**Essay Question 4**

A country's social expenditure is made up of cash handouts, rebates, subsidies and social welfare in areas such as home ownership, healthcare and education to improve the standard of living of its citizens

*Source: The Straits Times, 30 April 2018*

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| (a) | Explain the consequences of a government not achieving its Macroeconomic Aims. | [10] |
| (b) | Assess whether a government injection on social spending is likely to have a significant impact on the standard of living of its citizens. | [15] |

**Question Analysis**

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| Command | ‘Explain’ – students need to explain the effects on the economy when the government fails to achieve the macroeconomic aims related to unemployment, economic growth and balance of payments stated in the preamble.  |
| Content  | macroeconomic aims, macro issues |
| Context | Any (Give own examples) |
| Approach | Students need to explain the effects/consequences on the economy and the economic agents when the macroeconomic aims are not achieved.  |

**Suggested Answer Scheme**

Introduction

Most governments aim to achieve four macroeconomic aims: sustainable and inclusive economic growth, low unemployment rates, low inflation, and a healthy balance of payments position that is neither too far into the surplus nor deficit. This part of the essay discusses the consequences of not being to achieve sustained SG, low unemployment rate, and healthy balance of payments.

Failure to Achieve Sustained Economic Growth

* Economic growth is defined as an increase in the real output of an economy. It can be analysed in terms of actual growth and potential growth. The former refers to the increase in real output that has already been experienced by a country while the latter refers to the increase in an economy's productive capacity.
* Sustainable growth indicates a rate of growth that can be maintained without creating other significant economic problems (such as depleted resources and environmental problems), particularly for future generations. It implies a stable and positive growth rate over an extended period of time.
* Inclusive growth indicates a rate of growth that is sustained over a period of time, is broad based across economic sectors for the majority of the country’s population.
* Undesirable rates of economic growth include low/negative economic growth, or economic growth rates that are either unsustainable or not inclusive.
* Not achieving actual economic growth or experiencing a negative economic growth could mean that the level of output in the economy is declining. Material living standards could decline because the quantity of goods and services for consumption is reduced.
* As fewer units of output is produced, demand for labour falls. This may be accompanied by falling income and rising unemployment rates. Lower or no income reduces individuals’ abilities to consume goods and services, leading to lower material living standards.
* Individuals could reduce savings or draw on past savings during the period of lower income. Funds available for investment and capital accumulation could be reduced, restricting potential growth.
* The welfare of present and future generations is adversely impacted through environmental pollution and unpleasant living spaces such as congested transportation and air pollution. For example, power generating stations that burn fossil fuels emit carbon dioxide and other harmful gases affect residents who live nearby, leading to a deterioration of their non-material standard of living.
* Rapid economic growth may lead to rapid changes in the demand for different labour skill sets. While some people may gain from higher incomes and thus a higher standard of living, there are also others who may find that their skills are no longer relevant. and they may find themselves unemployed or forced to take low paid unskilled work. This may lead to inequitable distribution of income within a country.

Failure to Achieve Low Unemployment Rates

* Unemployment refers to the situation where people are unable to find work or unwilling to accept jobs that are currently available. The unemployed refers to people who are actively seeking employment (i.e. able and willing to work) but are currently without a job.
* The unemployed suffer from lower material living standards because of the lack of wage income. Social problems like crime and delinquency arise. Hence there are negative externalities associated with unemployment as third parties are affected by the higher crime, falling property values and a general degradation in the living environment. All these contribute a lowering of material and mental well-being.
* Unemployment of labour means that there is underutilization of resources. The economy is productively inefficient as it is producing below its full potential.
* Rising unemployment often also strains the fiscal budget. Rising unemployment means more public expenditure is required for unemployment benefits and tax revenue declines as personal income and consumption taxes fall. This causes government spending to be diverted from the provision of important social services like education, healthcare and transportation, which adversely affects the society both in the short and long term.

Failure to Achieve Low and Stable Inflation Rates

* Inflation refers to a sustained increase in the general price level of an economy, where general price level is the average price of goods and services in an entire economy.
* Inflation leads to a redistribution of income. Some people become better off at the expense of those who become worse off. With inflation, those who derive fixed income (e.g. from fixed pensions, interest securities and rents) will face a fall in real income. Workers whose percentage increase in nominal wage is less than the percentage increase in price level will also be worse off as real wage / income will fall.
* In an unanticipated inflation, debtors gain and creditors lose. The debtors gain because the real value of their debt is reduced by the price increase. They end up paying less than what they owe in terms of the real value of money as the money they borrowed earlier had greater purchasing power. Thus, wealth is redistributed from creditors to debtors.
* Unanticipated inflation or fluctuations in inflation rate results in uncertainty. When firms are uncertain about the future costs and prices of their products, and hence the rates of return on their investments, they will be less willing to take risks and invest, especially in long term projects.
* Firms and households may be pre-occupied with short-term, unproductive activities such as dabbling in properties and shares, which tend to yield attractive returns in an inflationary environment. Firms may divert investment funds out of productive investment into commodity hoarding and speculation. Such activities do not benefit the economy but only fuel an unsustainable rise in commodity and property prices.
* If a country has a relatively higher rate of inflation than its trading partners, then exports of that country would be relatively more expensive and imports into that country would be relatively cheaper. If the demand for the country’s exports is price elastic, it would lead to a fall in export revenue, as the rise in (relative) price of exported goods leads to a more than proportionate fall in quantity demanded of exports. Meanwhile the country’s demand for imports will increase as consumers switch to purchasing imports instead of buying locally produced goods, resulting in an increase in import expenditure. Hence it is likely that the country which has a relatively higher inflation rate will experience a worsening in its balance of trade, possibly even a deficit.
* A relatively higher inflation in the country will result in the demand for the country’s currency in the foreign exchange market to fall as foreign countries will spend less on the country’s products (assuming demand for the country’s export is price elastic). On the other hand, the demand for imports will increase, resulting in an increase in import expenditure. The country has to purchase more of the foreign currency by selling its own currency on the foreign exchange market. This will lead to an increase in the supply of the country’s currency on the foreign exchange market. The fall in demand and increase in supply, the external value of the country’s currency will fall. A persistent depreciation of the country’s currency may result in loss of confidence in the country’s economy among investors.

Failure to Achieve Healthy BoP Position

* The BOP is a statement of a country’s international transactions over a period of time, usually a year. The BOP thus records the international inflows and outflows of a country’s currency. A persistent BoP deficit means that the outflow of a country’s currency is persistently more than its inflows.
* A depreciation of the currency could result. If the country is very reliant on imports, the currency depreciation could cause import prices to rise sharply, leading to cost-push inflation. This is detrimental to material well-being because the inflation reduces the purchasing power of individuals and households. It could also increase the price of exports and make them uncompetitive in global markets.
* In a fixed exchange rate regime, the central bank may sustain the external value of the currency by giving up its foreign currency reserves for domestic currency. Once the central bank runs out of reserves and loses the ability to support the currency, the resulting depreciation is likely to be sudden and severe, triggering imported inflation and soaring debt repayments.
* On the other hand, sustained BOP surplus exerts and appreciation pressure on the currency. This may hurt exports as they become less price-competitive in global markets, in turn adversely affecting the material well-being of entrepreneurs and workers in the related industries. Furthermore, the appreciation of home currency could lower import prices, allowing domestic consumers to substitute domestic goods and services to those produced overseas. However, currency appreciation could reduce imported inflation as prices of foreign goods and services are reduced.

Conclusion

As the issues of slow or negative economic growth, high unemployment rates and sustained BOP deficits have severe implications on the material well-being of residents, most governments set targets on these indicators and take active policy measures to ensure that they stay within the acceptable range.

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| (b) | Assess whether a government injection on social spending is likely to have a significant impact on the standard of living of its citizens | [15] |

**Question Analysis**

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| Command | ‘Assess’ – students are required to weigh the impact of government injection on SOL of its citizens  |
| Content  | Standard of Living |
| Context | Social spending on home ownership, healthcare and education |
| Approach | T: Government injection on Social spending will have significant impact on SOL ( material and non-material )AT: Limitations of government injection on Social spending will have on SOL ( material and non-material )Synthesis:Other aspects of government policy can be more/equally as significant impact on SOL ( material and non-material )o Focusing on external sector (export sector)o Achieving sustainable growth [pollution] |

**Suggested Answer Scheme**

**Introduction**

Standard of Living (SOL) reflects the well-being of an average person in a country. It includes the material and non-material aspects. The material well-being refers to the quantity of goods and services available to the average person in a country. The non-material well-being examines the quality of life of an average person in a country. This includes the number of working hours per period, leisure time, quality of physical environment, life expectancy…etc. As mentioned in the preamble, country's social spending is made up of cash handouts, rebates, subsidies and social welfare in areas such as home ownership, healthcare and education to improve the standard of living of its citizens

In this essay, we will look at how a government injection on social spending is likely to have a significant impact on the standard of living of its citizens and other policies that a government may need to undertake in order to improve the standard of living of its citizens.

**Body:**

**T: Government injection on Social spending will have significant impact on SOL (material and non-material)**

Government injection on Social spending will have a significant impact on SOL as it can enhance actual and potential economic growth as well as improves equity. With an increase in the government expenditure (G) on housing and healthcare, it will have an impact on the Aggregate Demand. Aggregate Demand (AD) = Consumption (C) + Investment (I) + Government Expenditure (G) + Exports (X) – Imports (M). With an increase in G it will lead to a rightward shift in the AD for example from AD1 to AD2, the unused resources can be put to use, with no upward pressure on prices. Thus, there will be a rise in output and employment while the general price level remains unchanged. With the increase in output and employment, workers will have a higher wage and thus increases the Material SOL of its citizens. With more citizens having found jobs and thus are less worried about basic necessities, the stress of looking for a job is reduced and thus improve the non-material SOL of citizens. However, those whom may have found jobs may now work in a stressful work environment thus leading to a fall in non-material SOL. The extent on the gain on non-material SOL remains to be seen.



A government spending on education will have the similar impact on AD in the short run. However, there is a long run aspect to the spending where when the citizens are educated, there would be an improvement in the quality of inputs (ie labour) and thus increasing the AS this will cause the AS to shift right (thus having potential economic growth)



The rightward shift of the AS curve will result in both Actual and Potential Economic Growth in the LR. The new national income level will increase from Y0 to Y1 thus improving the material SOL of citizens. The potential growth would indicate that there will be room for economy to grow in the future and thus further increasing the material SOL of the citizens, however this is dependent on the future increase of AD.

Government spending on housing together with subsidies for lower income on housing for example on 1-5 Room HDB flats, would improve equity within the population. This is so and the government redistributes tax from higher income earners and subsidise the housing of the lower income group. This will improve both material and non-material SOL of citizens as now everyone owns a house and has a roof over their head. Basic need of access to clean water and sanitation comes with the ownership of a flat.

**AT: Limitations of government injection on Social spending will have on SOL ( material and non-material )**

Economic growth of the economy may not benefit the lower skilled workers as they may not reap the increased in income from growth and thus having a limited impact on their material SOL.

1 room flats are rental flats and occupants do not truly own the flats, thus will have limited impact on their material SOL. But the access to free flowing water and sanitation will indeed already increase their material SOL but not to the extent of owning a flat. 3-5 room flats are owned but occupants will have to undertake 20 – 30 years of housing loans. Ownership of the flats may increase their material SOL but would have an adverse impact on non-material SOL due to the stress of a long housing loan to pay.

Government spending on Education will only improve material SOL in the LR, when the students/learners acquire the skills and get hired for work. When they are undergoing training or education, there is no direct impact on their material SOL and may even have an adverse impact on non-material SOL given the stress in training.

Provision on Skills training may have limited impact on material SOL of low skilled and/or poor workers, as this group of workers will have to take time off from work to train but they need to work in order to put food on the table on a daily basis. Thus for them to get trained and increase the material in the LR, they have to forgo material SOL in the SR, thus not all workers would be willing to undertake the training.

**Synthesis**

As a government seeks to increase the standard of living of its citizens, many would turn to social spending to achieve this. These spending would in turn raise stardards of both material and non-material well being to varying degrees. Dependent of the nature of country, there may be other aspects of government policy that can be more/equally as significant impact on SOL (material and non-material ).

o Focusing on external sector (export sector)

Given Singapore’s nature of a small and open economy, Singapore is also heavily dependent on the external sector, particularly trade to drive economic growth. As such, the Singapore government should perhaps focus improving the export sector instead to achieve a higher material standard of living. Due to Singapore’s lack of natural resources, we are heavily reliant on imported inputs, and therefore highly susceptible to imported inflation thus ensuring flow of imports into our shores is of a greater significance to our material SOL. As our exports and imports accounts for >300% of our annual GDP, attention on the external sector will have a more significant impact on material SOL.

o Achieving sustainable growth [pollution]

Government will also need to spend on other priorities other than on Social spending to have a significant impact on SOL. Especially since the government should also need to ensure that sustainable growth is achieved, where other significant economic problems, such as depleted resources and environmental problems will not be created, particularly for future generations. The government can provide grants to firms to encourage more R&D on cleaner and green technology. Carbon taxes can also be implemented to reduce carbon emissions and lessen air pollution. All these will reduce the amount of environmental problems, thus leading to more sustainable economic growth in the long run.