H1 CSQ 2

Suggested Answers

(a) **Using the data in Table 1,**

    (i) **Describe the trend in real Gross Domestic Product for Singapore from 2013 to 2016.** **[1]**

    Real Gross Domestic Product for Singapore increase from 2013 to 2016. **[1]**

    (ii) **Identify the year where General Price Level was the highest.** **[1]**

    General Price Level was the highest in 2014. **[1]**

(b) **What conclusion would you draw about the overall economic performance of Singapore in 2016 compared with 2013?** **[4]**

Comparing between 2013 and 2016, Singapore's real GDP growth fell from 2.6% to 2.5%. This implies that its real GDP is increasing at a decreasing rate and its unemployment rate rose from 1.9% to 2.1%. The increase in unemployment reflects an increase in unutilised resources in the economy. Since GDP measures the total value of final goods and services produced within the geographical boundary of a country in a given year. A fall in Singapore's real GDP growth rate reflects a slower growth and this is supported by a -2.5% growth in its gross fixed capital formation. This signifies a fall in the level of investment in the country which is detrimental to the economy both in the short and long run. Although there is an improvement in the Balance of Trade in 2016 as compared to 2013, we have insufficient information to conclude on the overall Balance of Payment account of the country. Hence, the overall economic performance of Singapore deteriorated in 2016 compared to 2013. **[1]**

*Any 3 indicators – 3m*
State the conclusion – 1m

(c) **Using elasticity concepts, analyse the incidence of agricultural subsidy on producers and consumers of grain.** **[4]**

From Extract 6, Para 2 "Separately the government pledged increased agricultural subsidies…set aside 14 billion yuan (US$2.26 billion) in subsidies to grain farmers" → Lower cost of producing grain → Supply curve shifts to the right → a fall in equilibrium price and increase in equilibrium quantity. **[1]**

Concept of price elasticity of demand and supply can be used to determine the incidence of subsidy that is experienced by the producer and consumer of final goods and services.

Demand for grain tends to be price inelastic due to grain being a staple in Asian country like China. Hence, degree of necessity is high. **[1]**

Use diagram to illustrate the incidence of subsidy on consumers and producers of grain
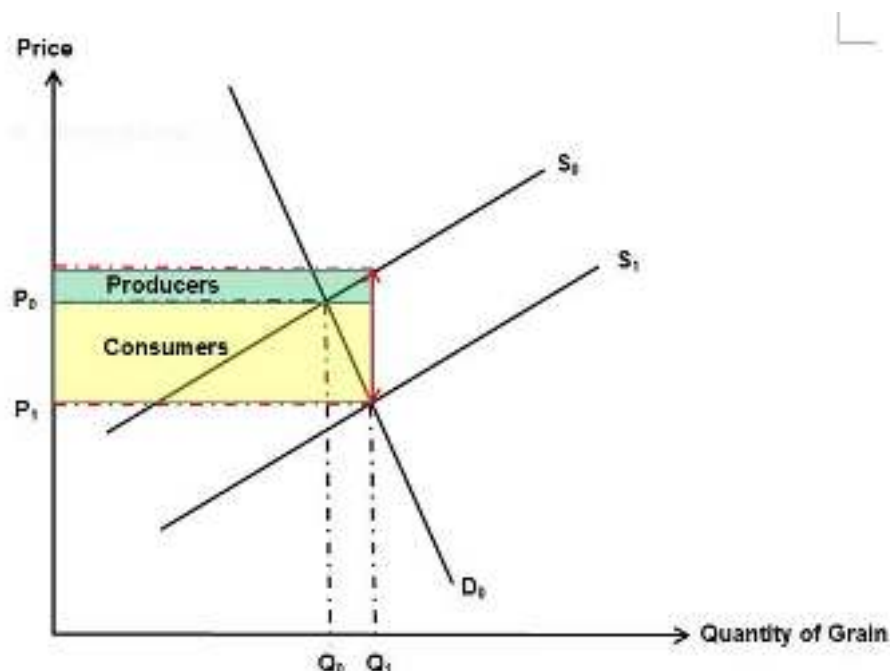
Since PED for grain is more price inelastic than PES for grain [1]

Where demand for grain, which is a necessity for China (since most Asian consume rice as a staple) are highly price inelastic, a fall in price leads to a less than proportionate increase in quantity demanded by consumers. As consumers are relatively less responsive to price changes than producers, producers can more easily pass on the fall in cost of production to consumers. As a result, the consumers would bear a greater proportion of the subsidy while producers bear a smaller proportion.

Evaluation: [1]

In conclusion, whether the incidence of agricultural subsidy will fall more on consumers or producer depend on the relative elasticity of demand and supply for grain.

(d) **(i)** **Using AD/AS analysis, explain how 'surprise devaluation of the yuan' can reignite growth in China.** **[4]**

The aim of the Japanese government is to seek to boost economic growth which slowed to 7 percent in the first quarter of 2015 as mentioned in Extract 6, Para 1.

A 'surprise devaluation of the yuan' will cause China's exports to gain international competitiveness → exports will become relatively cheaper in foreign currency → Assume demand for exports to be price elastic, a decrease in the export prices will bring about a more than proportionate increase in quantity demanded for exports (X) resulting in an increase in export revenue of China. **[1]**

Locals will now find imports to be relatively dearer than before in local

currency → Assume demand for imports to be price elastic and that imports and locally-produced goods are close substitutes, there will be a more than proportionate fall in quantity demanded for imports (M) resulting in a fall in import expenditure of China. **[1]**

Assuming Marshall-Lerner condition holds where the sum of the price elasticity of demand for imports and exports is greater than one [$E_X + E_M > 1$] **[1]** → increase in (X-M) → increase in AD → trigger the multiplier → multiple expansion of production, output, employment & national income **[1]**

(ii) **Suggest a possible reason why this policy may have limited effectiveness.** **[2]**

As mentioned in Extract 7, Para 1 "traders feared the move could also ignite a currency war" **OR** Extract 7, Para 2 "fear a prolonged currency war … US and Japan retaliate" **[1]** → retaliation by China's trading partner in the weakening of their currency hence, China's exports will seem relatively dearer in foreign currency to them leading to a fall in demand for China's export, c.p. AD ↓ → limiting the effectiveness of the policy to reignite growth in China. **[1]**

Any **POSSIBLE** reason may be accepted: **[2]**

- Demand for exports and imports are price inelastic

Demand for exports and imports may be price inelastic in the short run. There are <u>other determinants affecting locals' decisions to buy foreign goods and foreigners' demand for a country's exports</u> (other than price considerations).

For instance, it will take some time for consumers to switch their taste and preferences. In addition, it will also take time for trading contracts between firms to expire before they can respond to the change in exchange rate and switch trading partners. Thus the aggregate demand might <u>not</u> rise by the full extent.

- Conflict with other macroeconomic goals

Devaluation improves the country's export competitiveness and helps to stimulate aggregate demand and economic growth. However this could be at the expense of demand-pull inflation especially if the economy has supply bottlenecks or is operating at full employment levels. Hence, policymakers in deciding the timing and extent of growth policies have to weigh the benefits of economic growth versus the costs of higher inflation (demand-pull inflation).

However, it must be noted that China is facing economic slowdown. Hence, unless the increase in AD is substantial enough, China should not be hit with the problem of inflation.

- Ceteris paribus assumption does not hold in real life

Ceteris paribus assumption does not hold in the real world. There could be other external shocks or variables affecting the level of aggregate demand and the economy – which could cancel out the effectiveness of the implemented exchange rate policy.

- Time lags

*It takes time before the economic situation is fully recognised as time is needed to gather key economic statistics and data **[recognition lag]**.*

*Central banks also need time to make decisions and implement the appropriate monetary policy **[implementation lag]**.*

*There is also a time lag for the monetary policy to affect the economy and inflation **[impact lag]**.*

Owing to the time lag associated with the working of monetary policy, the depreciation of exchange rate may take effect at a time when the economy may have already recovered from the economic recession, thus resulting in the economy overly expanding and facing inflationary pressures instead.

- Uncertainty

There is uncertainty to the extent and duration of the macroeconomic problem – recession – at hand. Governments do not have perfect information as to the degree and duration to weaken the exchange rate.

(e) **Analyse the effects of the TPP fallout and China's slowdown on the Singapore economy.** **[6]**

Effects of TPP fallout on SG economy:
- TPP was intended to be a multilateral FTA among a number of countries, aimed to create freer trade and investment flows among these countries → increase (X-M) and increase I → link to actual and potential growth → sustained EG
- Benefits of TPP cannot be reaped (Extract 8: "fostering trade and investment to boost growth")
- Lack of increase in (X-M) to increase AD, and lack of increase in I to increase AD and LRAS
- Inability to achieve sustained economic growth (stagnation) and reduce cyclical unemployment
- If there is a decrease in investor confidence, might even result in a decrease in I → lower AD and AS → fall in sustained growth

Effects of China's slowdown on SG economy:
- China's slowdown → Chinese economy growing at a slower rate (i.e. slower pace of increase in economic growth)
- Slower rise in incomes than before (or lower than expected increase in incomes)
- Adverse effect on purchasing power
- Chinese consumers will spend on fewer goods and services, including imports from Singapore
- Fall in Singapore's export demand
- Fall in Singapore's export revenue
- Assuming Singapore's import expenditure remains unchanged, there will be a fall in net export revenue (X-M)
- Adverse effect on BOP: Lower (X-M) → BOT, current account and hence BOP worsens
- Adverse effect on EG and unemployment: Lower (X-M) → lower AD → multiplier process → decrease in real NY → fall in actual growth in Singapore; fall in derived demand for labour → rise in cyclical

unemployment (AD/AS diagram)

Evaluation:

All in all, both events have had adverse impacts on the Singapore economy, in terms of worsening or stunting her economic performance. However, the death of TPP is likely to have a more substantial impact on the Singapore economy than China's slowdown, as although Chinese economic growth is slowing, there is still positive growth. Hence, the loss of confidence due to the death of TPP leading to adverse impacts on C and I would probably have more severe impacts on the SG economy.

L2	For a developed answer that explains the impact of **both** the TPP fallout and China's slowdown on the Singapore economy, with links to Singapore's macroeconomic goals and/or standard of living	4-6
L1	For an undeveloped answer that describes/states the possible impacts of the TPP fallout and China's slowdown on the Singapore economy, with lack of economic reasoning or significant missing links **OR** For an answer that only addresses the impact of **either** the TPP fallout **or** China's slowdown on the Singapore economy	1-3

Extract 9 explains Trump's "America First" protectionist stance, which he claims will address the negative consequences brought about by globalisation.

(f)   **[8]**

Discuss whether Trump's protectionism can ever be justified.

Introduction (and brief explanation of protectionism in U.S. context)

Protectionism involves measures taken to partially or completely protect domestic industries from foreign competition in domestic markets. According to Extract 9, Trump's protectionism policy, "Buy American, Hire American", involves incentivising firms to use domestic factor inputs (e.g. raw materials, assembly parts, labour) instead of imported inputs, and getting the U.S. government to purchase locally produced goods and services as opposed to imported ones. In doing so, this would reduce America's import demand and hence import expenditure.

T1: Trump's protectionism may be justified – helps to reduce structural unM

One argument to justify protectionism may be that it helps to reduce structural unemployment. According to Extract 9, globalisation has brought "cheap consumer goods into the country, costing domestic jobs". This could imply that the U.S. has lost its comparative advantage in the production of certain goods and services (sunset industries), due to the emergence of countries which can produce these same goods at a lower cost of production (e.g. emerging economies such as Vietnam and China

being able to produce low-end manufactured goods at lower prices due to their lower labour costs). Since globalisation involves the freer flow of goods and services, households around the world will tend to buy the relatively cheaper goods and services from other countries. As a result, U.S. firms' product demand and hence revenue will fall due to the lack of competitiveness. Subsequently, if they earn subnormal profits in the long run, they will shut down and leave the industry. This may lead to structural unemployment as U.S. workers in these sunset industries may not have the relevant skills to work in other industries (occupational immobility), which in turn has adverse effects on material and non-material standard of living.

As a result, protecting domestic industries in the above-explained ways would help to boost demand and revenue for local firms, preventing them from shutting down. This helps to avoid structural unemployment.

AT1: Limitations of above argument that protectionism can help reduce structural unemployment

However, the above argument has its limitations. Importantly, protectionism does not solve the root cause of the problem when it comes to structural unemployment. The U.S. is losing its comparative advantage because of the emergence of low cost competitors that are more efficient in production. Protectionism merely artificially protects the U.S. from competition with the rest of the world, but does nothing to solve the problem of inefficiency/lack of competitiveness. What should probably be done instead is to implement supply side policies to improve productivity/efficiency in production, or for the U.S. to bite the bullet and develop new areas of comparative advantage instead.

Furthermore, such protectionist policies are at the expense of households' standard of living, as they will be denied access to cheaper foreign imports. This not only reduces the quantity of goods and services available to them, but also reduces the variety of goods they get to enjoy, hence worsening material standard of living.

T2: Trump's protectionism may be justified – helps to protect domestic workers

Extract 9 also mentions that there has been "outsourcing of jobs to cheaper markets". In these cheaper markets, the lower cost of labour leads to lower cost of production. However, many a time, workers in these countries are being exploited by producers, or are being treated unfairly by labour laws deliberately keeping the cost of production low. This lowers the material and non-material standard of living of the workers in such low-cost labour countries. Hence, one argument by Trump might be that protectionism is justified in shielding the U.S. from such imports produced via exploitation of labour.

AT2: Limitations of above argument that protectionism can help protect domestic workers

However, wages in developing countries are usually low because of the abundance of labour (large labour pool). Labour productivity is also usually

relatively low in such countries due to the relatively lower education and skill levels, thus explaining their relatively lower wages compared to that in developed countries, where higher skilled workers command a higher wage. As such, if lower labour costs are due to these reasons, then the argument that workers in developing countries are being exploited is moot.

Furthermore, as argued earlier, the U.S. should instead upgrade their factors of production (especially labour and capital) such that they have a comparative advantage in certain types of goods, so that they can increase their wages in the long run, rather than trying to sustain current wages by protecting their domestic industries.

(Other possible arguments: protection against unfair foreign competition i.e. dumping, protection to achieve self-sufficiency, protection to develop infant/strategic industries)

AT3: Protectionism: beggar-thy-neighbour policy → could invite retaliation

Worse still, protectionism is well known as a beggar-thy-neighbour policy i.e. an economic policy where one country (in this case, the U.S.) attempts to solve its economic problems by means that worsen the economic problems of other countries. With this in mind, other countries might retaliate against the U.S. and implement similar protectionist measures against U.S. exports too. If this were to happen, the lower export revenue in the U.S. would lead to lower AD, and via the multiplier effect result in a multiple decrease in real national income, adversely affecting economic growth. The balance of payments could also worsen because the worsening balance of trade (lower (X-M)) would worsen the current account. Ultimately, retaliation by the U.S.'s trading partners would result in the U.S. economy being negatively impacted.

Retaliation by U.S. trading partners would also mean that import controls/restrictions are being implemented across countries. This would lead to an all-round contraction of world trade, which goes against the principles of free trade being mutually beneficial to all countries.

Evaluative Conclusion

It is unlikely that protectionism can ever be justifiable because no matter what arguments are provided by governments to justify their protectionist actions, there are loopholes to these arguments that either render the argument moot or suggest that other policies may be more appropriate instead.

In the case of the U.S., which is a large economy with many trading partners, protectionism is a hostile anti-trade policy to adopt. Besides worsening U.S. economic performance in the current period, the souring of trade relationships with her trading partners might lead to worsening economic performance in the future if the U.S.' trading partners decide to trade less with the her.

As such, it is better for the U.S. to implement other policies to deal with the economic problems that they are facing instead – for instance, if faced with structural unemployment due to loss of comparative advantage, the U.S. should probably adopt supply-side policies i.e. education and

retraining/skills upgrading to help displaced workers develop relevant skills so that they can transit to other jobs instead.

L2	For a developed answer that discusses reasons why protectionism may **and** may not be justified, with the use of economic reasoning and evidence from the case material. Links to economic goals and standard of living should be drawn	4-6
L1	For a one-sided answer that explains why that protectionism can (or cannot) be justified **OR** For an undeveloped or descriptive answer that discusses whether protectionism can ever be justified, without economic reasoning and application to context	1-3
E2	For a reasoned conclusion using economic reasoning, and with application to the U.S. context	2
E1	For a conclusion stated without economic reasoning used in justification	1