**Essay Question 2**

**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]**

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.

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.

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.