



HWA CHONG INSTITUTION
Year Two H1 Economics 2013

- 4 (a) Explain the main causes of unemployment in Singapore in the recent years. [10]
- (b) Discuss the view that supply side policies are the best option for the government in reducing unemployment. [15]

Suggested Outline:

(a) Causes of Unemployment in Singapore in the RECENT YEARS

Cyclical Unemployment

Cyclical unemployment is caused by a lack of demand in the downswing of the business cycle. During the downswing (recession or depression), aggregate demand decreases and firms find they cannot sell all their current output, and stocks pile up. Firms will then adjust to the deficiency of demand by cutting back on production and hire fewer workers, leading to an increase in cyclical unemployment. Therefore, cyclical unemployment is sometimes referred to as **demand-deficient unemployment**.

In the recent Global Financial Crisis (US sub-prime mortgage crisis) in 2008/09, the economy went into sharp contractions as a result of these external shocks. These shocks badly affected our export trade with the rest of the world, tourism and international banking as well as financial services sectors. In short, it hit our export revenue (X) and investment (I) components of AD causing domestic consumption to fall. And since exports from Singapore are dominated by high-end manufactured goods and services which tended to have a high income elasticity of demand, falling global income could have a pronounced adverse effect on export demand from Singapore. As AD falls, actual sales are lower than expected sales and firms experience an unplanned increase in stocks. This will cause them to cut back on production as actual stock levels exceed desired levels. In so doing, firms will hire fewer workers and hence cyclical unemployment rises.

Structural Unemployment

Structural unemployment arises when changes in technology or international competition change the skills needed to perform jobs or change the location of jobs. As a result of this changing structure of the economy, **there is a mismatch between the workers' skills and job requirements**. People are made redundant in one sector of the economy cannot immediately find jobs elsewhere because they either do not have the necessary skills or are unwilling to move to another area/region where prospects are better (occupational and geographical immobility of labour respectively).

Frictional Unemployment

Frictional unemployment arises because of **imperfect information in the labour market** as it **takes time for workers to be matched with suitable jobs**. It is also known as search unemployment. The unending flow of people into and out of the labour force and the process of job creation and job destruction create the need for people to search for jobs and for firms to find suitable employees. Since both employers and employees spend time searching what they believe will be the best match available, frictional unemployment arises.

Marking Scheme

Level	Descriptor	Marks
L3	For a competent explanation of at least 2 possible causes of unemployment of which one must be cyclical unemployment due to an external crisis e.g. US Financial Crisis (recent years).	7 - 10
L2	For an answer that shows comprehension of concepts required but limited ability in giving a clear explanation of the causes of unemployment. OR Answer that explains causes of unemployment in general (theoretically), not meeting the requirement of the question which says in recent years in Singapore in specific.	5 - 6
L1	Merely listing the causes of unemployment without explaining. Able to state the basic knowledge but shows confusion in certain concepts. Points given are non-economic (descriptive). Making conceptual errors.	1 - 4



- (b) Discuss the view that supply side policies are the best option for the government in reducing unemployment. [15]

Introduction:

Supply-side policies are mainly micro-economic policies designed to improve the supply-side potential of an economy, make markets and industries operate more efficiently and thereby contribute to a faster rate of growth of real national output.

Supply side economics is an approach which focuses directly on the Aggregate Supply (AS). If successful, AS curve will shift outwards, thus increasing output for any given level of prices or reducing prices for any given level of output.

This essay shall discuss whether SSPs are the best option in reducing the different causes of unemployment and whether there are other better options in doing so.

Body:

Supply side policies are the best option for the government in reducing unemployment.

1. SR SSP to reduce Cyclical Unemployment

Short-run supply side policies primarily target at reducing business costs. They are usually stop-gap measures that yield only temporary results. To fully solve the problems, other policies have to be in place.

Some of the examples will be price and income policies such as price controls, wage freeze/ flexible wage system, and temporary cut in CPF. For instance, employer's CPF contribution rate was reduced from 16% to 13% in 2003 during SARS period. This effectively lowered labour costs, thereby cushioning the effects of a falling aggregate demand on cyclical unemployment. Also, other cost cutting measures like corporate tax rebates, utilities rebates and rent rebates were adopted in 1999 to help firms stay in the black.

The outcome is illustrated by an increase in the short-run aggregate supply (SRAS) curve, increasing output and lowering general price level.

Figure 1: Short-run supply-side policies work to lower business costs (during RECESSION)

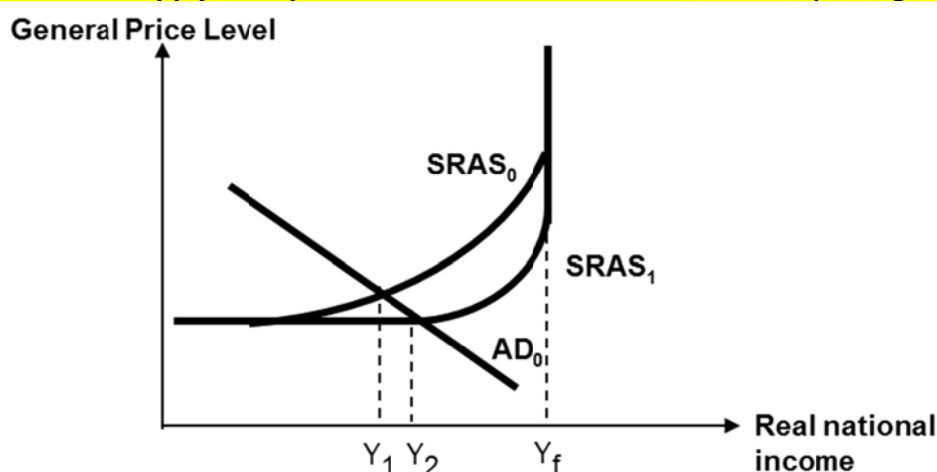


Figure 1 depicts a picture of slow growth due to deficiency in demand (weak AD-can be illustrated by drawing AD cutting at / near Keynesian AS range) as equilibrium output at Y_0 is much lower than that of full-employment level Y_f .

The use of short-run supply-side policies is able to shift the SRAS curve from $SRAS_0$ to $SRAS_1$. The actual growth of the economy is increased from Y_0 to Y_1 . Though it is not very significant as AD is weak during



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recession, it helps to keep some business from going bust and thus save some jobs, thereby reducing cyclical unemployment.

2. LR SSP to reduce Structural Unemployment Education and Training

- As the problem with structural unemployment lies with occupational immobility, one of the most direct solutions would be to help workers who are displaced and whose skills have become irrelevant, find new employment by equipping them with new skills. Hence, the government could focus its spending on the retraining of workers displaced from these industries, helping them acquire new skills to enter the new industries which had arisen as a result of shifts in comparative advantage, thereby easing structural unemployment. For example, firms could tap on the Skills Development Fund (SDF), as well as the Skills Programme for Upgrading and Resilience (SPUR) which was implemented during the 2009 Budget. These initiatives provide subsidies to firms who sent their workers for re-training or upgrading courses so as to raise labour productivity and retain their employability.
- The government can design the education system to meet to the requirements of economic development. For example, more vocational schools and technical colleges should be set up to train more mechanics, foremen and technicians so as to overcome the problem of a shortage of skilled labour.

Evaluation

The main concern with such a policy lies in the **attitude, aptitude and age** of the workers who were sent for the courses. Without a good attitude towards learning, an aptitude and flair for learning new skills, and the ability to internalise the skills set learnt quickly, the level of productivity may not have increased as desired and hence render the policy less effective.

Moreover, the cost of providing or subsidising training can impose a burden on the government budget.

3. SSPs to reduce Frictional Unemployment

To deal with frictional unemployment, policies that focus on improving labour market information would help improve efficiency in the labour market. These can range from setting up of employment agencies (like those in the US) to job matching websites like JobStreet.com and JobsDB.com which helps collate potential employees details and match them to the needs of prospective employers. Other examples include job fairs that the Ministry of Manpower in Singapore organizes regularly to bring together employers of the same industries to hold a mass recruitment exercise where workers can seek out their most suitable jobs.

Other policies are better in reducing unemployment

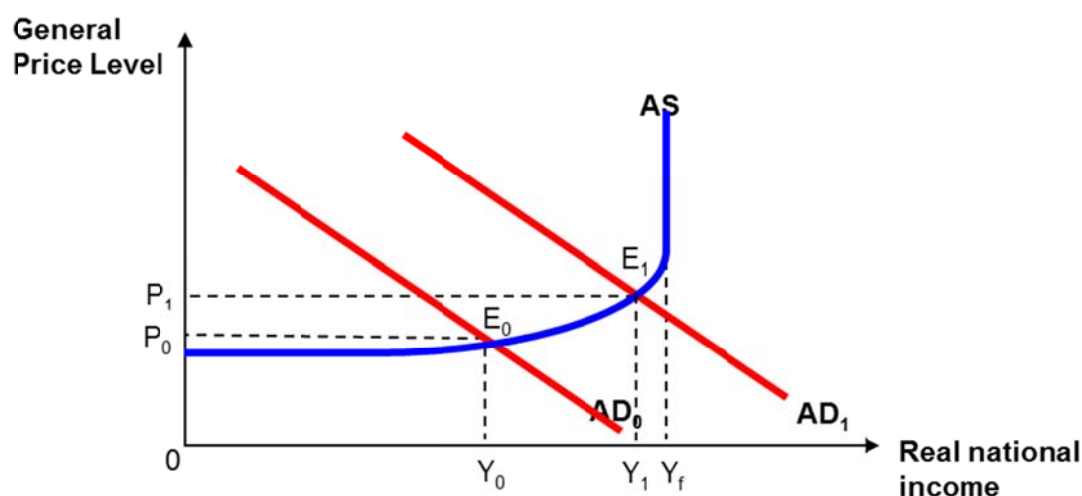
Explain briefly how demand-management policies such as expansionary fiscal and monetary policies would be better in reducing cyclical unemployment

Expansionary Fiscal Policy

This policy works by increasing government spending as illustrated by the Singapore government's 2009 budget of S\$20.5 billion. In addition, Singapore corporate tax rates were reduced from 18% to 17% in 2009. This raised the after-tax profit of the firms and increased their expected rate of returns, hence encouraged more investment.



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This will then cause an increase of AD from AD_0 to AD_1 and lead to an unplanned decrease in stocks. As the firms increase production to increase their stock levels back to desired levels, they hire more workers (as well as other factors of production), employment levels rise. National income increases by a multiplier from Y_0 to Y_1 getting closer to the Y_f .

Evaluation

The extent of rise in income and employment would depend on the size of multiplier. For small, open economies such as Singapore, very high withdrawals from the circular flow in the form of savings and import expenditure would lead to the small size of the multiplier, limiting the effectiveness of the policy.

If the cause of the cyclical unemployment is due to a fall in external demand for goods (due to global financial crisis), given the relatively small size of government spending as a component of AD, a fall in export revenue would require a significant increase in G to make up the fall in AD.

Exchange Rate Policy - Depreciation

Hence, cyclical unemployment during poor external demand can be countered by exchange rate policy. For instance, by depreciating the currency, it makes Singapore's exports cheaper in terms of foreign currency and hence allow the exports to gain export price competitiveness. Assuming $PED_x > 1$, quantity demanded of Singapore's exports will rise more than proportionately and hence increase export revenue (X). Additionally, imports will become relatively more expensive in terms of S\$ and assuming $PED_m > 1$, quantity demanded for imports will fall more than proportionately and hence import expenditure will fall (M). Overall net exports ($X-M$) will increase, leading to an increase in AD. Since there are unplanned fall in stocks, producers will hire more workers to meet this shortfall and hence cyclical unemployment will be solved.

Evaluation

A depreciation of S\$ will raise the price of imports such as raw materials and contribute to import price push inflation for the Singapore economy. This will raise cost of production for firms and lead to a loss in export price competitiveness, which will lower X and AD and hence worsen unemployment.

Protectionism

In times of recession there is a tendency for economies to practice protectionism to minimise the level of (cyclical) unemployment in the economy. As an expenditure switching method, protectionism will raise the price of imports and hence consumers will switch to buying relatively cheaper local goods. This results in greater quantities supplied by domestic producers. These producers will need to hire more units of labour to produce the goods, hence increasing employment opportunities and saving jobs as a result.



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Evaluation

Other countries are likely to retaliate with their own trade barriers, thereby sparking global trade wars. The net result is the rapid contraction in world output and income and employment.

Conclusion:

SSPs are the best option only if the main cause of unemployment is structural. However, if the cause of unemployment is cyclical or due to a dip in global demand for exports, other expansionary demand-management policies should be implemented together with cost-cutting measures (SR SSPs) to help boost external demand and tackle the root cause of the problem.

Marking Scheme

Level	Descriptor	Marks
L3	For an answer that shows the ability to apply arguments with good illustrative examples – at least 2 other dd-mgt policies are discussed. AND Well-developed analysis and evaluation of whether supply-side policies are the best option of reducing unemployment <i>Able to look into the fact that there exist different types of unemployment in the economy and ss-side policies are more effective in reducing structural unEm whereas dd-mgt policies are needed to reduce cyclical unEm, apart from ss-side policies.</i>	9 – 11
L2	Answer that shows some ability to describe the supply-side policies to reduce unemployment but in a largely generic context. At least 1 other dd-mgt policy is discussed. OR Shows ability to balance arguments but application is too generic.	6 – 8
L1	Answer is mostly irrelevant and contains only a few valid points made incidentally in an irrelevant context. Arguments presented are basically lop-sided i.e. without considering other demand-management policies. OR Answer shows some knowledge of the issue but overall there is no clear focus or direction	1 – 5
Evaluation Marks		
E2	For an evaluative judgment based on analysis and supported with a strong conclusion	3 – 4
E1	For an unexplained judgement, or one that is not supported by analysis	1 - 2