The economic environment of Singapore has been challenging for a while with the world economy yet to fully recover from the financial crisis while a clear growth driver has yet to emerge as major powers like the United States and China continue to grapple with reform and recovery. All these have had a dampening effect on global trade and by extension, Singapore's small, open economy.

Adapted from the Straits Times, 2016

5. **Discuss the extent to which Singapore has control over her economic performance. [25]**

Introduction:

Meaning of economic performance: Sustained and inclusive growth, low unemployment, low inflation, healthy balance of payments.

- The economic performance of a country could be a result of economic policies or exogenous factors outside the control of economic agents

Thesis: Singapore has control over her economic performance

(Any **3** policies which links to at least 2 different measurements of economic performances)

In the thesis argument, students are expected to show how Singapore has control over her economic performance with the use of suitable policies to boost a sustainable and inclusive economic growth (or to mitigate a recession), maintain price stability (or curb inflation), maintain a low unemployment rate (or reduce unemployment) and ensure a healthy balance of payments.

1. **In context of economic recession: Sg can implement an expansionary fiscal policy (EFP) to alleviate the fall in actual growth and reduce demand deficient unemployment, hence gaining control over her economic performance.**

(a) Singapore government can attempt to cut direct taxes (personal income taxes and/or corporate taxes) and/or raise government spending (G) (for example, increase spending on public infrastructure) to boost aggregate demand (AD) and achieve actual growth.

With a cut in personal income tax, this has the effect of raising household's disposable income and stimulating consumption (C). With a cut in corporate tax, this has the effect of raising the after-tax profits of the firms thus stimulating investments (I) since there is now more incentive to increase investment expenditure in Singapore. With the rise in C, I and G, AD is raised, (Explain the multiplier (k) effect), which results in a multiple increase in national income and hence, this could help stimulate actual growth (and mitigate the effects of a recession) and reduce demand deficient unemployment as a result of a recession.

In the long run, with the increase in I →increase in capital stock accumulation → increase in productive capacity →achieves potential growth.

(Illustrate the effects on actual and potential growth with the AD-AS diagram)

However, the effectiveness of the policy depends on:

1) The size of the multiplier. The smaller the multiplier, the smaller will be the increases in national income which may deem the policy ineffective.

2) The budget position of the government. If the government is currently experiencing a fiscal deficit, it may be difficult to expand the expenditure and this could reduce the effectiveness of the expansionary effects on the economy.

(b) In addition, increases in government expenditure can also help to promote a more inclusive economic growth.

Real world examples

The government can increase the expenditure through income redistribution. Under the Wage Credit Scheme, the Government will co-fund 40% of wage increases given to Singapore Citizen employees earning a gross monthly wage of $4,000 and below in 2013 – 2015. Only Employers are eligible for the co-funding.

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 as there is greater incentive to work with wage increases and companies will also have more incentive to increase the wages of workers.

This prevents the increase in income gap between low income workers and high income workers, hence ensuring a more inclusive growth.

(c) Unlike a conventional fiscal policy where the government simply reduces taxes without differentiating the income group, a more inclusive growth can be achieved with the implementation of a progressive tax system in Singapore.

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 22%. Tax revenue generated are redistributed as subsidies to make healthcare, education and housing affordable to all. Income gap between the higher income and lower income is then narrowed

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, which may reduce potential growth.

Evaluation

Hence, the government has to ensure that the tax rates implemented is managed wisely and does not distort the incentive to work.

2. **In the context of a fall in external demand: Singapore can control its economic performance with the use of exchange rate policy via a depreciation (or zero appreciation stancw) of the SGD to promote export competitiveness, increase AD and revive actual growth and reduce demand deficient unemployment.**

MAS can pursue a zero-appreciation of SGD exchange rate policy to allow a weakening of the strength of the SGD → fall in Px in foreign currency terms, rise in Pm in domestic currency terms , which leads to an increase in quantity demanded for exports and decrease in quantity demanded for imports →assuming Marshall – Lerner condition (MLC) is satisfied such that Epx + Epm >1 → net exports (X-M) increases → increase AD →k effect→ multiple increase in national income, output and employment→ raises actual growth and reduce demand deficient unemployment in the short run.

Balance of payments may also improve with the increase in net exports via the current account. Hence, in this aspect, SG can control falls in external demand with a suitable usage of the exchange rate policy. This meant that the government may need to decide when to allow the currency to appreciate and when to adopt a zero appreciation stance.

3. In the context of a high inflation present in Singapore, the use of the exchange rate policy via an appreciation stance can help to control inflation and hence Singapore's economic performance.

Singapore is a small and open economy which is export-led and import-reliant. Hence, external factors are significant contributors to inflation in the economy.

- In recent years, the more significant causes of inflation in Singapore are mainly due to external factors of rising global and oil prices.
- Thus, one of the policies that Singapore has implemented to cope with inflation in the economy is to adopt a strong S$ exchange rate policy so as to cope with changes in the external economy.

How it works? (Explain using the economic concepts)

1. Curbing import price push inflation (Direct transmission mechanism)

- By allowing S$ to appreciate when there is import-price-push inflation, imports become relatively cheaper in terms of domestic currency.
- Most of Singapore's imports are raw materials and necessities and Singapore being a resource scarce country, demand for imports is expected to be relatively price-inelastic(qty dd increases LTP when prices fall). Hence, import expenditure on raw materials and necessities will fall and this translates to lower COP for firms. This increases SRAS and helps to reduce inflationary pressures. (Fig 1) and general price level will fall.
- As necessities become cheaper in terms of domestic currency ➔ lower GPL as price of final goods and services are lower.

<u>**Impact on other macroeconomic indicators**</u>

In addition, since many exports in Singapore are produced with high import content (contains a significant proportion of imported inputs), the fall in the prices of inputs can lower the cost of production of exports and hence improve export competitiveness where SG exports can be sold at a lower price. The fall in price of exports can then translate to a more than proportionate increase in quantity demanded for exports (assume that demand for SG's export is price elastic). This will result in an increase in export revenue and increases in net exports, c.p which might also improve the balance of payments and bring about actual economic growth and full employment in the short run.

Evaluation on the exchange rate policy

The monetary policy centred on the exchange rate in Singapore focuses on achieving price stability. Achieving low inflation, however, is not an end in itself. Price stability is seen as prerequisite for sustainable economic growth. [Consider how a low inflation environment encourages saving and investment which add to the productive capacity of the economy, shifting the AS to the right.]

However, the monetary policy per se in Singapore (via exchange rate management) cannot affect the long-term growth capacity of the economy. In the long run, the growth of an economy is determined by supply-side factors such as technological progress, capital accumulation, and the size and quality of the labour force. Some government policies may be able to influence these supply-side factors, but monetary policy generally cannot do so directly

Thus, the Singapore government cannot just rely on exchange rate policy alone for sustained growth. It must be accompanied by other macroeconomic policies in order to ensure that the Singapore economy can continue to grow in the long term.

Limitations of Exchange rate policy

- However, such as a policy is inappropriate in times of export slump, as in the current situation with world-wide recession, as resulting in further slowdown in actual growth could lead to significant cyclical unemployment problems.(where further fall in AD could lead to unemployment)

- Moreover, exchange rate policy is unable to tackle inflation caused by internal factors ➔ there is a need to implement supply-side policies to achieve price stability in the economy as well.

3. Singapore can control its economic performance through the use of supply-side policies to promote actual and potential growth and achieve non-inflationary sustained economic growth (LR)

Long-term supply-side policies

- Industrial policies to develop dynamic CA

E.g. Singapore government disburses grants and provides tax rebates to attract FDI to promote the development of new growth industries and develop industries with potential CA. E.g. clean energy sector, bio-medical sector, etc.

In the LR, with the CA established in these sectors → promotes export growth→ increase export revenue → increase AD→increase real NY more than proportionately through the k effect → raises actual growth.
With increase in FDI in these sectors → increase capital stock accumulation, technology transfer →increase productive capacity → achieves potential growth.

- Manpower policies to increase productivity

Manpower policies in the form of government spending on training of workers to enhance skill sets of workers (e.g. WTS) → raise labour productivity → i) lowers labour cost →increase SRAS, achieves actual growth; ii) increase quality of labour→ raises productive capacity →achieves potential growth.

Short-term supply-side policy

- Wage policies to reduce cost of production to firms

Through the tri-partite labour market system, under the NWC platform, annual wage recommendations takes into account the prevailing economic conditions facing Singapore and have been advocated such that wage increases granted have lagged behind productivity growth → reduce unit labour costs → increase SRAS→ raises actual growth.

4. **Lastly, Singapore can use suitable trade Policy: Free trade agreements (FTAs) to promote exports growth, FDI inflows to increase AD and AS to sustain economic growth in order to control the economic performance.**

FTA which is a legally binding agreement to lower or remove trade barriers between two or more countries has been employed by Singapore as a trade policy to promote Singapore's export growth. FTAs allow Singapore to overcome the constraints of her small domestic market and expand its markets for exports. E.g. removal of tariffs against Singapore's exports → lowers price of Singapore's exports → assuming PEDx>1 → more than proportionate increase in Qdded for X → increase in X revenue →increase AD→ increase real NY by more than proportionate through the k effect → raises actual growth.

FTAs have also allowed Singapore to attract FDI as foreign MNCs see Singapore as an attractive destination for their investment given Singapore's preferential access to key markets. Increase in I → increase AD and AS → sustained economic growth as described above.

Anti-thesis: Singapore may not have control over her economic performance

1. Limitations of the policies above (any 3 policies):

Some of the limitations could have been mentioned as an evaluative point in the thesis argument due to differences in structure.

- EFP: small k for Singapore due to high MPS due to compulsory saving scheme (CPF) and high MPM due lack of natural resources → limits the ability of EFP to increase real NY sufficiently to increase actual economic growth.

- Exchange rate policy: depreciation of SGD would worsen BOT due to the J-curve effect. In the SR, demand for X and M are likely to be price inelastic due to trade contracts as exporters and importers are not able to respond very much to changes in Px and Pm given the exchange rate changes → fall in net X value →fall in AD→ more than proportionate fall in NY due to reverse k effect → fall in actual growth.

- Supply side policies: lack of receptiveness and uncertainty of results →low wage workers may not be receptive to training due to unwillingness to forgo paid employment for training as that would mean losing earned income especially for daily-rated workers. Training of workers may not automatically translate to transference and application of skills gained to the work setting, difficult to increase productivity. On the whole, supply-side policies are LR policies, does not work effectively as a short-run response to sudden and severe economic shocks.

- Trade policy (FTA): Just as FTAs enables Singapore to increase its X growth, it would also mean an increased degree of competition from low cost imports → fall in (X-M) and AD and actual growth. However, this effect is unlikely to be significant in terms of curtailing economic growth due to Singapore's open nature of its economy, where in fact, low cost imports has been viewed positively in curbing imported inflation.

2. External factors (*Note: Some of the points below could also be seen as limitations of the policies undertaken by SG*)

- **Singapore may be unable to control the economic performance with demand-side shocks that stems from external factors.**

  As seen from the preamble, "the environment has been challenging for a while with the world economy yet to fully recover from the financial crisis while a clear growth driver has yet to emerge as major powers like the United States and China continue to grapple with reform and recovery. This has all had a dampening effect on global trade and by extension, Singapore's small, open economy."→Singapore has relied heavily on exports for economic growth. In fact, net exports make up the largest component of Singapore's GDP (net exports making up at least 2/3 of the AD). Hence, Singapore may have problems controlling the economic performance of the country and this might limit the ability of Singapore to use demand management policies to boost domestic demand and actual growth given its high degree of reliance on external demand for its economic growth.

  This could be the reason why Singapore was the one of the first few Asian economies that was hit by the global economic crisis in 2008.

- **Singapore may be unable to control the economic performance with supply-side shocks that stems from external factors.**

Rising prices of imported raw materials→this would put a limit to Singapore's ability to continually appreciate SGD without severely compromising export price competitiveness. For instance, if oil prices were to increase significantly, MAS may not be able to appreciate the SGD extensively to cope with the sudden, sharp increases in oil prices as they need to ensure that the SGD still remains within the S$NEER band (Singapore dollar nominal effective exchange rate, where Singapore currency is managed against a trade-weighted basket of currencies against her major trading partner). Any sudden increases in the value of the SGD could threaten currency stability and investors' confidence hence MAS may only tweak the policy at a gradual rate.
Thus, this would mean that SG has a limited control over its economic performance when there are sudden changes in the external environment.

- **Competition from foreign countries for investments and exports (No control over rivals' policies).** Just as Singapore can pursue economic policies to improve its export competitiveness, there is nothing to preclude other competing countries to engage in similar policies to compete with Singapore for FDI and exports. This is especially the case given the increasing integrated nature of the global economy.

  Other external factors that could impact Singapore's trade position and its vulnerability.
- Also, as if Singapore's trading partners adopt more a more protectionist approach, this could hamper trade flows between Singapore and these countries which are not within the control of Singapore. Singapore has to watch out for ramifications from protectionist politics, which, if widespread, can be harmful for the trade-dependent economy in the long run,

  Evaluation:
- Hence, it is crucial for government policies to consistently adapt to these external changes to manage Singapore's economic performance. Following the United States' formal withdrawal from the 12-nation Trans-Pacific Partnership (TPP) which is not within the control of Singapore, the impact could impair the growth if policies are not in place to manage these changes. In lieu of this, Singapore can continue to pursue other avenues of economic cooperation, such as the Regional Comprehensive Economic Partnership (RCEP).

Synthesis:

Economic performance can be controlled as long as policies result in international competitiveness and external conditions are favourable. For a small and open economy, growth is not within her control to the extent that globalisation has led to synchronisation and shortening of business cycles.

Hence, the level of control that the government has over Singapore's economic performance is dependent on a few factors:

1. The extent of the changes in external factors. Globalisation has caused many countries to be interconnected and economies to be mutually interdependent. Hence, a recession in one country though may not affect Singapore immediately, could affect Singapore significantly at a later stage due to the contagion effect. On a separate note, countries with limited trading relations with Singapore may not affect Singapore's economic performance that much as compared to Singapore's major trading partners. Hence, it depends on what changes in external conditions are there and the extent of the impact on Singapore's economic performance.

2. Budget constraints/allocation of the government which could be accordance to the government's priority at the point in time. For instance, if inflation is at its highest and the government may prioritise controlling inflation at the expense of other macroeconomic

objective (i.e. trade-offs between goals). Also, if the government does not have sufficient funds to implement suitable policies, this could also limit the control of Singapore over its economic performance.

Level	Knowledge, Application, Understanding and Analysis	Marks
L3	Balanced arguments, strong analysis and valid application to Singapore's economic performance.	15-20
L2	Balanced arguments, undeveloped explanation or analysis, weak application to SG economy	9-14
L1	Descriptive, conceptual inaccuracies, one-sided or irrelevant responses One sided (only thesis/anti-thesis) No application to Singapore context	1-8
	Evaluation	
E1	Unsubstantiated judgment- Merely stated a stand	1
E2	Underdeveloped but substantiated judgment with elaboration of factors to determine whether Singapore has control over its economic performance.	2-3
E3	Well-developed and substantiated judgment to determine if Singapore has control over its economic performance.	4-5