

In light of the trend towards globalization, achieving a healthy Balance of Payments is the top macro-economic objective for governments

- a) Explain the domestic and external effects of changes in exchange rates on the macro economy (10m)
- b) Assess the view that the Singapore government should focus on achieving a healthy balance of Payments as its main macroeconomic goal (15m)

**Suggested answer scheme:**

**Part a)**

**Intro:** explain that exchange rates are determined through the use of market forces (DD&SS). Changes in exchange rates could be due to changes in the demand and/or supply of the currency. External effects would be related to the external sector of the economy (BOP) while domestic effects would be related to the impact on the other macroeconomic indicators (employment, growth and inflation)

**Development: (student may choose to explain the effects of either an appreciation or a depreciation of the currency)**

Domestic effects of an appreciation of the currency would be to increase the price of exports in foreign currency, and reduce the price of imports in domestic currency. Assuming the M-L condition holds, the value of net exports would fall, and the AD curve would shift to the left. This would reduce national income, growth and employment through the multiplier process (illustrate using AD/AS diagram)

An appreciation of the currency could also attract investments into the country due to higher returns, hence increasing AD and leading to actual growth. In the long run, potential growth could also be achieved, resulting in a rightward shift of the AS. (Illustrate using AD/AS diagram)

External effects of an appreciation would be to reduce the value of net exports, hence reducing the current account balance of the BOP, ceteris paribus. However, the inflow of investments from abroad could help to improve the balance on the capital account.

**Conclusion:** Changes in exchange rates would have consequences both on the domestic and external sectors of the economy, and these effects would be magnified, given the current trend towards globalization.

<b>Knowledge, Application, Understanding and Analysis</b>		
<b>L3</b>	Explanation of both the domestic and external effects of a change in the exchange rate on the macroeconomic goals of a country, with the use of analytical tools and evaluation	<b>7-10</b>
<b>L2</b>	Undeveloped explanation, e.g. an explanation of the domestic or external effects but not both  OR on some descriptive explanation of the effect on the macroeconomic goals	<b>4-6</b>
<b>L1</b>	For an answer which has some basic correct facts such as an unexplained list of potential effects on the macro economy and/or an understanding of the effect of exchange rate changes on the prices of exports and imports.	<b>1-3</b>

### **Part (b)**

#### **Intro:**

State the macroeconomic goals of the government:

All governments aim to achieve full employment, price stability, high and sustained economic growth and healthy BOP

#### **Development:**

**Thesis:** A healthy BOP should be the main objective of the government, as there are benefits of achieving a healthy BOP, as well as the fact that pursuing this particular goal also allows other macroeconomic aims to be achieved

#### **Explain the benefits of achieving a healthy BOP**

- Higher Standard of Living (current & future)
- Goods and services produced are competitive
- Decrease in foreign debt
- Rise in country's assets

#### **Explain that pursuing a healthy BOP also allows other macroeconomic goals to be achieved:**

- Increase in actual & potential growth.
- Also leads to a fall in GPL and helps achieve price stability.

(Explain using AD/AS diagram)

**Anti- Thesis:** A healthy BOP should not be the main objective of the government.

**Explain how a the pursue of a healthy BOP may bring about conflicts with other macroeconomic goals**

E.g. depreciation of the currency to improve the current account balance could lead to a fall in net exports, reducing AD, national income, output and employment through the multiplier process.

(Explain using AD/AS diagram)

**Explain why other macroeconomic goals should be the main economic priority of the government, given the trend towards globalization**

E.g. Whether the government should pursue a healthy BOP would be dependent on other factors such as priority of govt and current economic situation

Priority of the government: if the government is currently experiencing inflation, or negative economic growth or unemployment, then these might be the more urgent objectives as compared to a healthy BOP.

**Conclusion (judgment):** Whether a healthy BOP should be the main goal of the SG government is dependent on the government's priorities. With the recent trend towards globalization, the increasing volumes of trade in goods and services would increase the risk of imported inflation for a small and open economy like Singapore. Globalization has also resulted in the business cycles of major trading countries becoming increasingly synchronized, which have increased the risks of economic downturns and structural unemployment during global negative events for SG. Hence, due to the characteristics of the Singapore economy as well changing economic conditions due to globalization, the SG government tends to focus on other macroeconomic goals like economic growth and employment, with achieving a healthy BOP being an offshoot of achieving these other 2 macroeconomic goals.

Level	Marks	Knowledge, Application, Understanding & Analysis
L3	9 - 11	For a developed balanced argument that considers the effects of a healthy BOP on the other macroeconomic goals with the usage of analytical tools
L2	5 - 8	An answer that explains the pros and cons of having a healthy BOP but lacks depth in economic analysis OR An underdeveloped explanation i.e. no linkages to other macroeconomic goals OR A one-sided answer that explains the need for healthy BOP
L1	1 - 4	For an answer that shows some knowledge on the benefits of healthy BOP with inaccuracies.
Up to 4 additional marks for evaluation		
E2	3 - 4	Reasoned judgement with the usage of appropriate criteria

E1	1 - 2	Mainly unexplained judgement
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