

H1 Suggested Answers Question 4

- Explain the causes of a deficit in the balance of payment. [10]
- Assess the view that supply side policy is the best policy to manage balance of payment in Singapore. [15]

4a) Explain the causes of a deficit in the balance of payment. [10]

Command	Content	Context
Explain	Causes of BOP deficit	General No countries in context, encouraged to explain how the causes differ across different economies
	Cyclical Factors: Economic Growth/ Recession, Inflation	
	Structural Factors: Cost structure	
	Others: Exchange rate differences, government policies, interest rate	

Recession in trading countries (E.g. 2008 Worldwide recession)	<ul style="list-style-type: none"> -> <u>In trading countries</u> -> Decrease in economic growth and employment -> Decrease in income level -> Decrease in purchasing power -> Decrease in consumption of goods and services -> Decrease in demand for imports -> <u>In domestic country</u> -> Decrease in demand for exports -> Fall in export revenue -> Fall in net export -> Persistent decrease will lead to a deficit and trade and service balance -> Deficit in the current account of BOP *Greater effects for economies producing income elastic exports
Inflation in domestic country (E.g. India, China)	<ul style="list-style-type: none"> -> Increase in general price level -> Increase in price of domestically produced goods and services -> <u>Exports</u> -> Price of exports will be relatively more expensive -> $PED > 1$, due to availability of substitutes from trade -> Qdd of exports will fall by more than proportionately -> Decrease in export revenue -> <u>Imports</u> -> Fall in quantity demanded of domestically produced goods -> Increase in demand for imports -> Increase in import expenditure -> <u>Net export</u> -> Overall fall in net export -> Worsening of trade and service balance -> Persistent worsening will lead to a current account deficit in the BOP *Dependent on the cross elasticity of demand

Relatively lower interest rates (E.g. USA vs China or Australia)	-> Foreign countries having a relatively higher interest rates -> Higher rates of return for portfolio investments -> Profit maximizing investors invest attracted to short term capital investments overseas -> short term capital outflow for domestic economy -> Persistent outflow will lead to a deficit in the capital and financial account -> Leads to a BOP deficit
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L3	For an answer that uses analysis to underpin discussion on the causes of BOP deficit in different economies via different accounts of the BOP	7-10
L2	An answer that undeveloped discussion on the causes of BOP deficit. Described only 1 single component of BOP.	4-6
L1	Descriptive knowledge and/or without link to Balance of payments deficit.	1-3

- b) Assess the view that supply side policy is the best policy to manage balance of payment in Singapore. [15]

Command	Content	Context
Assess	Manage BOP	Best Policy in Singapore Relating to the Small and Open economy, make comparison between the policies.
	Supply Side Policy	
	Exchange Rate Policy	
	Trade Policy	

Supply Side Policy (E.g. SGD\$2 Billion National Productivity Fund or SGD\$16.1 Billion for The Research, Innovation and Enterprise Council (RIEC))	-> <u>Enhance productivity among business and workers</u> -> Lowers unit COP -> Pass on cost savings -> Lowering of prices for consumers -> PED>1, availability of substitutes from trade -> More than proportionate increase in Qdd -> Increase export revenue -> Improve trade and service balance -> Improve current account of BOP -> <u>Research and development of new products</u> -> Improve on the quality of the products -> Meet the taste and preference of consumers -> Increases the demand for exports -> Increase export revenue -> Improve trade and service balance -> Improve current account of BOP
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	<p>OR</p> <ul style="list-style-type: none"> -> <u>Enhance productivity among business and workers</u> ->Lowers unit COP -> Higher profits -> Higher rate of return -> Attracts more foreign direct investments -> Capital inflow -> Improve capital and financial account of BOP -> <u>Research and development of new products</u> -> Improve on the quality of the products -> Meet the taste and preference of consumers -> Increases the demand for goods and services -> Increase expected revenue -> Attract more foreign direct investments -> Capital inflow -> Improve capital and financial account of BOP
Exchange Rate Policy (E.g. Depreciation)	<ul style="list-style-type: none"> -> Depreciation -> Value of currency is worth higher in terms of foreign currency -> Price of exports is relatively cheaper in terms of foreign currency -> Price of imports is relatively more expensive in terms of domestic currency -> Assuming Marshall Lerner's Condition holds, where sum of price elasticity of demand for imports and exports is more than one -> Increase in net export -> Improve trade and service of current account hence BOP <p>OR</p> <ul style="list-style-type: none"> -> Depreciation -> Value of currency is worth higher in terms of foreign currency -> Cost of production in terms of foreign currency will be relatively lower -> Higher expected rate of returns (ESP if currency is expected to appreciate again) -> Attract more foreign direct investments -> Capital inflow -> Improve capital and financial account of BOP
Trade Policy	<ul style="list-style-type: none"> -> Signing more Free Trade Agreement -> Increasing export countries -> Higher export revenue possible -> Increase export revenue -> Improve trade and service balance -> Improve current account of BOP <p>OR</p> <ul style="list-style-type: none"> ->Signing more Free Trade Agreement -> Increasing export countries -> Higher expected rate of returns

	-> Attract more foreign direct investments -> Capital inflow -> Improve capital and financial account of BOP
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L3	For an answer that uses analysis to underpin discussion on whether supply side policies implemented by Singapore government are the best policy to manage BOP . There should be at least 3 policies discussed. Max of 9 marks if candidate did not address the question requirement on the best policy . Providing a conclusion for the question in accordance to Singapore economy.	9-11
L2	An answer that undeveloped discussion on best policy in Singapore economy. Limited link to context Max of 6 marks on one-sided discussion OR a case where there is very good explanation on fiscal policy and its supply side effects.	6-8
L1	Descriptive knowledge of policies, which does not fully address the question.	1-5
E2	For an evaluative assessment based on economic analysis	3-4
E1	Unexplained evaluative comments	1-2