(a) Explain how price stability can help achieve the aims of the government. [10]

Price stability implies that there is low inflation rate. Inflation is defined as a sustained, inordinate and general increase in the prices of goods and services. Price stability is often regarded as a pre-requisite for attaining government's other micro and macro-economic goals which includes sustained economic growth, low unemployment rate, healthy balance of payment and allocative efficiency in the society.

In the macroeconomics aspect, price stability creates an environment that promotes savings and investment. Price stability will also reduce uncertainty among the business community, causing potential investors will be more certain about future costs, prices of their products and hence the rates of return on their investments. This increase in investment will increase the aggregate demand for the country and subsequently a multiple increase in national income via the multiplier effect. Actual growth is achieved. This increase in real output will also be accompanied with an increase in demand for labor, thereby lowering the unemployment rate since labor is a factor input in the production of goods and services.

When a country has a lower rate of inflation than its trading partners, exports of the country would be relatively cheaper whereas imports into the country would be relatively more expensive. Assuming the demand for the country's exports is relatively *price elastic*, a relatively lower price will lead to a more than proportionate increase in quantity demanded for exports, increasing export revenue earned by the country. Since trading partners are facing a higher inflation rate, trading partner's exports is still relatively more expensive than domestically produced goods. As a result, locals will decrease demand for imports from trading partner. Assuming the demand for import is price elastic, the rise in price will lead to a more than proportionate decrease in quantity demanded, decreasing import expenditure of the country. Given the rise in export revenue and a fall in import expenditure, the country's balance of trade and hence balance of payment account position will improve, achieving a healthier balance of payment.

In the microeconomics aspect, price stability will enable the society to achieve allocative efficiency. High inflation will cause inefficiency in the allocation of resources because when all prices in the economy are rising, producers will be unable to distinguish between a rise in price caused by an increase in the demand for their good and a rise in price for all goods in general as a result of inflation. Wrong decisions may be made as some firms will increase output thinking that society desires more of their product (i.e. too much resources may be allocated towards producing goods that society do not really desire). As such, this results in an inefficient resource allocation.

In conclusion when price stability is achieved, there are many positive implications that comes along with it. Hence government will aim to achieve price stability most of the time in their country.

Level	Description	Marks
L3	Developed explanation of how price stability can aid in achieving 3 other government aims (micro or macro aims).	8-10
L2	Developed explanation of how price stability can aid in achieving 2 other government aims (micro or macro aims). **OR**	4-7

	Undeveloped explanation of how price stability can aid in achieving 2 other government aims (micro or macro aims).	
L1	Developed explanation of how price stability can aid in achieving 1 other government aims (micro or macro aims).	1-3

(b) Discuss the considerations that influence the type of policy the government undertakes to achieve price stability in Singapore. [15]

Given the benefits of price stability, government has the incentive to achieve price stability in the country. There are generally two types of inflation – cost-push inflation and demand-pull inflation. These inflation can occur due to internal or external factors. As such, the choice of policy depend on the type and source.

An example of cost-push inflation arising from internal sources is the implementation of a foreign worker levy in Singapore. Firms will face an increase in cost of production which then responds by cutting back on production and passing on some of the rise in cost to consumers in the form of higher prices. The fall in SRAS will lead to an increase in GPL in Singapore. This is an example of a cost-push inflation which stems from internal sources. To deal with this and achieve price stability, the Singapore government have adopted SRAS policies such as Wage Credit Scheme which aims at helping firms to reduce their cost in other aspect. With government co-funding, the cost of production will be lowered compared to before, increasing SRAS and hence lowering GPL.

An example of cost-push inflation arising from external sources is the rise in import prices. Singapore is a resource scarce country and is highly dependent on imports. Increase in prices of imports is an example of a cost-push inflation which stems from external sources. To deal with this and achieve price stability, the Singapore government have adopted a gradual appreciation of Singapore dollars. Singapore exports will be more expensive in foreign currency while imports will be cheaper in terms of Singapore dollars. This enables the price of imported food to be cheaper, lowering the cost of production for domestic firms and hence increasing SRAS and reducing GPL.

On the other hand, when there is a positive global economic outlook which leads to higher demand for Singapore exports from its trading partners, Singapore will experience an increase in net export and hence AD which increases the GPL. This is an example of a demand-pull inflation from external source. To dampen the external demand and lower GPL, the Singapore government can adopt a gradual appreciation of Singapore dollars. Singapore exports will be more expensive in foreign currency while imports will be cheaper in terms of Singapore dollars. Assuming Marshall-Lerner Condition (PEDx + PEDm > 1) is satisfied, net exports will fall, leading to a decrease in AD and hence GPL in Singapore.

It can be observed that when inflation stems from external sources (from overseas), exchange rate policy is the preferred policy as it can tackle the inflation at its source.

When there is positive economic outlook leading to increased confidence level of consumers and firms in Singapore which will encourage them to increase their domestic consumption (C) and investment (I) respectively, AD will increase leading to increase in general price level (GPL) in the country. To deal with this and achieve price stability, the Singapore government have delayed government projects and reducing government expenditure. With the fall in G, AD will fall and hence price stability can be achieved.

In conclusion, the Singapore government has several considerations before deciding in which policy to adopt in order to achieve price stability in Singapore.

Level	Description	Marks
L3	Developed discussion of 2 considerations (i.e. demand-pull and cost push AND internal and external sources) with examples depicting the situation and what policy the government can undertake to achieve price stability.	9-11
L2	Undeveloped discussion of 2 considerations (i.e. demand-pull and cost push **AND** internal and external sources) with examples depicting the situation and what policy the government can undertake to achieve price stability.	5-8
L1	Smattering of valid points which mainly includes policies which can be adopted to achieve price stability in Singapore with no considerations for the factors which influence the types of policy adopted.	1-4

Level	Description	Marks
E2	Evaluations which considers the nature of Singapore and the constraints which it faces to assess which type of policy is better suited to achieve price stability.	3-4
E1	Evaluations which are superficial and not elaborated nor contextualised to the case of Singapore.	1-2