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CHAPTER 8 : Understanding the Singapore's economy

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THE ABOUT

CHAPTER ANALYSIS

MASTERY

- Understanding why certain policies are not applicable in the context of Singapore
- Understanding the nature of the Singapore's economy

EXAM

- Usually have to bring in as examples or comparison to other countries

WEIGHTAGE

- Relatively heavy weightage as questions usually like to focus on Singapore's context
- Even if question did not specifically mention about Singapore, it is usually expected to bring in Singapore's examples to support your stance

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KEY CONCEPT

Macroeconomic overview
Fiscal Policy
Monetary Policy

An overview

	Economic Growth	Inflation	Employment	Balance of Payments	Exchange Rate
Aims	High sustained economic growth	Mild inflation	Low unemployment	BOP Equilibrium	Modest and gradual appreciation of SGD
Remarks	Singapore focuses more on long run growth rather than short run growth Singapore relies more on supply side policies • Attracting investments • Increasing employability, education or skills	Mild inflation is favourable as it is a sign of economic growth Generally affected by cost-push inflation Especially vulnerable to import-led inflation because we are highly reliant on imports	Singapore usually suffer from structural unemployment This is the result of moving up the value chain and tertiarization	Singapore BOP runs a surplus (X>M) • We tend to export more high-value goods Singapore's capital and financial account is always negative	SG's exchange rate system is a managed float. The MAS policy on a modest and gradual increase of our exchange rate is in place to make imports cheaper in light of our dependence on imports for raw materials (cost of production of our subsequent exports are hence cheaper) Exchange rate is kept relatively higher to avoid imported inflation. *Singapore is able to do this because we don't compete on price

FISCAL POLICY

Singapore does not conduct fiscal policy on the demand side due the following

- Small, open economy – are price takers
- Overall high MPW – multiplier is small
  - High MPM – Imports amount to 175% of our GDP (in 2008)
  - High MPS – The gross domestic savings (GDS) rate was 50.5% in 2006
  - Low MPT – have to maintaing competitiveness, attract investments
    - Not a welfare state, no need for large tax revenues
    - Corporate taxes: kept low
      - ✓ Attract foreign investment
      - ✓ Encourage local enterprise
    - Income taxes: kept low
      - ✓ Prevent brain drain
      - ✓ Attract foreign expatriates

Singapore's FP is directed primarily towards long term economic growth

- The private sector as the engine of growth, with the government providing a stable, conducive environment for the private sector to thrive
- A focus on enhancing economic competitiveness, attracting foreign investments (see next point)
- Hence, in addition to low corporate taxes, we have tax incentives for MNCs to take root locally

Government expenditure is thus spent on supply-side policies

- Improving existing infrastructure
- Expanding our labour force and our citizens' employability
  - WIS, retraining etc.

Hence, having a prudent FP, Singapore allows other macroeconomic tools (like the exchange rate policy) to be able to focus on their primary goals without needing to balance these goals against requirements for deficit financing.

MONETARY POLICY

Our main conduct of monetary policy is through our exchange rate policy

- Singapore is a price taker
- Wants to allow free capital flows (recall theory of the impossible trinity)
  - ➢ Forgoes the control of interest rates
    - ▪ Domestic interest rates are thus determined by foreign interest rates
    - ▪ And also by investor expectations of futures in the SGD

Singapore's Exchange Rate Policy

The S$NEER is managed against a basket of currencies of our major trading partners and competitors

- Different currencies given different weights
- Based on extent of trade dependence with that country
- This basket is periodically revised to take into account changing trade patterns

The exchange rate regime is a managed float

- Allowed to fluctuate within an undisclosed policy band
- Should the exchange rate move out of the band, MAS intervenes by selling or buying forex
- This gives us the flexibility to cope with periods of uncertainty

The MAS maintains the SGD at a gradual appreciation

- Contributes to low and stable inflation
  - ➢ (X-M) decreases, reducing demand-pull inflation
  - ➢ Prices of imported RMs decrease, lowering COP and reducing cost-push inflation
  - ➢ Prices of imports decrease in general, reduces imported inflation
- Contributes to economic growth
  - ➢ Investments
    - ▪ A low and stable inflation rate provides certainty in long term planning
    - ▪ A gradual appreciation of the SGD enhances the value of capital assets
    - ▪ Thus, investments increase, which constitutes a direct injection to AD, increasing NY
    - ▪ Investments also help to increase the AS in the long run, allowing Singapore to achieve non-inflationary economic growth
  - ➢ Export earnings
    - ▪ In the long run, exports are more competitive compared to exports of other countries which experience higher inflation rates

Trade off between rapid economic growth Today and growth in future

There is a trade off between rapid economic growth today and growth in the future.

- Rapid growth today may exhaust resources and create environmental problems for future generations, including the depletion of oil and fish stocks, and global warming.
- High economic growth would mean an increase in national output and production, which may involve burning of more fossil fuels for energy, or the exhaustion of natural resources (over-mining, deforestation, over-fishing etc.).
- This can result in greater pollution, and an unsustainable pace of resource depletion.
- Furthermore, a rapid growth rate could result inhigher income inequality as well as structural unemployment. These would result in a worsening SOL, material and non-material.
- These undesirable effects arise from the likely uneven growth, as certain sunrise sectors thrive and grow, while other sunset sectors shrink.
- Thus, creating income inequality between workers and entrepreneurs of these sectors. This also extends to the skilled and unskilled workers, who will face growing wage differentials. Workers from the sunset industries may also find it difficult to find jobs and enter these growing industries due to a mismatch of skills.
- Therefore, achieving sustainable economic growth requires Singapore to enjoy a sustained rate of growth, but also adopt policies to address the significant trade-offs that are created.

What is sustainable growth?

For an economy with large pool of natural resources and domestic market, its sustained growth is more due on domestic factors since it is able to sell to its own domestic market or obtain domestic capital to fund future expansion and investments.

- Eg: large economies like the USA / Australia have abundant natural resources and have relatively large domestic sectors or consumption to drive growth and act as buffer to insulate the economy from external shocks. Hence it is likely to adopt fiscal or monetary policy due to the large proportion of domestic C, I and G relative to X if the weak growth is due to lack of AD. In US, domestic C accounts for more than 60% of the GDP which indicates a large multiplier effect (relatively high MPC) and hence greater effectiveness in stimulating GDP.
- The use of monetary policy has also been used by US; ‘quantitative easing’ was adopted to address the slowdown in the economy. It is less likely to use exchange rate centred monetary policy given that it has a floating exchange rate system.
- While large economies can also use trade policies to tap on global market to increase export revenue, it is less important to them due to the relatively smaller X+M / AD.

- In contrast, for an economy without natural resources and has a small domestic market, its sustained growth is dependent on its reliance on foreign markets for sale of its products and foreign funds and capital for development of its economy and to create jobs.
  - ➢ Eg: for small, resource-poor and open countries like SG, it would be more vulnerable to external shocks and this would lead to severe impact on the country’s growth. Hence, it is likely to use exchange rate centred monetary policy to manage the competitiveness of its exports and to tackle imported cost-push inflation as the latter will have adverse impact on its exports and hence actual growth. Such economies will also adopt a pro-globalisation approach to tap on the foreign markets.
- Furthermore, in the case of SG, as it is operating under managed float system, it will lose control of her domestic money supply and interest rate. While fiscal policy can be used by these economies, the impact will be weak due to the weak multiplier effect (high MPM and MPS in the case of SG).
- In SG, the use of fiscal policy is used more for stabilisation purpose (for eg in a recession) rather than to bring about actual growth which is more significantly affected by exports and FDI. Instead, it is more commonly used to deliver supply side initiatives to promote long-term potential growth.
  - ➢ For example, the use of lower corporate and personal income taxes to encourage FDI, direct government spending on specific infrastructure to attract R&D, spending on training to improve labour productivity. These will both lower horizontal AS and shift vertical AS outwards and hence achieving both actual and potential growth.

- While supply side policies can be used for all types of economies to boost potential growth and improve international competitiveness of a country, they are more crucial to small and open economies in achieving sustained growth because of the resource constraints they face and the need to continually create external demand through competitiveness of exports (both price and non-price competitiveness).
  - ➢ For eg, there is widespread implementation of supply-side policies with respect to land, labour, capital and entrepreneurship in SG. It is also used to stimulate R&D and innovation efforts to improve on the quality and attractiveness of its exports.

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