Question 5 (a)
Some economies have balance of payments deficits while others have balance of payments surpluses.
(a) Explain the importance of a sound balance of payments to Singapore. [10]

Answer Model 5 (a)

Balance of Payments

The **balance of payments** is a record of transactions that take place between Singapore and the rest of the world in a year. A balance of payments is sound when it is in a surplus.

A **balance of payments surplus** occurs when the total value of receipts from international transactions exceed the total value of payments for international transactions i.e. the balance of payments is positive.

A balance of payments surplus is due to a surplus in the current, capital or financial accounts or all of them.

The BOP is an indication of the economic health of Singapore

- reflecting the competitiveness of the country's goods and services in the global economy

- its competitiveness and attractiveness as a investment destinations (for DFI from MNCs)

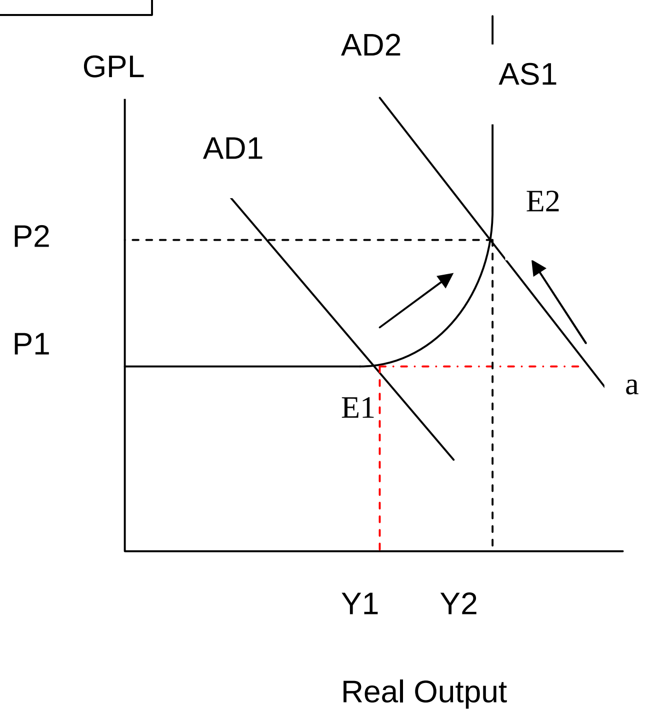
Higher exports

More Direct Foreign Investment

Higher injections

Higher net exports and DFI shifts the AD curve from AD1 to AD2. → New equilibrium, prices ↑ from P1 to P2, output ↑ from Y1 to Yf.

The extent of the increase in income and GPL depends on the slope of the AS curve which indicates the responsiveness of aggregate supply.



Conclusion

Thus, we see sound BOP indicates competitiveness which leads to higher net exports and DFI. This in turn will channel through to higher employment, actual growth. It can also leads to inflation.

On contrary, a persistent, large and unplanned BOP deficit lowers confidence and generates uncertainty. It may deter foreign investment. This makes long term planning difficult and the standard of living may suffer. May also cause speculation against the S$.

CONTENT

Part (a)

The BOP is an outcome of a country's international transactions. It is an indication of the economic health of a country; reflecting the competitiveness of the country's goods and services in the global economy; its competitiveness and attractiveness as a investment destinations (for DFI from MNCs). Competitiveness leads to higher net exports and DFI which in turn will channel through to employment, growth and inflation. A persistent, large and unplanned BOP deficit lowers confidence and generates uncertainty. It may deter foreign investment. This makes long term planning difficult and the standard of living may suffer. May also cause speculation against the S$.

	Knowledge, Application, Analysis and Evaluation	
Level	Descriptors	Marks
L3	For an explanation of the importance of a sound BOP for Singapore	7 – 10
L2	For application of knowledge and critical understanding of the outcomes of sound BOP	4 - 6
L1	For knowledge and understanding of the outcomes of sound BOP	1 - 3

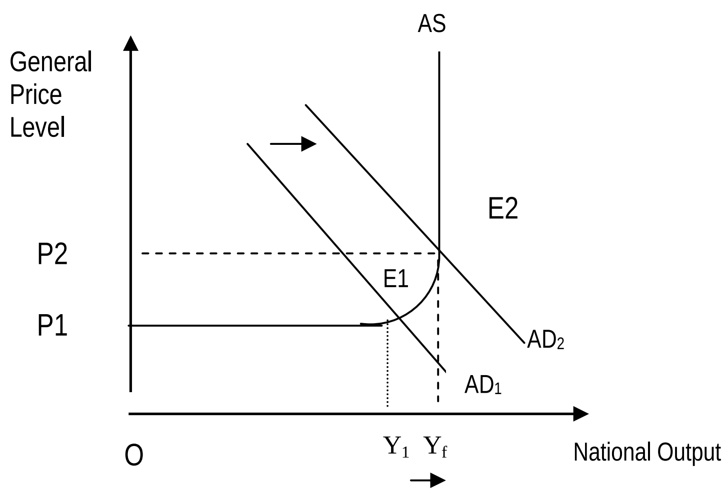
Question 5 (b)

In 2009, the Singapore government implemented a budget deficit while the Monetary Authorities of Singapore pursued zero appreciation of the exchange rate to stimulate her stagnating economy.

Discuss the factors that would affect the success of these two policy measures to boost economic growth in Singapore. [15]

1. Explain how a budget deficit helps to stimulate growth:

Exp fiscal policy → budget deficit stance
→ govt. increases its expenditure (G) → G > T → Increase in AD directly since AD = C + I + G + [X-M]
→ Govt reduce T. Fall in taxes – can be a fall in personal income tax or fall in corporate income tax →
Increase in I and C → increase AD → AD curve shifts to the right .The equilibrium shift from E to E1. Output increases from Y1 to Y2 The NI, and output increase by a multiple of the change in AD → actual economic growth.



2. Explain how a zero appreciation of Sing dollar helps to stimulate growth:

Zero appreciation of SGD → Depreciation of SGD given that SGD was relatively strong before . Exchange rate of SGD depreciates, leading to a fall in price of exports in terms of foreign currency and rise in price of imports in the domestic currency. → net export increases if ML condition holds. Domestic consumers switch their consumption towards domestically produced goods, increasing domestic consumption.
Hence exports and domestic consumption increases → increasing AD → promotesAG

Development 1: Explain the significance of each factor on success of the two policies in SG

Multiplier

- The size of the multiplier in an economy determines the effectiveness of demand management policies in raising the National income in pursuit of high stable economic growth.
- The multiplier (k) refers to the number of times national income changes as a result of a change AE.

  $K = \Delta Y / \Delta AE$
- Hence, the size of the multiplier varies directly with marginal propensity to consume, and inversely with the marginal propensity to withdraw. The greater the leakages, the smaller will be the multiplier size & thus the multiplier effect.

Crowding out

- . If govt. spending is financed by borrowing, the govt. will be competing with the private sector for funds. This increase in demand for funds →higher interest rate → higher cost of borrowing and this will reduce I and C. Thus, we say govt. expenditure crowds out private expenditure. In the extreme case, the fall in C and I might offset totally the rise in G such that AD does not rise at all. The fall in I and C will result in a fall in AD, hindering economic growth, reducing the effectiveness of the policy.

PED of exports and imports

- The PED of exports and imports can be applied in the context of the Marshal Lerner condition which is defined as the sum of price elasticity demand for exports and imports, (PEDx + PEDm) > 1.
- The Marshal Lerner condition is significant in the implementation of exchange rate policy.
- The exchange rate policy tool is part of monetary policy, in pursuit of macroeconomic goals. It can used by the gov to alter the external value of their domestic currency and hence impact the AD of the economy.
- Explain how the marshal lerner condition has to hold for exchange rate policy tool to be effective on (X-M) hence AD. The greater sum of PEDx+m, the greater the impact on (X-M). This has implications on how much exchange rate should be altered.

Development 2: Evaluate the relative significance of the above factors in influencing the success of the two policies

- For **small, open economies** liken to S'pore, there is heavy reliance on exchange policy tool to manage AD of the economy.
- With a relative greater external demand (X-M), the Marshal Lerner condition is significant in ascertaining the effectiveness of exchange rate policy tool on influencing (X-M) and hence AD in pursuit of her macroeconomic goals.

- Given that the global recession around the world today resulted from a dampened demand, the size of multiplier in Singapore s of great significance in determining the effectiveness of expansionary demand management policies to increase National income upon any implementation of demand management policy tools.
- For SG which has a small multiplier size, any increase in components of AD will not raise NI by a significant amount. This influences the need for the government to change the magnitude of policy tools considerably to achieve the desired increase in NI.

Synthesis/ Conclusion:

Level	Knowledge, Application, Understanding, Analysis	Marks
L3	For an answer using analysis to support the explanation of the various factors that affect the effectiveness of the two policy measures. The answer must be set in the context of the Singapore economy.	9-11
L2	For an answer that gives a descriptive explanation of the various factors that affect the effectiveness of the two policy measures. Undeveloped answers which lack rigour and scope when discussing the factors that affect the effectiveness of the 2 measures in Singapore OR answers that are largely theoretical with little reference to the Singapore context	6-8
L1	For an answer that shows knowledge of the various factors that affect the effectivieness of the 2 policy measures. For an answer which shows some knowledge of the 2 measures and/or the multiplier but largely descriptive with their links unexplained or with conceptual errors	1-5
	Allow up to 4 additional marks for evaluation	
E2	For an evaluative assessment based on economic analysis	3-4
E1	For an unexplained assessmen.	1-2