



YISHUN INNOVA JUNIOR COLLEGE
JC 2 PRELIMINARY EXAMINATION
Higher 1

CANDIDATE
NAME

CG

INDEX NO

ECONOMICS

8823/01

Paper 1 Case Study Questions

2 September 2019

3 hours

Additional Materials: Answer Booklet

READ THESE INSTRUCTIONS FIRST

Write your index number and name on all the work you hand in.

Write in dark blue or black pen.

You may use an HB pencil for any diagrams, graphs or rough working.

Do not use staples, paper clips, highlighters, glue or correction fluid/tape.

There are **two** questions in this paper. Answer **all** questions.

The number of marks is given in brackets [] at the end of each question or part question.

This document consists of **9** printed pages and **1** blank page.

Answer **all** questions.

Question 1 Government Support: Beneficial or Not?

Extract 1: Problems with subsidies

Subsidies have been provided by governments to encourage a wide range of activities or for reasons they deem valid. However, over time, subsidies which once served a useful purpose may become entrenched and serve primarily the interests of participants in the industry receiving the subsidies. There is also a tendency for subsidies to continue long after they are necessary. This will strain governments' resources eventually.

Source: <http://www.fao.org>

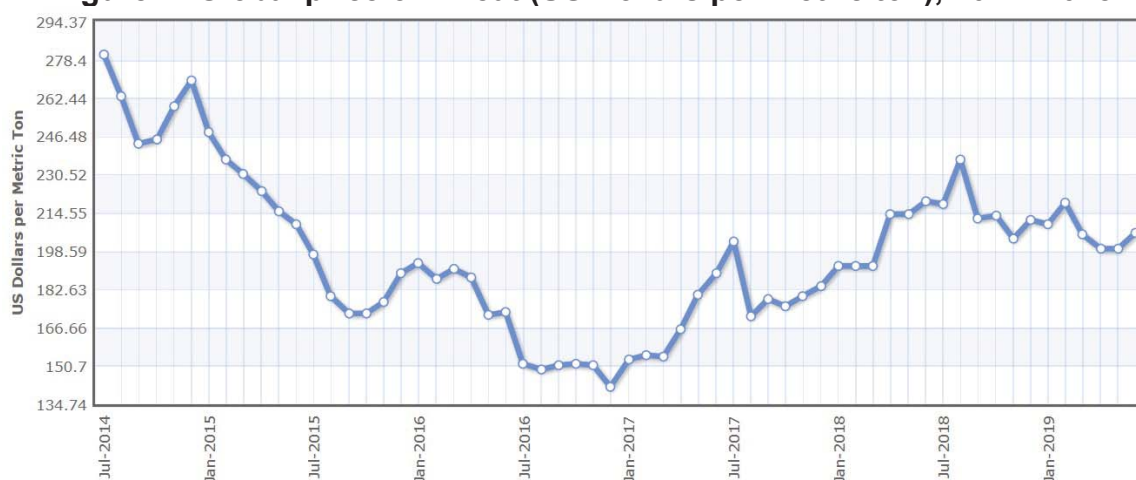
Extract 2: Bank of Botswana urges government to phase out subsidies

Bank of Botswana (BoB) presented a paper on funding options for the country's industrialisation and transition into a high-income economy. It highlighted that infrastructure would be the key to power the country's industrialisation. But blanket subsidies and tax exemptions were locking up public funding that could be better directed towards infrastructure development. "There's a case for the gradual removal of some subsidies that constitute a large proportion of government budget and reallocate resources to infrastructure," it said.

Head of research and financial stability, Tshokologo Kganetsano said, "The government has subsidised food items because they want to target the poor, but others also benefit even though they are not the poor. Fuel is another candidate for a removal of subsidy. Look at the price of petrol in Botswana and compare to South Africa. How much are South Africans paying? Even education is another candidate, but I don't want to go into details. If you go to rural areas, government provides a lot of things. The subsidy is benefitting people who are not prepared to do serious farming."

Source: <http://www.mmegi.bw>

Figure 1: Global price of wheat (US Dollars per metric ton), 2014 -2018



Source: <https://www.indexmundi.com>

Extract 3: Wheat prices continue to see volatility

Wheat prices are experiencing a period of excessive volatility, according to the Food Security Portal's Excessive Food Price Variability Early Warning System. From 2005 to 2013 the land used to cultivate wheat, soy, and corn grew by 11% globally. Worldwide wheat production is reaching the highest volume in 2014. "The new abundance will have broad effects, weakening incomes of farmers and companies that supply them," writes Gregory Meyer of the Financial Times. And what has caused this explosion in grain supplies? Prices. They were unusually high in recent years and have encouraged farmers to pour money into boosting production.

However in 2018, there are rumors of potential wheat export bans in Russia and the Ukraine, two of the larger exporters of wheat, leading to spikes in wheat prices in the global markets. In addition, severe hot weather and drought conditions in several major producing regions have also affected wheat prices in recent weeks. The European Union, the Black Sea Region, and Australia are all experiencing significantly dry conditions that have stunted wheat growth and reduced production prospects.

Such uncertainty and price volatility have raised concerns and in some countries, governments have seen a need to support the workings of the market.

Source: *various*

Extract 4: Revamp government support to make sure it protect stakeholders

In recent years, developing countries' agricultural subsidies have grown rapidly. China's agricultural subsidies now dwarf those in the US and EU combined. From 2005 to 2011, India's minimum price supports for wheat and rice grew by 72% and 75%, respectively, significantly exceeding those in the US.

If done well, these developing countries' spending in agriculture could support innovation, help build a stronger middle class, feed the hungry, generate export revenue and pull millions out of poverty. But such spending must be targeted and short term. For example, a subsidy could be used to support the adoption of technologies.

However, such spending also can hurt efforts to promote efficiency and more sustainable agriculture, as this mean that farming to meet society's current needs compromises the ability of future generations to meet their needs. For example, India subsidises the cost of energy to pump water, which encourages producers to pump more water than they need. Subsidies also lead producers to overuse fertilisers or pesticides, resulting in soil degradation, groundwater depletion and other negative environmental impacts.

Governments need to wake up to the long-term implications of agricultural subsidies as it can stifle innovation and make producers both less competitive and more dependent on government. Many developing countries still struggle to provide basic

services such as clean air and water, education, public services, infrastructure and healthcare. With these competing needs, we need to ensure that any agricultural subsidies increase productivity, efficiency and global competitiveness.

Source: <https://www.theguardian.com/>

Extract 5: General subsidy for higher education

Should the government offer a general subsidy, i.e. subsidy to everyone who attends higher education institutions, in developing countries?

The costs and benefits of education are simple to enumerate. Social costs include everything that must be given up in order to produce the education. These include the resources that must go into paying for tuition and books, and a student's living expenses such as food and housing. They also include the foregone income that the student could have earned by working instead of studying.

Social benefits include the private benefits enjoyed directly by the individual, such as higher earnings through life. They also include public benefits. These include having (a) a critical mass of well-informed citizens; (b) a larger pool of capable business people who can run more efficient businesses and expand the economic pie; (c) political leaders who can understand fast-evolving conditions in the local and international arena; and (d) scientists who can play key roles in adapting and integrating developed world practices to advance a country.

A general subsidy becomes a good idea if the gains produced compare favourably with those of alternative policies. However, investing in primary and secondary school education and primary health care often give a much better return on public funds than subsidising higher education. Helping the well-off obtain higher education when many of them already manage to do so without government help does not make sense economically. Hence, governments should reconsider the case for a general subsidy for higher education and look into more targeted subsidies instead.

Source: *Journal of Higher Education in Africa*, 2003

Questions

- (a) (i) What is the main characteristic of a normative statement? Identify one example of a normative statement from Extract 2. [2]
- (ii) Using the production possibility curve diagram, explain the likely effects of directing more public funding towards infrastructure development on the current and future standard of living of Botswana. [6]
- (b) (i) Describe the trend in the global price of wheat from 2014 to 2018. [2]
- (ii) Account for the trend in the global price of wheat from 2014 to 2018. [4]
- (c) Using a demand and supply diagram, explain the likely consequences of minimum price support on the Indian farmers and government, and comment on the effectiveness of this government measure. [7]
- (d) With reference to Extract 4, discuss the extent to which agricultural subsidies will hurt efforts to promote more sustainable agriculture. [8]
- (e) With reference to Extract 5, explain how a rational student decides on whether to participate in higher education in the absence of any form of government intervention. [4]
- (f) A government subsidises a wide range of economic activities that it wants to encourage or for reasons it deems valid.
- Discuss the view that the provision of subsidies leads to an efficient allocation of an economy's resources. [12]

[Total: 45]

Question 2 Economic growth in Singapore and other countries

Table 1: Growth and Inflation Rates of Selected Economies

	Real GDP Growth rates (annual %)			Inflation, Consumer prices (annual %)		
	2015	2016	2017	2015	2016	2017
Japan	1.2	0.6	1.9	0.8	-0.1	1.9
Malaysia	5.1	4.2	5.9	2.1	2.1	5.9
Singapore	2.9	3.0	3.7	-0.5	-0.5	3.7
United Kingdom	2.3	1.8	1.8	0.4	1.0	1.8
United States (U.S.)	2.9	1.6	2.2	0.1	1.3	2.2

Source: *International Monetary Fund*

Extract 6: Road to recovery

2016 was a slog for the world economy. Weak international trade and subdued investment, among other culprits, conspired to slow world growth to its weakest pace since 2009. And even though the outlook is modestly brighter in 2017, unusually heightened uncertainty about policy direction in major economies casts a long shadow over the prospects of economic confidence and recovery. Indeed, some of these economies are not optimistic about the prospect of more production and increase in jobs created.

The new U.S. administration is expected to diverge sharply from past policies. Because developments in the U.S. economy, the world's largest, have effects far beyond its shores, the changes in policies will likely have substantial global implications. What, for example, would be the effect of the promised fiscal stimulus? Improvements in US growth in the near term can potentially have knock-on benefits to other economies. That said, the full impact of any fiscal stimulus would depend on a host of factors.

At the same time, growth remains weak in many countries, where low inflation indicates that slack has yet to be eliminated. Some are being held back by weak productivity growth. Commodity exporters in many developing economies such as the Middle East face stagnant growth as commodity prices fall.

With greater risks to growth in the medium rather than short-term, this cyclical upturn after a few years of disappointing growth provides an ideal window of opportunity to undertake critical structural reforms to boost productivity and labour supply. Such reforms would prevent any possible slowdown, raise potential output and increase living standards.

Adapted from *IMF World Economic Outlook, October 2017* and the *People's Daily*,
15 February 2017

Extract 7: Singapore Macroeconomic Review: October 2017

The Singapore economy has performed slightly better than envisaged six months ago, while inflation has kept well within expectations.

GDP growth 2017 is expected to be in the upper half of the 2–3% forecasted. The economy grew by 6.3% in Q3 2017, following the 2.4% recorded in Q2, underpinned by strong expansion in electronics production, reflecting an enduring upturn in global demand for IT products. Trade related services and some domestic-oriented industries also performed better. However, the marine and offshore engineering and private residential construction industries remained weak.

MAS Core Inflation, which excludes the costs of private road transport and accommodation, fell marginally to 1.5% year-on-year in July-August 2017, while the CPI-All Items inflation fell from 0.8% to 0.5%. The decline was largely due to smaller year-ago price increases for oil-related components, and lower car prices as well.

Imported inflation is likely to rise mildly, as global demand improves. Oil prices are expected to increase slightly in 2018 while food commodity prices may rise modestly. Economy-wide cost pressures should remain restrained as wage pressures are unlikely to accelerate, as the slack which had accumulated in the labour market takes time to be fully absorbed and as productivity grows gradually. Non-labour costs such as commercial and retail rentals will stay subdued.

MAS Core Inflation, is projected to be at around 1.5% in 2017 and average 1–2% next year. Given the economic outlook at this stage and consistent with medium-term price stability, MAS will maintain the rate of appreciation of the S\$NEER policy band at zero percent, in what is widely seen as a bearish stance for its policy. In fact, Singapore had only previously adopted a zero slope in times of recession. Analysts note that the central bank's move is a response to expectations that inflation will stay lower for longer.

Adapted from IMF World Economic Outlook, October 2017

Extract 8: Singapore's productivity growth – A work in progress

Data released by the Ministry of Trade and Industry (MTI) showed that overall labour productivity¹ grew by 4.5% in 2017, its highest since 2010, driven by gains in externally-oriented sectors such as manufacturing, wholesale trade and finance and insurance, where productivity jumped by 6.7%. By contrast, productivity in domestically-oriented sectors dipped 0.2%.

Singapore has been working to push up its labour productivity levels for years, given that it forms a key part of the equation in ensuring sustainable wage rises and economic expansion as the country's workforce growth slows, as well as attract domestic and foreign firms. This would allow living standards to be raised.

¹ Labour productivity is measured by the output per hour worked.

Often, wage rises can occur when firms increase their demand for labour. This can in turn happen when there is an increase in the quality of labour, or when there is an increase in demand for the goods and services that the labour can produce.

But given how productivity gains were mainly fuelled by the externally-oriented sectors, Singapore's productivity push remained a "work in progress", said MTI's Loh Khum Yean. Firms in externally-oriented sectors are "incentivised to optimise operations and seek efficient production methods to remain competitive", according to MTI.

Economists echoed that view, with CIMB's Song Seng Wun describing productivity growth as an "outlier" due to a sharp rebound in global demand. "Simply put, it's about factories, which were less busy in the past two years suddenly becoming busier with orders, so it looked like we had a sharp improvement in productivity. It's mostly that, instead of factories implementing new effective ways of production."

Also, productivity growth may not be a big draw for firms in the current economic climate, where many are speculating a slowdown in global demand ahead.

Source: *Channel News Asia*, 17 April 2018

Extract 9: Ensuring inclusive economic growth

After decades of high and sustained economic growth, the Singapore government has over the past decade placed a greater focus on "inclusive growth". This comes amidst a slowing long-term growth trends as the economy matures, greater economic shocks stemming from greater global uncertainties, a rapidly ageing population and more visible income disparities as Singapore positions itself as a global financial and technology hub.

One of the most visible aspect of the Government's commitment to inclusive growth has been the increase in fiscal transfers, even as the Government remains committed to maintaining fiscal sustainability and keeping the burden of taxation on middle and high income earners low. These transfers include:

- GST vouchers in the form of cash payouts, Medisave top-ups and utilities rebates based on HDB room-type
- Workfare Income Supplement (WIS), which tops-up to the wages of low wage earners (monthly income <\$2,300) above 35
- Pioneer Generation Package which provides financial assistance for all elderly Singaporeans born before 1950, especially through enhanced healthcare subsidies and subsidies for the payment of Medishield Life (national healthcare insurance). Similar benefits were extended in 2019 in the Merdeka Generation Package to those born before 1960
- Subsidies for childcare and kindergarten for all Singaporeans, with additional subsidies for lower and lower-middle income earners

Many observers want the Government to do more, noting that the Workfare payments are paltry especially for younger workers. A 37-year old earning \$1,500, for example, gets a monthly WIS payout of \$32 in cash and \$42 in CPF top-ups, and this may not significantly increase his disposable income.

However the Government is already funding social spending from 50% of the annual returns on its reserves, which is the maximum provided for under the Constitution. The Government has stressed that it is working hard to support lower wage workers move up the wage ladder through skills upgrading, which it also heavily subsidises and getting industries to adopt a Progressive Wage Model where firms in industries commit to training their workers to perform work requiring higher skills so that they can earn higher wages.

Adapted from *Various*

Questions

- a) Explain whether the data provided in Table 1 is sufficient to conclude that the Japanese economy is experiencing an economic recovery in 2017. [4]
- b) Explain and comment on how “improvements in US growth in the near term can potentially have knock-on benefits to other economies (Extract 6).” [6]
- c) Using AD/AS analysis, explain how lower commodity prices would affect a commodity exporting country such as the United Arab Emirates and a commodity importing one such as Japan. [6]
- d) (i) Explain why exchange rate is an appropriate tool for the Singapore economy to moderate inflation. [4]
- (ii) Explain two factors that the MAS has to consider in making a decision to maintain the rate of appreciation of the S\$NEER policy band at zero percent. [4]
- e) Explain and comment on how productivity growth can increase standard of living in an economy like Singapore. [9]
- f) With reference to the case material and your own knowledge, assess the effectiveness of the policies in place to bring about inclusive economic growth in Singapore. [12]

[Total: 45]

- End of Paper -

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Yishun Innova Junior College
JC2 H1 Economics 2019
Preliminary Examination
Suggested Answers
Paper 1

Question 1

(a)	(i)	What is the main characteristic of a normative statement? Identify one example of a normative statement from Extract 2.	[2]
<p><u>Suggested Answer</u> Identification of value judgement as the main characteristic of normative statement Identification of a valid example from Extract 2</p>			
(a)	(ii)	Using the production possibility diagram, explain the likely effects of directing more public funding towards infrastructure development on the current and future standard of living of Botswana.	[6]
<p><u>Suggested Answer</u> Fully-labelled diagram More production of infrastructure → movement along PPC → less resources available for production of consumer goods → lower current material standard of living More production of infrastructure → increases the quantity and quality of resources in the future → resulting in higher productive capacity → PPC shifts outwards → more goods and services are available for consumption in the future → future material standard of living improves</p>			
(b)	(i)	Describe the trend in the global price of wheat from 2014 to 2018.	[2]
<p><u>Suggested Answer</u> <ul style="list-style-type: none"> • Generally falling • Except for 2017-2018 (anomaly) OR • Volatile </p>			
(b)	(ii)	Account for the trend in the global price of wheat from 2014 to 2018.	[4]
<p><u>Suggested Answer</u> As global wheat prices increase, farmers find it more profitable to produce wheat instead of other food crops, thus switching over to producing wheat. Thus the supply of wheat increases, causing a surplus that creates a downward pressure on wheat prices. However, the production of wheat is subjected to weather fluctuations which affects the supply of wheat. Hot and dry weather conditions lower the harvest of wheat, causing a shortage in the market and thus pushing up prices. OR</p>			

As the demand for wheat is price inelastic due to it being an important staple for many countries, the changes in supply would lead to significant changes in prices.			
(c)		Using a demand and supply diagram, explain the likely consequences of minimum price support on the Indian farmers and government and comment on this government measure.	[7]
<p><u>Suggested Answer</u></p> <p>Minimum price support diagram</p> <p>Explain how</p> <p>The government sets minimum prices to prevent them from falling below a certain level to protect producers' incomes as the industry is subject to supply fluctuations and thus prices are likely to fluctuate severely.</p> <p>Possible comments:</p> <ul style="list-style-type: none"> • Surplus created farmers are not able to clear the stocks □ may try to evade prices • High price may discourage these farmers from finding more efficient methods of production and lower costs (lower efficiency) • High price may discourage farmers from producing alternative crops which they could produce more efficiently or which are in higher demand • Government will need to buy up the surplus. This might not be a sustainable in the long run given that government's budget is limited. 			
(d)		With reference to Extract 4, discuss the extent to which agricultural subsidies will hurt efforts to promote more sustainable agriculture.	[8]
<p><u>Suggested Answer</u></p> <p><u>Introduction</u></p> <p>Sustainable agriculture is farming that meet society's current needs without compromising the ability of future generations to meet their needs. With more efforts now directed to manage the environmental aspects of agriculture, more attention should be given to the impact of agricultural subsidies.</p> <p><i>Thesis: Agricultural subsidies can undermine efforts to promote more sustainable agriculture</i></p> <p>Agricultural subsidies → lower unit COP of agricultural production → increase profitability of agriculture production → producers have more incentive to increase agriculture production → increase in demand for factor inputs required, e.g. increased use of fertilisers, pesticides → greater negative environmental impact, e.g. soil degradation → deterioration of quality of land available for use in agricultural production → compromising ability of future generations to use resources to meet their own needs</p> <p>Agricultural subsidies that lowers cost of inputs → lowers price of water of factor input, e.g. subsidies for cost of energy in water lower price of water → increase in quantity of water used → depletion of groundwater → less resources available for future generations</p> <p><i>Anti-thesis: Agricultural subsidies may not necessarily hurt efforts to promote sustainable agriculture</i></p>			

Agricultural subsidies can be given to support adoption of technology in farming → improvement in method of production → increase efficiency in production → less wastage of resources used in production → more resources available for future generations

Agricultural subsidies can be given to support R&D → innovation → better quality crops, e.g. more resilient → less need for fertilisers or pesticides → negative environmental impact minimized → limit erosion in quality of land used → ability of future generations to use resources to meet their own needs not compromised

Conclusion

Whether agricultural subsidies will hurt efforts to promote sustainable agriculture depends on the form subsidy takes or type of activities encouraged by the subsidy. If given to support innovation or adoption of technology, less likely to lead to negative environmental impact and resource depletion compared to if given to merely to help farmers to lower cost of production directly.

Level	Description	Mark
L2	A balanced answer with well-developed analysis addresses how agricultural subsidies can have both negative and positive impact on sustainable agriculture.	4-6
L1	A descriptive answer that lacks economic analysis.	1-3
E2	For an answer that gives evaluative statements that addresses the question.	2
E1	For an answer that gives unsupported evaluative statements.	1

(e)	With reference to Extract 5, explain how a rational student decides on whether to participate in higher education.	[4]
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Suggested Answer

Private benefit: Knowledge and skills acquisition, higher-paying jobs

Private cost: College fees, time spent could be used to earn income (opportunity costs)

Participates if private benefits exceed private costs.

(f)	A government subsidises a wide range of economic activities that it wants to encourage or for reasons it deems valid.	[12]
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Discuss the view that the provision of subsidies leads to an efficient allocation of an economy's resources.

Suggested Answer

Introduction

- Explain meaning of efficient allocation of resources and implication of not achieving it
- Emphasise on need to ensure provision of subsidies is directed to the right areas

Thesis: Provision of subsidies can lead to an efficient allocation of resources in cases when positive externalities exist

- Explain what positive externalities is with the use of an example, e.g. education (Extract 5)
- Explain how the existence of positive externalities can result in under-consumption of education, i.e. market failure exists with the use of a diagram

- Explain how the use of a subsidy can increase consumption of education, leading to efficient allocation of resources, i.e. correct market failure

Anti-thesis: Provision of subsidies might not lead to efficient allocation of resources

- Need to consider extent of subsidies given: If subsidies given more than required (e.g. more than MEB) → over-consumption of good → too much resources allocated into market (Extract 5)
- Govt has other objectives in provision of subsidies: E.g. Govt could be more concerned about addressing problems of inequity → use of subsidies to lower prices of goods → lower income households are able to afford goods as well → greater consumption of goods, but not necessarily at socially optimal level → does not result in efficient allocation of resources (Extract 2)
- Govt subsidies might lead to unintended consequences which result in inefficient allocation of resources: E.g. overusage of water, fertilisers, pesticides → external cost generated → too much resources allocated to these areas → does not lead to efficient allocation of resources (Extract 4)

Conclusion

Whether provision of subsidies leads to efficient of resources depends on the objectives of govt intervention, the extent of subsidies given and possibility of unintended consequences arising.

L3	A balanced answer that includes a well-developed analysis of how provision of subsidies lead to efficient allocation of resources with considerations of its limitations, with good reference to the case materials, considering different economic activities or government aims (e.g. equity).	6 - 9
L2	A balanced answer that includes some analysis of how provision of subsidies can lead to efficient allocation of resources with considerations of its limitations, with some reference to case materials.	3 - 5
L1	An answer that is lacking in economic analysis, e.g. describing how subsidies work or some limitations with use of subsidies.	1 - 2
E2	For evaluative judgement that considers the analysis, weighing the appropriate factors for government consideration with good reference to case materials.	2 - 3
E1	For an answer that gives unsupported evaluative statements.	1

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Question 2

a)		Explain whether the data provided in Table 1 is sufficient to conclude that the Japanese is experiencing an economic recovery in 2017.	[4]
<p><u>Suggested Answer</u></p> <p><i>Explain how data can show that Japan is experiencing economic recovery</i></p> <ul style="list-style-type: none"> Improvement in GDP growth rate from 2016 to 2017: GDP is increasing at an increasing rate and could show an increase in rate of production and hence indicate economic recovery. Accompanied by inflation in 2017: increase in general price level (compared to deflation in 2016) could mean that the economy is nearing full employment and hence there is upward pressure on wages and general price level, signifying economic recovery <p><i>Explain how data may be insufficient to conclude that Japan is experiencing economic recovery</i></p> <ul style="list-style-type: none"> In spite of data, Japan may not be experiencing economic recovery: even with increased GDP, there may not be increased hiring if there was significant underemployment previously, or if the increase in demand for factors of production is more for capital. Data is not sufficient: the data provided does not show the unemployment rate for us to conclude on the proportion of unemployed in the economy. Data is not sufficient: the data provided is for 3 years and not sufficient to conclude that economic recovery is underway 			
b)		Explain and comment on how “improvements in US growth in the near term can potentially have knock-on benefits to other economies (Extract 1).”	[6]
<p><u>Suggested Answers</u></p> <p>An increase in US growth means an increase in income for the US. This could then lead to an increase in demand for imports by the US. Economies that are dependent on exports to the US will then face an increase in export revenue, and an increase in AD. This would cause an unplanned running down of stocks and firms would increase production and demand for more factors of production. This would reduce cyclical unemployment. At the same time, the real GDP of these economies would then increase via the multiplier process.</p> <p>However, the extent to which this happens can depend on:</p> <ul style="list-style-type: none"> Proportion of the economy’s exports that are demanded by the US: the smaller this proportion, the less significant the impact of US growth on the economy Size of exports as a proportion of the country’s AD: the smaller this proportion, the less significant the impact of US growth on the economy 			
c)		Using AD/AS analysis, explain how lower commodity prices would affect a commodity exporting country such as the United Arab Emirates and a commodity importing one such as Japan.	[6]
<p><u>Suggested Answer</u></p> <p><i>For a commodity exporting country</i></p> <p>Lower commodity prices would reduce the price of exports in foreign currency. Given that the demand for commodities tend to be price inelastic due to the lack of substitutes, export revenue would decrease and AD would decrease, leading to an unplanned accumulation of stocks. Firms decrease production and demand for less factors of production. Real GDP would fall via</p>			

the multiplier effect, and cyclical unemployment will rise. There may be less demand-pull inflation if the economy is near full employment as the decrease in demand for factors of production lead to a decrease in unit cost of production.

For a commodity importing country

Lower commodity prices would reduce the price of imports in domestic currency and lead to lower unit cost of production. This would then increase the AS of the economy and lead to deflation and actual growth.

d)	(i)	Explain why exchange rate is an appropriate tool for the Singapore economy to moderate inflation.	[4]
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Suggested Answer

Singapore is a small and open economy that:

- Relies on imported raw materials: an appreciation of the exchange rate would help to lower the price of imported raw materials, lowering the cost of production throughout the economy and moderate cost push inflation.
- Relies on export revenue: an appreciation of the exchange rate would increase the price of exports in foreign currency and lower import prices in local currency and if demand for exports and imports are both price elastic, then AD will fall. This would help to moderate demand-pull inflation.

d)	(ii)	Explain two factors that the MAS has to consider in making a decision to maintain the rate of appreciation of the S\$NEER policy band at zero percent.	[4]
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Suggested Answers

- Cost of maintaining zero percent appreciation: may lead to imported inflation, but this risk is quite low as imported inflation is only expected to rise mildly
- Benefit of maintaining zero percent appreciation: may lead to increase in demand for exports as compared to the past appreciation, there is effectively a depreciation and this would increase demand for exports and boost AD, particularly when economy is not doing well.

OR

- Effectiveness of policy
- Feasibility of policy

e)		Explain and comment on how labour productivity growth can increase standard of living in an economy like Singapore.	[9]
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Suggested Answer

Explain how productivity growth can help to bring about wage increases and economic growth and hence improving standard of living

- Productivity growth means an increase in output per hour worked. With such an increase in quality of labour, there will be an increase in demand for labour and this would lead to higher wages. With higher wages and assuming inflation is lower than wage rises, the purchasing power of citizens will increase, thereby increasing their material well-being.
- At the same time, with rising productivity, labour can receive higher wages for the same number of hours worked, and this could translate to a higher number of leisure hours that will increase their non-material well-being.
- Productivity growth can also increase the productive capacity of the economy. This would allow the economy to enjoy a simultaneous outward and downward shift in AS. This is

especially so as the quantity of factors of production in Singapore is unlikely to increase significantly with an ageing population and thus the economy has to rely on increasing the quality of labour to increase AS. This would allow the economy to enjoy potential growth.

Comment on the extent to which standard of living can be raised for Singapore

- 1) In spite of productivity growth, unemployment rates may increase or not be lowered
 - Takes time to see the effects of productivity growth on productive capacity and wage increases
 - Decrease in extent of underemployment may be captured as productivity growth and this will not lower unemployment rates
- 2) In the long run, productivity growth can help to attract FDI as foreign firms may be attracted to the pool of skilled labour. This would lead to an increase in AD in the future and further increase in productive capacity, thus ensuring that AD and AS rise in tandem, allowing for increase in real GDP and material well-being.
- 3) In spite of productivity growth, firms may not increase investment
 - If business outlook is bleak, firms may not project future returns favourably and may not increase their investment. Under such circumstances, AD may not increase in tandem with AS and real GDP, and hence purchasing power, may not increase.

f)		Assess the effectiveness of the policies in place to bring about inclusive economic growth in Singapore.	[12]
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Suggested Answer

Explain how the policies can bring about inclusive growth in Singapore

- Identify the policies: fiscal policy (increasing fiscal transfers) and supply-side policies (subsidising skills upgrading, encouraging the adoption of progressive wage model)
- Fiscal transfers can increase disposable income of lower-income households and lead to an increase in C, thereby increasing AD and leading to actual growth via the multiplier process.
- The benefits of this growth is enjoyed by more by lower-wage individuals who would benefit from additional subsidies and utilities rebates. Hence the growth improve income equality and is seen to be inclusive.
- Supply-side policies to subsidise skills upgrading would encourage more workers to go for training and would increase the quality of labour in the economy, thereby increasing the productive capacity of the economy in the long run and leading to potential growth.
- The benefits of the training will be felt by the workers as firms adopt a progressive wage models and the improvement in productivity would lead to higher wages. Hence, the growth would improve income equality.

Explain the limitations of the policies in bringing about inclusive growth in Singapore

- The amount of fiscal transfers given has to be significant to bring about a change in behavior in lower wage workers. For instance, the WIS may not lead to a large increase in disposable income for workers and thus they may not increase work effort and enjoy the benefit of economic growth.
- Supply-side policies which involve a change in the wage structure of firms, such as the progressive wage model, may take time to take effect and thus the effectiveness of such a policy may not be felt in the short run.

- The policies may lead to a fall in economic growth as the increase in fiscal transfers (in the form of social spending) may mean be financed by earnings from past reserves and could limit the ability of the government to carry out expansionary fiscal policy in future that would lead to an increase in AD and bring about actual growth. Thus, the policies may mean slower economic growth in future.

Evaluative conclusion

The effectiveness of the policies can depend on the receptiveness of lower wage workers to going for training, how widely the progressive wage model is adopted, and how much the subsidies are. The fiscal transfers tend to improve income equality in the short run and may lower economic growth, while the supply-side policies can improve income equality and raise economic growth in the long run. Thus, the policies that have been implemented largely complement each other, in that some are short-term in nature, to increase disposable income of lower-income workers, while there are others that are aimed at increasing the income of these workers.

L3 [6-9]	An answer that explains how the fiscal and supply-side policies may <u>and</u> may not be effective in bringing about growth that is sustained over a period of time, is broad-based across economic sectors, and creates productive employment opportunities for the majority of the country's population, with reference to the Singapore context.
L2 [3-5]	For an answer that only focuses on how <u>one policy</u> (eg. fiscal transfers) may <u>and</u> may not be effective in bringing about either sustained growth <u>or</u> broad-based growth, with limited reference to the Singapore context.
L1 [1-2]	A vague, descriptive or list-like answer on how the policies may or may not be effective in bringing about growth.

In addition, up to a further 3 marks for valid evaluative comment. This should focus on seeing how the policies are part of an overall approach that considers both the short- and long-term effects of the policies.



