope for inclusive growth.

**Lower income group will be taxed more than higher income group (GST is regressive) – govt tries to switch to GST to raise tax base – more will be taxed**

**SS-side policies to enhance productivity for sustainable growth**

* Improvement in Infrastructure in Jurong Island, Biopolis → ↑external EOS→ ↑productivity
* The Productivity and Innovation Credit Scheme (PIC) scheme was introduced by the government to encourage productivity and innovation in Singapore. It creates the incentive to invest in areas to improve their productivity. Businesses enjoy 400% tax deductions/allowances if they qualify.
* The increase in investment → ↑ productivity → ↑AD and AS → ↑sustainable growth.

**Appropriateness:**

* PIC support local businesses which might not enjoy internal EOS due to the small domestic market and therefore, cannot compete with foreign firms in the global market.

**Limitations:**

* Expensive to fund and costly to monitor the appropriate use of the PIC.
* Higher global economic uncertainty, leaving little impetus for firms to invest in productivity-enhancing capital despite these SS side policies.

**SS-side policies to reduce income gap**

* Education subsidy making it affordable to low income family → ↑ labour productivity → ↑demand for labour → ↑wages → reduce income gap
* The Continuing Education and Training Masterplan, aims to ensure a competitive and career resilient workforce. It enables working adults, regardless of their starting qualifications, to continue to build and deepen their skills and competencies, throughout their careers.
* This reduces occupational immobility and helps workers to stay relevant in view of changing demands in the job markets.
* Allows workers in all sectors to remain relevant and generate stable incomes.
* Increases productivity growth which is essential for inclusive growth.

**Appropriateness**

* Singapore being a small economy, lack resources which results in a tight labour market. Hence, it is critical to increase productivity to match with the increase in wages.
* The openness of the Singapore economy allows free mobility of capital. This leads to increase in the pace and frequency of structural changes in the economy.
* Therefore, policies focusing on reducing occupational immobility is instrumental to achieve inclusive growth in Singapore as direct income distribution is not sustainable.

**Limitations:**

* Time lag between reforms and outcomes. For example, there is a time lag between the time when investments in education are made and the time when returns from improved labor skills are collected.

**Progressive Tax System**

Singapore’s personal income tax rates for resident taxpayers are progressive. This means higher income earners pay a proportionately higher tax, with the current highest personal income tax rate at 20%. Tax revenue generated are redistributed as subsidies to make healthcare, education and housing affordable to all. One limitation for a more progressive tax system is that it creates a disincentive to work and deter foreign talent, this might lower the quality of labour, reducing potential growth.

Other possible policies:

* Exchange rate policy
* Wage policy

Conclusion

Upon evaluation, government policies focusing on income redistribution to achieve inclusive growth is necessary in the short run but may not be sustainable, especially for a small and open economy like Singapore. As such, SS side policies that focus on productivity growth and productive employment will remain to be the most important approach to achieve inclusive growth in Singapore as it mitigates the negative impact of structural changes and her vulnerability to external shocks.