**Question 1**

**For the past few years, China has been experiencing rapid rise in consumption, investment, government expenditure and net export growth. Consequently, the country achieves higher national income and hence, it has achieved great economic improvement.**

**b) Comment on the relative importance of the various components of AD in enhancing economic growth. (15) (increase in real GDP)**

Part b)

Introduction

Aggregate demand components are crucial expenditures that will influence the economic activities in the economy and contribute to the rise in the national income via the multiplier process.

Main body

1. **Explain the roles of the AD components by showing how they affect the national income via the multiplier**

**Increase in the various component of AD – increase in the value of AD – vi multiplying process – increase in real GP**

**- explain the multiplier process**

**2) Explain the characteristics of the respective components and list their contributions to the economy (significance of the various components of AD)**

**Consumption (definition)**

Contribution

i) It is the fuel for the growth of production that will induce investment Consumer market is the basis for production – bigger consumer market – consumption -larger population

ii) It reflects the level of domestic expenditure - essential for economic growth when external demand is low

**Investment (definition**)

Contribution

- determines the production capacity – affect the production level – affect national income

- enables the economy to raise its technology through high value investment provides massive employment - if it is from manufacturing

- infrastructural development – raise the efficiency of the economy – raise the real GDP – higher EG

High valued FDI – raise the profit level – affect the value of the national income – more taxable for the government

investment will affect consumption – affect production and demand for workers – affect wage and affect disposable income – affect consumption

**Government expenditure**

Contribution

- takes care of the social needs

- an instrument to adjust the economic activities so to smoothen and correct the fluctuations in the economy

- provide the resource for the building of the infrastructure and facilities that support business operation - aiding the growth of investment (smoothen the production and distribution process – further promote economic growth

Export

Contribution

- provides the expenditure necessary for the growth of the economy especially for an economy that is small (significance is seen from export demand to GDP ratio)

- enables the firms to increase greater production to reap economies of scale – large external market will help to expand production

**Imports**

Contribution

- increases the availability of resources and capital equipment, raising potential economic growth – overcome the limitations of absence natural endowments

- imports of new products and services raising the standard of living and enhancing the economic development

- overcome the limitations of resources for production and help to attain sources of resources which is at lower cost. lower cost of imports – lower cost of production – lower price of export – raise competitiveness – raise export revenue – promoting EG

Conclusion

It is important to take note the various contributions of AD components as they not only contribute to the rise of national income but has other importance.

The degree of the significance of the AD components depend on the nature of the economy – like SG – small and open economy – import demand , export demand and foreign direct investment are important AD components

Describe the type of growth China is inclining towards – consumption-led growth – Why?

* Large population – larger amount of consumption
* Growing affluence
* Unequal distribution of income – not everyone can consume
* Low interest rate and availability of credit consumption
* Availability of welfare – reduce the need for saving – raise consumption

Analysis – why the consumption component will be more significant for China than other AD components?

* **Why other components have become less significant?**
* Government expenditure cannot be raised further – huge value of public debts, saturation of infrastructural development
* Export demand face rising new economic countries like Vietnam, trade protectionism
* FDI – lack of innovative and high-valued FDI to propel economic growth – need for 2025 made in China products
* **Why consumption becomes significant in influencing China’s economy?**
* Consumption are recurring expenditures – sustained aggregate demand – sustained production – sustained employment – promoting sustained economic growth
* High- valued consumption – promote high-valued growth – generate more taxes – goods and service tax
* Large population and affluent lifestyle, credit consumption

**Question 2**

**To help Singapore achieve sustainable economic growth, the government has been reducing income and corporate tax over the years. It also increased its reliance on indirect taxes – raising the rates of Goods and Service Tax (GST) from 5% to 7% in 2007.**

**Discuss whether the changing tax structure will improve current and future living standards in Singapore. (25)**

**direct tax – ability to pay , indirect tax – benefit of consumption**

**Introduction:**

•Definition of SOL (quantitative/qualitative)

•State that the changing tax structure advocates the emphasis of greater reliance on the use of indirect tax instead of direct tax to affect economic activities to achieve economic growth and thus, improves standard of living. However, there are certain limitations in this tax reform to achieve this aim

**Main Body:**

1) Explain how the changing tax structure will raise current and future SOL

**a. Show how reduction in direct tax will raise GDP (**personal income tax and corporate tax)

* decrease corporate tax – profit after tax increase – investment will increase
* decrease direct income tax – disposable income increase – raise consumption
* raise AD – increase real GDP via the multiplying effects. (multiplying effect para)
	+ - **In the multiplier process**, the initial increase in the aggregate expenditure expands the circular flow of income and then increasing the income of the factor earners which will further expand the circular flow of income with new consumption activities. As long as more consumption activities take place, the circular flow of income will continue to expand at the respective level of economic activities until the withdrawal effect is equal to the initial injections which will cease the expansion of the circular flow of income. Consequently, the national income will increase by several folds, depending on the value of the multiplier which is determined by the sum of the MPW (Marginal Propensity to withdraw - MPS + MPT +MPM)

**b. Show how ↑ in GDP will raise real per capita income, indicating on improvement in SOL**

* rise in real per capita - percentage increase in real GDP is greater than the rate of population growth and inflation rate
* real GDP per capita – higher purchasing power – higher level of material comfort – high level of SOL
* higher real GDP – more tax revenue – more to finance public expenditure – higher degree of welfare – more provision of public goods and merit goods
* higher real GDP – more production of goods and services – higher level of material comfort

**c. Show how the reduction in direct tax will encourage greater level of investment which will raise the production capacity for production in the future and how the rise in indirect tax will raise saving to raise SOL in the future**

-higher degree of infrastructural development – enhance mobility of resources – expand production capacity – potential growth – raise possibility of higher SOL in the future

higher indirect tax – less consumption – more saving – more fund for future investment – create growth in the future

2) Evaluate the extent of the capacity for changing tax structure to raise the current and future SOL

**a. Why the changing tax structure will not raise Real GDP extensively to raise SOL?**

investment fails to increase as the economy may be politically unstable or market demand is still weak – therefore lower level of investment will not raise real GDP extensively

small market demand is unable to induce large extent of increase in investment to raise AD which will not increase real GDP

small multiplying effects – increase in Ad will not lead to extensive increase in real GDP – (reasons why k is small) – high MPS and MPM

**b. State how increase in indirect tax will lower current SOL**

raise indirect tax like GST – decrease in disposable income – lower purchasing power – decrease consumption – lower level of material comfort and welfare

**c. Explain why increase in GDP may not lead to higher current and future SOL (Problem of time comparison)**

**fails to consider the qualitative aspect of SOL – requires economic indicators like human development Index and Measurement of economic welfare**

**lack of consideration of the distribution of income**

**the quality of goods and services**

**Conclusion:**

The changing tax structure is said to be *capable of* raising current and future SOL as it can help to promote sustainable economic growth to raise real GDP per capita. However, **there are limitations of tax structure in raising GDP in the short and long run and** **the value of real GDP capita as a mean to measure SOL is also limited in certain ways,** which will explain why it may not be conclusive to sate that current and future SOL will improve

1. **economic principles – how change in tax structure affects real GDP (how tax affects Ad via k to affect real GDP)**
2. **how increase in real GDP affects Sol**
3. **problems of time comparison**

**Essay Question 3**

**In 2019, robust global demand for Australian commodities will support the external sector. Fixed investment, especially non-mining business investment, is also expected to expand, albeit at a modest pace. Public infrastructure has also been planned.**

Explain how the above events would **affect Australia’s national income** and assess the effects on **Australia’s standard of living**. (25)

**Introduction**

* definition and concept of national income and standard of living
* **state** that the above changes will affect the aggregate demand components and thus **determine the value of national income and standard of living**

**Main body**

**1. Explain how the above changes affect the aggregate demand**

Export demand because Australia export mineral, investment also increases, government expenditure

From the above economic activities identified in Australia, the surge for the demand of commodities from Australia will induce an increase in the export demand while the investment in the businesses in these industries will contribute to rise in investment expenditure. To support the economic development, the government has engaged in infrastructural development to develop road network, transport facilities and other amenities to raise economic development. All in all, there will be an increase in aggregate demand which will contribute to rise in production that promotes rise in national income or real GDP which leads to actual economic growth via the multiplier process.

**2. Explain how the above changes affect the value of national income**

2.1 Must show how the multiplier affects the value of national income.

2.2 draw diagram and describe the diagram – how the increase in AD from AD0 to Ad1 – increase in real GDP from Yo to Y1 and how GPL increases from Po to P1

**3. Explain how the above changes will improve SOL**

* + Increase in real GDP – increase in real GDP per capita – higher purchasing power and higher material level of comfort
	+ Increase in real GDP – higher level of production- more goods and services for enjoyment
	+ Higher level of taxation - higher level of public and merit goods being produced to raise the welfare of the citizens

**4. Explain why the SOL of Australia may not improve**

Problems of time comparison – increase in real GDP (%) > % change in price and population growth – indicate improvement in SOL – the increase in real national income will lead to larger share of income among the population

-unequal distribution of income is not accounted

 - quality of goods and services not accounted

 - composition of expenditure – rise in real GDP does indicate improvement in SOL as the production in the economy is mainly from the production of resource market which do not deirectly produced pubic or merit goods which are for the society.

**5. Explain why a wider spectrum of SOL based on non-material aspect of SOL is needed to better assess SOL**

Why qualitative value of SOL is needed to assess SOL of Australian (human development Index and measurement of economic welfare – HDI measure the progress of the well-being of the citizens, MEW measures the intangible aspect of SOL in monetized value (externality)

**Conclusion**

 In retrospect, we can use the concept of AS-AD analysis to explain how real GDP or national income will increase because of the above economic activities in Australia. By the understanding of the material and non-material aspect SOL, the value of standard of living for Australians can be assessed.