Anglo-Chinese Junior College
JC2 Economics 2024

H2	Macroeconomic Policies

TUTORIAL WORKSHEET

SECTION A: ESSAY QUESTIONS

Question 1

The recent worldwide recession caused many governments to re-assess their use of fiscal policy in order to stimulate their stagnating economies.

(a) Explain the possible demand-side and supply-side reasons for a recession in an economy. [10]

(b) Assess the relative importance of fiscal policy and exchange rate policy to manage Singapore economy when faced with a worldwide recession. [15]

Question 2

In 2017, the annual rate of inflation in Singapore was significantly lower than the average rate for Southeast Asia.

(a) Explain a possible demand side reason and a possible supply side reason for a rise in the rate of inflation. [10]

(b) Assess whether policies designed to prevent a large and continuing rise in inflation in Singapore are the most appropriate policies for all economies. [15]

Question 3

Singapore's economy expanded a faster-than-expected 1.8 per cent in the last quarter of 2016. Moving ahead, growth remains uncertain. Internally, Singapore has adopted a policy of restricting foreign labour and restructuring towards productivity-driven growth. Externally, higher US interest rate may lead to higher interest rates in Singapore.

Source: Adapted from Channel Newsasia, 3 January 2017

(a) Explain the possible conflicts in government macroeconomic objectives caused by a policy of restricting foreign labour and restructuring towards productivity-driven growth. [10]

(b) Assess the impact of higher US interest rate on Singapore's macroeconomic performance. [15]

Additional Essay Practices:

Question 4

The rate of unemployment in more than 50 of the world's countries, including several European countries, exceeds 10%. Governments face a difficult decision about whether income tax rate cuts are the most effective policy measure to reduce unemployment to more acceptable levels.

(a) Explain how a reduction in the rate of income taxes paid by workers and firms might have consequences on an economy's aggregate demand and aggregate supply. [10]

(b) Discuss whether a reduction in the rate of income taxes is likely to be the best policy measure to reduce high unemployment in a country. [15]

Question 5

In Singapore in 2018, the resident population below the age of 20 fell by 1.5% while the resident population over 65 grew by 6.0%. If these population changes continue into the future, there are likely to be significant consequences for Singapore's economy.

Source: singstat.gov.sg, accessed 22 June 2019

(a) Explain the likely economic consequences of these population changes for Singapore's economy in the future. [10]

(b) Discuss the policy measures that Singapore's government should take to address the economic consequences of these population changes on its economy. [15]

Question 6

There is potential for governments to achieve both inclusive and sustainable economic growth.

(a) Explain what is meant by inclusive growth and sustainable growth. [10]

(b) Discuss the extent to which it is possible for a small, open economy such as Singapore to achieve both inclusive and sustainable growth. [15]

SECTION B: CASE STUDIES

Case Study Question 1:

Imbalances in the United Kingdom and China economies

Table 2: Government debt (percentage of GDP)

Year	China	UK
2010	33.7	76
2011	33.6	81.6
2012	34.3	85.1
2013	37	86.2
2014	39.9	88.1
2015	42.6	89

Source: IMF

Table 3: GDP Composition breakdown by percentage in 2015

	China	UK
Consumption Expenditure	37%	65%
Government Expenditure	14%	19%
Gross Capital Formation	45%	17%
Export Revenue	22%	28%
Import Expenditure	18%	29%

Source: World Bank

Extract 5: Is the game up for China's much emulated growth model?

From the early 1990s, China adopted an export-led strategy that delivered continuously increasing shares of the world market, fed by relatively low wages and very high rates of investment, enabling massive increases in infrastructure. It led to big increases in inequality and even bigger environmental problems, but the strategy seemed to work – until 2008-09, when exports were hit by the global financial crisis.

Yet even then, China, India and other large emerging markets continued to grow. The talk at the time was that they were already dissociated from the west. In reality, China (and much of developing Asia) had simply shifted to a different engine of growth without abandoning the focus on exports. The Chinese authorities could have generated more domestic demand by stimulating consumption through rising wage shares of national income, but this would have threatened their export-driven model. Instead they put their faith in investments to keep growth rates buoyant.

So the "recovery package" in China essentially encouraged more investment, which was already nearly half of GDP. Provincial governments and public sector enterprises were encouraged to borrow heavily and invest in infrastructure, construction and more production capacity. To utilise the excess capacity, a real estate and construction boom was instigated, fed by lending from public sector banks. Total debt in China increased fourfold between 2007 and 2014, and the private debt-GDP ratio nearly doubled to over 280%.

All this comes in the midst of an overall slowdown in China's economy. Exports fell by around 8% in 2014. Stimulus measures such as interest rate cuts do not seem to be working. As such, the recent devaluation of the yuan is clearly intended to help revive the economy.

However, it will not really help. Demand from the advanced countries – still the driver of Chinese exports and indirectly of exports of other developing countries – will stay sluggish. Meanwhile, China's slowdown infects other emerging markets across the world as its imports fall even faster than its exports.

A weaker yuan is bad news for export-oriented economies like Singapore, Hong Kong, South Korea and Taiwan as their exports will be more expensive to Chinese buyers. Their exports to other countries will also have to compete against Chinese rivals who have the advantage of a weaker currency.

This is not the end of the emerging markets, but is – or should be – the end of this growth model. Relying only on exports or debt-driven bubbles to deliver rapid growth cannot work for long. For developing countries to truly "emerge", a more inclusive strategy is essential.

Sources: The Guardian, 23 August 2015 and The Straits Times, 7 January 2016

Extract 6: New economic crash fears as British families run £40 billion deficit.

British families are on course to spend £40 billion more than they earn this year, fuelling fears that the country's economic growth is based on soaring levels of debt and could easily collapse.

The forecast by the independent Office for Budget Responsibility (OBR) led to warnings that the UK could be heading towards a credit crunch similar to that of 2008 because of unsustainable levels of borrowing and household spending.

Five years ago, UK households were comfortably not in debt, running a surplus of £70 billion as Britons tightened their belts in the wake of the financial crash and put money aside to save.

But the new OBR figures show households are now deeply in debt, as growing economic confidence has led to a national spending spree. There is a real risk that millions of families will face serious hardship if interest rates start to rise.

A Bank of England study found that the average mortgage debt in Britain rose from £83,000 in 2014 to £85,000 this year. Unsecured debt, which includes credit card charges, personal loans, student loans and utility bills, stands at around £8,000 per household.

Source: The Independent, 21 December 2015

Extract 7: UK trade deficit widens to four-year high.

UK's trade deficit last year was the widest since the alliance of political parties came to power, dealing a blow to the government's drive to rebalance the economy away from consumer spending.

Forecasting the outlook for this year, economists said exports would come under pressure from a stronger pound and a slowdown in important markets, especially the UK's main trading partner, the Eurozone.

The Eurozone remains unlikely to see much of an acceleration in growth in 2015, particularly given the uncertainty being generated by the prospect of a Greek exit from the single currency area. In addition, economic expansion is expected to continue cooling in China over the medium term, weighing down on export prospects there.

Chris Leslie, the shadow chancellor, said: "Britain needs a serious strategy to help exporters – this means redoubling efforts to boost productivity, tackling infrastructure obstacles, addressing the skills deficit and ensuring innovators can access the funds they need."

Source: The Guardian, 6 February 2015

Questions

(a) Compare the change in government debt levels as a percentage of GDP in China and the UK from 2010 to 2011. [2]

(b) With reference to Extract 5,

(i) "A weaker yuan is bad news for export-oriented economies like Singapore"

Using a supply and demand diagram, explain how the devaluation of the Chinese Yuan may eventually affect the revenue (in SGD) of a Singapore firm that exports to other countries. [4]

(ii) Explain the possible reasons why neither a cut in interest rates nor a devaluation of currency seem to work for China. [4]

(c) With reference to Extract 6, explain how households' standard of living in the UK may be affected if UK interest rates were to rise. [2]

(d) Assess the effectiveness of the UK government's proposed strategy to boost exports. [8]

(e) Discuss the factors that the UK and China's governments should consider in their macroeconomic decisions to rebalance their economies to achieve sustained economic growth. [10]

Case Study Question 2:

A more inward-looking China and the Russian-Ukraine Conflict

Table 2: GDP growth (annual %)

Year	United States	China	Singapore
2017	2.2	6.9	4.5
2018	2.9	6.7	3.6
2019	2.3	6.0	1.3
2020	- 2.8	2.2	-3.9
2021	5.9	8.4	8.9
2022	2.1	3.0	3.6

Source: *World Bank*, 2023

Extract 6: The regional impact of Russian's invasion of Ukraine

The ongoing war in Ukraine has dimmed prospects of a post-pandemic economic recovery for emerging and developing economies in Europe and Central Asia, says the World Bank's Economic Update. Energy price shocks continue to impact the region. So far, however, the region has weathered the storm of Russia's invasion of Ukraine better than previously forecast. Regional output is now expected to contract only by 0.2% this year due to the prudent extension of pandemic-era stimulus programs by some governments.

Source: *World Bank,* 2023

Extract 7: Why a more inward-looking China is bad news for the world economy

Ever since the 2008 global financial crisis, when the West's reliability as a trading partner was thrown into question, self-reliance has become a more decisive organising principle for Chinese officials. As a result, the export-dependent growth model on which China built its economic rise in recent decades has been fraying. Exports as a share of China's GDP peaked at 35 per cent in 2007 but had fallen to around 20 per cent by last year, a level not seen since before China's accession to the World Trade Organisation in 2001. This shows that net exports no longer make any meaningful contribution to Chinese GDP growth.

Although China's inward tilt towards self-reliance may have started out as a response to purely economic phenomena – the post-crisis global recession, belt-tightening in the West, the eurozone crisis, and a general softening of global trade growth in the post-crisis years – China's more inward-looking development path became clear in its response to the aggressive tariffs and export controls introduced by the Trump administration in the US.

The more obvious result of China's inward-looking approach is a rebalancing of China's economy away from a reliance on external demand as a stimulus to growth ('international circulation') towards increased self-dependence ('domestic circulation'). China is reducing its economic dependence on the West by reshaping trade and investment links. A greater push has been made for 'stronger, better, and bigger' state-owned enterprises (SOEs) and the past five years have indeed seen a measurable rise in the role that SOEs play in the Chinese economy. These firms now account for more fixed investment in the economy than private foreign firms, for the first time since 2005.

Since its dependence on imported technology, food, and fossil fuels, has created a substantial strategic vulnerability, Chinese policymakers will likely attempt to build up the country's ability to supply its own semi-conductors, food, and green energy source over the next few years. This all amounts to a more inward-looking Chinese economy that is more dependent on internal factors rather than external factors for its growth. For China itself, growth is likely to suffer, since there is a wealth of analysis to suggest that the efficiency of SOE-led investments is lower than that of foreign direct investments. For the rest of the world, a China that is more inclined to buy its own stuff than import also that means other countries will receive less of a boost to their economic activity per unit of China's GDP. And that is bad news for the world economy.

Source: Adapted from *Chatamhouse.org*, 2022

Extract 8: Russia-Ukraine conflict has a limited impact on China's food prices

China's emphasis on its own food production and security helps mitigate the impact of the Russia-Ukraine conflict on domestic food prices, analysts said. Notably, China is the world's second-largest consumer of corn, but only 9.4% of domestic corn consumption in 2021 came from imports. Only 5.9% of China's wheat consumption last year was imported. China has boosted agriculture production at home and expanded the sources of imported food.

However, soybeans are the only major crop for which China relies heavily on imports — 84% of domestic consumption in 2021, mostly from the U.S. and Brazil. Soybean prices have climbed as traders worry that a shortage of sunflower oil from Ukraine might boost demand for other vegetable oils, said chief executive officer of the U.S. Soybean Export Council.

Source: CNBC, 3 March 2022

Extract 9: The impact of Russia-Ukraine conflict on Singapore

Global supply chains had already been hammered by the Covid-19 related challenges and have been further dislocated by geopolitical tensions such as the Russia-Ukraine conflict. Tensions between the two countries could impact the global economy and contribute to rising living costs. Singapore is no exception.

Russia is the world's second-largest oil exporter. As the conflict worsened, it triggered an energy crisis, driving up oil and gas prices. Oil refining produces gasoline and natural gas, which are widely utilised in energy generation in many nations, including Singapore, which relies mainly on natural gas for power generation. Russia and Ukraine are also major exporters of metals and minerals. Supply disruptions in these commodities might have a big impact on the manufacturing industry, which makes stainless steel, sensors, transistors, and chips.

The situation in Ukraine has influenced inflation expectations, with prices of food staples such as wheat and corn skyrocketing. Ukraine is the world's third-biggest maize exporter and fourth-largest wheat exporter, with Russia being the world's largest wheat exporter. In January, food inflation was one of the critical causes of increasing consumer prices in Singapore.

Source: *Nexia Singapore,* accessed 19 July 2023

Questions

(a) Using Table 2, state three findings of Singapore's growth rates compared to other countries. [3]

(b) State the possible economic relationship between real GDP growth rate and inflation rate. [1]

(c) Using an aggregate demand and aggregate supply diagram, explain how China "that is more inclined to buy its own stuff" (Extract 7) might affect economic growth in Singapore. [4]

(d) Account for the climb in soybean prices as seen in Extract 8. [4]
Note to students: this is a question that tests on microeconomic concept, your tutor may skip this question for the purpose of this topic on Macroeconomic Policies.

(e) Discuss whether China should rely more on domestic or external factors to boost its growth rates further. [8]

(f) In the light of the Russian-Ukraine conflict, and China turning inwards, discuss how Singapore can boost its economic performance. [10]

Additional Case Study Questions

Case Study Question 3: 2018 H2 A Level

The US Economy Inflation Challenge

Extract 4: Why is inflation in the US so high?

Prices in the United States (US) jumped at an annual rate of 4.7% last year - faster than any other country in the Group of Seven (G7) advanced economies, according to the Organization for Economic Cooperation and Development (OECD). In the United Kingdom (UK), for example, inflation was just 2.5%.

Last month, inflation in the US hit 8.6%, one of the highest rates in the world. Many of the forces driving inflation last year - such as supply disruptions from Covid and higher food prices after severe storms and drought hurt harvests - were not unique to the US.

The reason the US fared worse? In two words - high demand. That was driven by the massive USD$5 trillion in spending, which the US government approved to shield households and businesses from the economic shock of the pandemic and has helped people to keep purchasing goods and services.

Goods like furniture, cars and electronics saw a surge of orders, as shoppers redirected money they might otherwise have spent on restaurants and travel. And as unusually high demand collided with supply issues stemming from Covid, businesses raised prices.

A recent study by the Federal Reserve Bank of San Francisco concluded that pandemic relief packages probably contributed to 3 percentage points of the rise in inflation until the end of 2021 - a factor that goes a long way to explaining why US inflation outpaced the rest of the world.

Source: BBC, 14 June 2022

Table 2: Government expenditure (% of GDP) and annual average inflation rate (CPI) (%) in the US

Year	Government expenditure (% of GDP)	Average Inflation by Year (CPI) (%)
2019	35.73	1.8
2020	45.3	1.23
2021	42.36	4.7

Source: Macro Trends and International Monetary Fund, 5 August 2023

Extract 5: Soaring used car prices are pushing inflation higher, and there's not much the U.S. can do about it

The Biden administration has blamed much of the rising inflation rates in the country on the used car market. In December, prices consumers paid for goods and services rose 0.5% while used car prices rose 3.5%. The price of used cars is also having a historically high impact on overall headline inflation.

Economist Bernstein wrote that the primary supply-chain hiccup responsible for both used car inflation and its impact on the consumer price index data is a shortage of semiconductors used in the manufacturing of new cars.

The pandemic has changed consumers' demand for cars and forced hundreds of thousands to cancel or postpone travel plans in 2020. That one-time mass cancellation led to unprecedented demand for cars in the spring of 2021.

Source: CNBC, 13 Jan 2022

Extract 6: Fed raises interest rate by 0.75 percentage points as US seeks to rein in inflation

The Federal Reserve announced another sharp hike in interest rates on Wednesday as the central bank struggles to rein in runaway inflation, increasing the cost of everything from credit card debt and mortgages to company financing.

The Fed expects the rate rises to hit housing prices and the job market – raising unemployment from 3.7% to 4.4% next year – and to decrease economic growth.

Source: The Guardian, 21 Sep 2022

Extract 7: Would emerging economies get trampled by US interest rate hikes?

While the global economy is still recovering from the COVID-19 pandemic, central banks in advanced economies are hiking interest rates. This spells double trouble for emerging economies which have borrowed from the US because interest rate hikes will increase their debts. Furthermore, the interest rate hikes in the US is likely to attract short-term investors to invest in the more appealing US market than in the emerging economies, with lower interest rates. This would cause the exchange rate between emerging economies and the US to widen, resulting in debt owed by emerging economies which is denominated by USD to increase even more and become unmanageable.

However, not all is lost for emerging economies, because the rising interest rates in the US benefit foreign trade. The stronger dollar that will accompany the interest rate increase should boost demand for products from the emerging economies, increasing corporate profits for domestic and foreign companies alike.

Source: Adapted from East Asia Forum, 18 August 2022 and Investopedia, 29 July 2023

Table 3: GDP growth rates (%) of selected emerging economies

	2018	**2019**	**2020**	**2021**
Brazil	1.8	1.2	-3.9	4.6
China	6.7	6.0	2.2	8.1
India	6.5	3.7	-6.6	8.7
South Africa	1.5	0.3	-6.3	4.9

Table 4: Export of Goods and Services (% of GDP) of selected emerging economies

	2018	**2019**	**2020**	**2021**
Brazil	14.6	14.1	16.5	19.6
China	19.1	18.4	18.6	19.9
India	19.9	18.7	18.7	21.5
South Africa	27.6	27.3	27.6	31.2

Source of Tables 2 and 3: World Bank, 5 August 2023

Questions

(a) Compare the trend between government expenditure (% of GDP) and consumer prices in the US between 2019 and 2021. [2]

(b) Using Extract 4 and an aggregate demand and supply diagram, explain why inflation in the US is so high. [4]

(c) (i) Explain the likely value of cross elasticity of demand between new and used cars. [2]

(ii) Using a diagram and Extract 5, explain how the "shortage of semiconductors used in the manufacturing of new cars" and the pandemic has caused the price of **used cars** to change. [4]

(d) Discuss the impact of interest rate hike by the Federal Reserve on the emerging economies. [8]

(e) Discuss whether raising interest rates is the most effective way to address high inflation in the US. [10]