Economics

**Essays – Economic Growth, Inflation and Unemployment**

**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]

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

**Essay Question 2**

Chinese consumption decreased from 51% of Gross Domestic Product in 1985 to 43% in 1995, 38% in 2005, and 34% in 2013. By comparison, consumption is around 61% in Japan and 69% in the United States. Regardless of its relative percentage of GDP, China’s consumption has been growing faster than any other economy’s in absolute terms.

Discuss whether raising domestic consumption as percentage of GDP is the best approach to achieve sustained economic growth. [15]

**Essay Question 3**

Discuss whether a country’s high rate of economic growth achieved by depending heavily on exports and investments is desirable. [15]

**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.**

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**(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.

**Essay Question 2**

**Chinese consumption decreased from 51% of Gross Domestic Product in 1985 to 43% in 1995, 38% in 2005, and 34% in 2013. By comparison, consumption is around 61% in Japan and 69% in the United States. Regardless of its relative percentage of GDP, China’s consumption has been growing faster than any other economy’s in absolute terms.**

**Discuss whether raising domestic consumption as percentage of GDP is the best approach to achieve sustainable economic growth. [15] must explain other policies**

Question Analysis

* ‘Discuss whether’ – examine closely taking account of the benefits and costs for and against
* ‘best approach’ – need to compare at least 3 approaches
* **Thesis –** Raising domestic consumption as percentage of GDP is the best approach to achieve sustainable economic growth
* **Anti-Thesis** – There are other better approaches to achieve sustainable economic growth
* Judgement – Give reasoned judgement to which is the best approach to achieve sustainable economic growth, given the contextual circumstance

Introduction

Sustained economic growth ensures growth without creating further problems such as BOP imbalances, high inflation rate and environment damage that will otherwise suppress it. Given the increasingly volatile and uncertain world brought about by globalisation, raising domestic consumption as percentage of GDP would be the best approach for big consumer markets in the quest for sustainable growth. However, this is not ideal for economies with small domestic markets and facing an aging population, and hence other approaches such as increasing productivity and investing in Research and Development to look for new areas of comparative advantages would be better approaches.

Main Body

**Thesis 1 – Internal Factors**

Raising domestic consumption as percentage of GDP allows economies with large domestic market to increase real national income via multiplier effect, leading to actual and sustainable economic growth. The high demand for goods and services from large domestic market induce employment opportunities in the retail and service sectors.

Comparing consumption and service - led economies and capital- led industries, consumption and service - led economies like US and Japan tend to create more jobs per unit of investment, accompanied by higher wages per dollar invested. Hence economies like US and Japan will benefit the most from this approach.

**(large population to induce greater consumption which leads to a higher value of increase in AD)**

P2

 Y1 Yf

General Price Level

Real National Income

0

P1

AD1

AS

AD2

Increase in private consumption causes aggregate demand (AD) to increase from AD0 to AD1, leading to increase in real national income via multiplier effect (Fig 1) and actual economic growth, with a positive spillover effects on internal economic health such as induced employment and higher standard of living for consumers (higher quality products in the case of Korean cosmetics). Hence, actual economic growth is sustainable and can be achieved with the approach of rising domestic demand and consumption.

**Thesis 2 – External Factors**

In addition, raising private consumption as percentage GDP eliminates the reliance on trade to achieve sustainable economic growth, thus, reducing susceptibility to external shocks for large economies such as China and hence is the best approach.

The increase in real national income obtained from raising private consumption contributes to the national official reserves and diminishes the need to build up foreign reserves through reducing import expenditure. This allows China to narrow her trade surplus and reduce conflicts arising from global trade imbalances with her trading partners. Moreover, by turning towards producing consumption goods, China is able to reduce excessive usage of natural resources such as fossil fuels, water and land required to produce capital goods (industrial parks) and mitigate mounting environmental pressures, therefore achieving sustainable economic growth.

Being one of the world’s greatest producers of greenhouse gases and the world’s largest coal consumer, China needs to adopt a more efficient use of resources in order to achieve sustainable economic growth. Hence, a rebalancing of China’s growth toward production of goods and services would help boost the country’s already – commendable efforts to put the economy on a more environmentally sustainable footing.

In addition to a lesser reliance on international trade, consumption spending in general simply tends to be much less volatile than either investment or exports. Investment can be postponed according to the cyclical needs of businesses, but consumers tend to prefer a smoother and permanent consumption trend over their lifetimes and at least some portion of consumption spending goes on non-optional basic necessities. .

Thus, raising domestic consumption as percentage of GDP is the best approach to achieve sustainable economic growth for economies with big domestic markets like China and the US.

**Anti-Thesis 1**

However, raising private consumption can be a challenge for developed economies facing aging population in a rapidly changing global economic environment like European economies and Singapore due to the necessary quantity and quality of labour required for potential economic growth, which then leads to cost–push inflation as these economies reach full employment level. Therefore, an approach that anchors on productivity–led growth will deliver sustainable economic growth for these economies.

An increase in labour productivity will lead to lower per unit labour cost and hence lower unit cost of production. This means higher rate of expected returns from investment, which attracts FDI into the economy and improve the economy’s capital and financial account. The inflow of FDI also improves employment by creating employment opportunities for the locals. Additionally, advanced technologies, machines, skilled labour and expertise that FDI bring in can expand productive capacity of the economy and contribute to higher potential economic growth. Therefore, scarcity of resources that otherwise hinders sustainable economic growth can now be addressing following this productivity–led growth approach.

General Price Level

Real National Income

0

AD0

LRAS1

LRAS2

Y1 Y2

P1

P2

Furthermore, Using AD-AS framework, labour productivity growth can reduce inflationary pressure caused by actual economic growth of economies operating at/near full employment level. An increase in labour productivity leads to rightward shift of LRAS from LRAS1 to LRAS2. Hence, general price level will decrease from P1 to P2 in response to an increase in real national income from Y1 to Y2 via multiplier effect. Hence, actual economic growth can be achieved without trade–offs with high inflation.

Improving labour productivity also help improve an economy’s BOP through price competitiveness and product differentiation. Labour productivity growth lowers unit cost of production and price of exports in foreign currencies, thus boosting international export competitiveness.

As demand for exports is price elastic, lower exports price leads to more than proportionate increase in quantity demanded for exports. Total export revenues R = P x Q thus increases and BOP in current account increases. This leads to a significant actual economic growth for small and open economies like Singapore where exports revenues take up 326% GDP. Moreover, improvement in process and product innovation (as part of labour productivity growth) such as improving users’ experiences in connectivity between consumers and electronics, as well as products/services improvement and differentiation through smart phones apps, wearable devices, data and media may lead to the development of consumer preferences to domestic products and form brand loyalty. This makes demand for domestic exports even more inelastic and price competitive with higher BOP surplus, contributing to sustainable economic growth.

Also, to mitigate the negative impact of an ageing labour force on labour productivity growth, it is important for the government to continue to focus on lifelong learning and retraining of older and less educated workers, as it will help the workers to remain relevant and productive in the domestic economy. Hence, enhancing labour force’s productivity and employability for older workers will be the key to help economies achieve sustainable economic growth and high employment levels.

**Anti-Thesis 2**

Another approach to sustainable economic growth is to seek new areas for comparative advantage and build up sunrise industries to improve attractiveness of investment climate. The economy is able to benefit from potential economic growth and increased spare capacity. In Singapore, the government has identified 4 pillars of growth as they hold significant growth potential, namely the water processing, tourism, biomedical and pharmaceutical industries.

With capabilities of high and advanced technology, Singapore also have found comparative advantage in water treatment plants(e.g NEWater). As a result of government focus on these industries, productive capacity in the country will rise as technology and expertise can be passed on to Singapore companies. This ensures sustainability as economic growth is supported with increase in workers’ skills and knowledge, thereby ensuring vibrant economic environment for investment and provides opportunities for employment.

However, there are also some adverse effects on citizens of lower income groups and skills. Such rapid industrialization and structural change might bring about increased income inequality and structural unemployment. Then again, the government needs to ensure lifelong learning through training programmes and workshops. One such example would be SkillsFuture, a philosophy led initiative in which the government provides opportunities to maximise one’s potential and develop a mastery of skills. This policy encourages Singaporeans, young or old, to achieve success through the growth mindset, charting our own paths and skills mastery. Hence, an approach to sustainable economic growth is to seek new areas for comparative advantage and build up sunrise industries to improve attractiveness of investment climate.

Conclusion

In conclusion, raising domestic consumption as percentage is the most appropriate for countries with large domestic markets and when there are external shocks as countries are able to rely on their factor endowments to achieve sustained economic growth. However, when countries rely on one another to boost economic growth due to small domestic markets, other approaches like boosting productivity and research on comparative advantages to attract investors would be more appropriate in sustaining all aspects of economies.

**Essay Question 5**

**Discuss whether a country’s high rate of economic growth achieved by depending heavily on exports and investments is desirable. [15]**

Analysis of the question:

* How higher export demand and investments will lead to high Economic growth
* Advantages of economic growth based on external demand
* Disadvantages - why relying on external demand is not beneficial
	+ Too heavily dependent on external factors for growth
	+ High growth rates (negative aspect) – jobless growth
* Evaluation/judgement

Introduction:

Main Body

**It is desirable for a country to achieve high rate of economic growth by depending on exports and investments**

* Able to tap on international market that enables the demand for domestically-produced goods to expand 🡪 volume of trade increases 🡪 firms can now operate on large scale and enjoy economies of scale 🡪 lower cost of production
* FDI allows for transfer of technological knowledge and skills from foreign firms to domestic firms, thereby improving productivity
* Increase in X and I increases AD and LRAS, thus achieving actual and potential growth, and increasing employment level
* Higher national income 🡪 higher purchasing power 🡪 higher material SOL
* This is especially desirable for an economy with relatively small domestic market. Eg. Singapore relies on trade and investment for growth🡪 X revenue is a significant component of AD 🡪 enables it to depend on increase in X revenue (rather than C) to achieve high growth rate. There is also a need for FDIs to invest in this small domestic economy to help promote sustained growth in the economy

**However, there are situations where it may be undesirable for a country to achieve high rate of economic growth through exports and investments**

* Vulnerable to external shocks - If country Z’s trading partners faced a recession 🡪 their NY falls🡪 demand less imports from other countries 🡪 translates to less X revenue and I spending in country Z 🡪 AD falls 🡪 RNY falls by multiples & higher unemployment level 🡪 undesirable as country Z’s growth is dependent on the state of other countries
* If most goods and services produced in the country are exported, left very little for domestic consumption 🡪 undesirable as material SOL is compromised
* With more investments entering the economy, there may be a changing structure of the economy as it changes from labour intensive to capital intensive industries. Structural unemployment may result if the workers’ skill level did not keep pace with the advancement of technology/ if there is a displacement of low-skilled workers through automation and improvement in quality of technology 🡪 labour not used fully 🡪 undesirable because there will loss of potential output and income
* Not sustainable to maintain such high growth rates 🡪 Rapid depletion of non-renewable resources 🡪 may compromise growth in the future
* Deterioration of the environment (higher pollution and waste level) 🡪 lower SOL

Evaluation

An investment or export-driven economy such as China has to depend on the state of the global economy and foreign demand for its products. If consumption cannot increase to play a much larger role in aggregate demand, then this rapid growth will slow down or even stop at some time in the future. With prospects for export growth weakening, such economy needs to rebalance its growth away from potentially volatile net exports toward a more sustainable path driven by domestic demand.

**Essay Question 3**

Discuss whether a country’s high rate of economic growth achieved by depending heavily on exports and investments is desirable. [15]

Definition of economic growth and meaning of high rate of economic growth

State that AD components will accelerate a country’s economic growth but at all times.

Main Body

1. Explain how Economic growth will be attained by rise in export demand and investment

Increase in export demand and investment – rise in AD – via the k process – rise in real GDP

Draw diagram

Description of diagram

2. Why economic growth will be accelerated by the rise in export demand and investment

* Export demand is a large percentage of the GDP like SIngapore
* Both export demand and investment will induce employment – rise in income and further increases other AD components like consumption
* Spare production capacity is still large, allowing higher level of production – induce higher GDP – accelerate economic growth
* Investment will improve technological advancement – accelerate economic growth, expand production capacity to promote higher growth rate

3. why it will not?

- higher inflation due to higher cost condition – cannot produce more to raise economic growth

- exchange rate is low – price of export demand is low – low export revenue

- low valued good – slower export value – lesser growth inn NY

- low valued investment – low valued production – slow growth

4. Why it is desirable?

* Give rise to employment – bec increase in XD and I will raise production – increase in demand for labour – raise employment
* Raise SOL – increase in real GDP – higher real GDP per capita
* Investment can expand production capacity – raise the availability of resources – decrease cost condition – control inflation and maintain price stability

5. Why it will not be desirable?

* May contribute to inflation (rise in GPL) – may contribute demand pull inflation – excessive demand under rising cost and full employment condition
* Accelerated EG – unequal distribution of income and wealth
* Extensive structural adjustment – sectoral changes – structural unemployment / jobless growth