

Q5) Assess the relative effectiveness of demand-side and supply-side policies in achieving macroeconomic objectives in Singapore. [25]

Question Approach

The question tests on the array of demand-side and supply-side policies that the Singapore government adopts to achieve her macroeconomic objectives. The words 'relative effectiveness' suggests the need to compare among the policies and argue why base on certain criteria these policies are deemed to be more effective. Some criteria include type of macroeconomic objectives and policy objectives, nature of Singapore's economy, limitations of policies etc.

Introduction

Briefly explain the macroeconomic objectives of the Singapore government

Like all governments, the Singapore government aims to achieve the 4 macroeconomic objectives. In particular, due to the small and open nature of the Singapore economy, Singapore aims to achieve healthy BOP as it indicates that the Singapore economy is competitive and attractive in the international market with good exports revenue and FDI inflow. This then has implication on positive economic growth and low cyclical unemployment in Singapore. In addition, being import reliant, Singapore is vulnerable to imported inflation and this affects real purchasing power and SOL. Lastly, rising structural unemployment due to structural changes in economy, an important cause of rising income inequality is also a concern of the government. This essay seeks to assess the relative effectiveness of demand-side and supply-side policies in achieving these macroeconomic objectives in Singapore.

To achieve sustained economic growth and to keep cyclical unemployment low, the Singapore government adopts both the demand and supply side policies. The relative effectiveness between the 2 policy approaches depends on the objective and intention of the policies.

During short term economic recession such as that of the global financial crisis in 2009 where negative economic growth resulted due to a fall in AD, demand management policies such as depreciation of the Singapore dollar was effectively adopted to achieve the goal of sustained economic growth. The Singapore government allowed a gradual modest depreciation of the Singapore dollar. With a fall in price of Singapore's exports in terms of foreign currency, volume of Singapore's exports increases. Hence, export revenue increases. On the other hand, price of imports in terms of SGD rises. With demand for M being price inelastic in Singapore, M expenditure rises. However, as Marshall Lerner condition holds in the long run, this leads to improvement in Singapore's (X-M). Hence AD improves. With reference to figure 1 below, AD increases from AD₀ to AD₁. Real national income increases from Y₀ to Y₁. The rise in production increases hiring of workers and reduces cyclical unemployment. This combats

the fall in AD due to the fall in demand from Singapore major trading partners due to the recession.

The exchange rate policy of depreciation is effective for Singapore during the recession due to Singapore's economy being export oriented and reliant on trade performance for growth. Depreciation targets net exports which has high influence on AD and hence is effective in raising AD.

However, Marshall-Lerner condition might not hold in the short run due to contractual agreements and inability to change taste and preferences. Hence the policy might worsen trade balance in the very short run instead worsening the recession. Also, Singapore's trading partners may also engage in relative depreciation to avoid impact on net exports during recession. This further undermines the effectiveness of Singapore's depreciation to improve net exports as the price effect is offset. Also, depreciation might also be adopted by other affected countries in the recession. With relative depreciation, Singapore might not gain a price advantage in exports over her major trading partners. Hence, rendering exchange policy less effective.

To complement exchange rate policy, the Singapore government adopts expansionary FP to boost AD to promote actual economic growth and reduces cyclical unemployment. For example, the Singapore government brought forward HDB upgrading projects and construction of MRT lines to increase G and increases AD further from AD1 to AD2 to raise RNY to Y2. While EFP is effective in raising AD through G, effects are usually restricted to specific sectors such as construction industry due to the boost in G on construction of infrastructure in the country. It is also limited by feasibility of government projects to be brought forward.

The combination of exchange rate policy and EFP has their merits and flaws. In addition to the limitations mentioned above, Singapore cannot depend on depreciation of the SGD to improve AD for an extended period of time for it might invite imported inflation to the country. In fact, during risk of imported inflation, the Singapore government might adopt gradual modest appreciation stance of SGD to control prices of imported FOP and final goods into the Singapore economy. This effectively increases SRAS and reduces GPL in the country. Hence, due to the conflict between the goals, a fine balance must be achieved in the control of SGD to balance among achieving all goals of the government. Both EMP and EFP are short term policies effective only to influence AD. In the long run, supply side policies are more effective in improving competitiveness of Singapore's exports to improve trade balance and achieve macroeconomic objectives of healthy BOP, potential economic growth and lower inflation in the long run.

The Singapore government invests heavily in firms to adopt better technological production methods to improve productivity and efficiency. An example would be the Productivity and Innovation Credit where the government subsidises 60% or allowed 400% tax deductions on technological investments by firms that improve productivity. This translates to higher productivity of the economy and results in rightward shift of the LRAS from AS0 to AS1 as shown in Figure 1

above. Higher economic growth is achieved from Y1 to Y2 with lower inflation from P1 to P2. At the same time, the improved productivity could translate to better quality of exports which increases export demand and improves current account.

Adopting new technology by firms involve high costs as new machines must be bought and workers must be trained to make use of these new technology. Firms might experience rise in unit COP in the short run instead. Hence, instead of improving price competitiveness and quality of exports, prices of exports might rise instead. Supply side policy is hence only effective in the long run to improve BOP and achieve potential economic growth.

Lastly, with continued globalization and structural changes to the Singapore economy, jobs in some declining industries are lost while new jobs are created. Workers become structurally unemployed as they lack the skills to take up the new jobs. The most effective policy to resolve structural unemployment and help the Singapore government in achieving the goal of low unemployment is supply side policy of retraining workers so they may learn and match their new learned skills to the jobs. The Skill future programme where subsidies are provided by the government to encourage retraining was adopted as a national movement to provide Singaporeans with the opportunities to develop their fullest potential throughout life, regardless of their starting points.

Effectiveness of the retraining programmes depends on adaptability of workers. The older workers are likely to be more resistant to learning new skills and hence less successful in benefitting from the programme. They then may not find new jobs. The programme also incurs high budget on the government which may potentially compete funding with other programmes in the country, incurring high opportunity cost.

Conclusion and judgment

Demand side policies aim to influence AD while supply side policies on AS. With different intentions, they aim to achieve different macroeconomic objectives. Hence, its effectiveness on goals depends on its use in the first place.

In the short run, the nature of Singapore's economy has made demand side policy such as exchange rate policy an effective tool to achieve most of the macroeconomic goals of the government as it may achieve healthy BOP, sustained economic growth, low cyclical unemployment and prevent imported inflation. EFP in addition to exchange rate policy contributes to boosting of AD and prevent job losses during recession. Effectiveness of these demand management policies are however, affected by the extent of their limitations in achieving the goals. For example, severity and sources of recession as well as reaction of major trading partners.

Supply side policy on the other hand are targeted for long run effects such as improving BOP and structural unemployment. It is less effective in the short run but irreplaceable as the only tool to achieve these goals. Effectiveness also depends on cooperation of firms and workers in adopting the initiatives.

Mark scheme (new syllabus 9757)

Level	Description	Marks
L3	<p><u>18 – 20 marks</u></p> <ul style="list-style-type: none"> - For a <u>well-developed answer</u> that <u>thoroughly explains</u> an array of demand-side and supply-side policies in achieving various macroeconomic objectives in the context of Singapore. - Answer shows <u>excellent application</u> to the Singapore economy i.e. in different context, for different macroeconomic objectives and limitations of policies. - Answer is <u>well-structured</u> to reflect <u>excellent organization of ideas</u>. <p><u>15 – 17 marks</u></p> <ul style="list-style-type: none"> - For a <u>well-developed answer</u> that <u>clearly explains</u> an array of demand-side and supply-side policies in achieving various macroeconomic objectives in the context of Singapore. - Answer shows <u>good application</u> to the Singapore economy i.e. in different context, for different macroeconomic objectives and limitations of policies. - Answer is reasonably <u>well-structured</u> to reflect <u>good organization of ideas</u>. <p>Max 15m for 3 reasonably developed demand and supply side policies in achieving at least 2 macroeconomic objectives in Singapore.</p>	15 - 20
L2	<p><u>12 – 14 marks</u></p> <ul style="list-style-type: none"> - For an <u>under-developed answer</u> that <u>explain</u> an array of demand-side and supply-side policies in achieving various macroeconomic objectives in the context of Singapore. - Answer may contain some theoretical mistakes and are somewhat applied to the Singapore economy - Answer is <u>somewhat structured</u> to reflect <u>some organization of ideas</u>. <p><u>9 – 11 marks</u></p> <ul style="list-style-type: none"> - For an <u>undeveloped answer</u> that makes an <u>attempt to explain</u> at least 2 demand-side and supply-side policies in achieving various macroeconomic objectives in the context of Singapore. - Answer contains policies that are <u>relevant but insufficiently explained</u> and <u>poorly applied</u> to the context of Singapore. - Answer is <u>poorly structured</u> and reflect <u>poor organisation of ideas</u>. <p>Max 9m for only 1 well-developed policy.</p>	9 - 14

L1	<p><u>5 – 8 marks</u></p> <p>- For an answer that makes an <u>attempt to explain some policies to achieve macroeconomic objectives.</u></p> <p>- Answer is <u>somewhat irrelevant</u> and <u>contains basic errors in economic theories</u> or are <u>inadequately explained</u> which demonstrates only <u>some basic understanding of economic concepts.</u></p> <p><u>-Answer may not be applied to the Singapore economy.</u></p> <p><u>1 – 4 marks</u></p> <p>- For an answer that is <u>largely irrelevant</u> and contains <u>conceptual errors.</u></p> <p>- Answer has few valid points and demonstrates <u>poor knowledge of relevant and basic economic theories.</u></p>	1 - 8
Evaluation		Marks
E3	Value judgments made with strong economic justifications which reflects considerations of assumptions and synthesis of analysis of relative effectiveness of policies between demand and supply side policies in achieving macroeconomic objectives.	4-5
E2	Some attempts to make value judgments with some economic justification on relative effectiveness of policies between demand and supply side policies in achieving macroeconomic objectives.	2-3
E1	An attempt to make a value judgment without justification.	1

Mark scheme (old syllabus 9732)

Knowledge, Application, Understanding and Analysis		
L3	<p>For a well-developed answer that explains an array of demand-side and supply-side policies in achieving various macroeconomic objectives in the context of Singapore.</p> <ul style="list-style-type: none"> • Answer shows excellent application to the context of Singapore <p>Max 15m for 3 reasonably developed demand and supply side policies in achieving at least 2 macroeconomic objectives in Singapore.</p>	15 – 21
L2	<p>For an undeveloped answer that an array of demand-side and supply-side policies in achieving various macroeconomic objectives in the context of Singapore.</p> <ul style="list-style-type: none"> • Answer shows some good application to the context of Singapore <p>Max 9m for only 1 well-developed policy</p>	10 – 14

L1	<ul style="list-style-type: none"> • For an answer which is largely irrelevant or contains inaccurate content. • For answer which is largely descriptive. 	1 – 9
Evaluation		
E2	<ul style="list-style-type: none"> • For a judgement that is based on economic analysis on relative effectiveness of policies between demand and supply side policies in achieving macroeconomic objectives. 	3 – 4
E1	<ul style="list-style-type: none"> • For a judgement made without evaluation or economic analysis. 	1 – 2