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Subject: H2 Economics

Topic: Growth & Policy Conflicts

Question Source: Compilation of Selected 2007 Prelims Questions

*“Singapore’s strategy has to be focus on growth, while maximizing opportunities for all Singaporeans - opportunities to get a good education, to work or grow a business, to retrain and upgrade, and to own a home.” - Ministry of Finance, Thursday February 15 2007*

*With reference to statement, consider whether economic growth should be the central objective of government macroeconomic policy.*

All government has major internal macroeconomic goals to be fulfilled by their policies and these goals include growth, efficiency, stability and equity. The goals are often interrelated, sometimes interdependent. Unfortunately, the policy tools used to attain each of the goals may be at conflict with each other and attaining a particular goal may result in undesirable trade-off in the other aspects. Governments must be able to balance these different goals through a combination of different macroeconomic policy tools. In today’s globalized world, many governments have decided to focus on economic growth as the central objective of macroeconomic policy in a bid to compete in the global arena and emerged as developed, modernized states. The various pros and cons have made economic growth a double-edged sword for policymakers but nonetheless, the pursuit of progress offers a solution to many of today’s problems and thus it is sensible for economic growth to be the central objective of government macroeconomic policy.

Economic growth is the sustained expansion of the economy, represented by positive change in the national income of the country over time. Economic growth here refers to the actual growth, which involves the increase in aggregate demand such that the equilibrium national income increases. Potential economic growth, represented by the level of full employment and the aggregate demand, will have to increase steadily as actual economic growth is experienced so that there’s scope for further growth, as illustrated by the following diagram.

[AD-AS diagram showing 2 AD curves and 2 AS curves, both shifting outwards such that equilibrium national income and the full employment level shifts right, representing increases]

Growth is believed to be the most important of the macroeconomic policies mainly because achieving growth puts us in a better position to manage and attain the other macroeconomic goals. Economic growth is able to alleviate the problems of poverty, and would directly raise the standard of living of the general population if the benefits of growth are well spread. It also means the creation of more jobs and the reduction in unemployment.

Economic growth that is too rapid can undermine the 3 other internal macroeconomic goals. If growth in AD is so rapid that increases in the productive capacity or the AS cannot keep up, stability is undermined because the country will risk inflation as the economy experience bottlenecks and thus price level starts to climb. Policy tools to curb inflation would be contractionary and require deflation of the economy. Rapid growth would also threaten efficiency as market failures emerge from congestion and pollution; at the same time, the benefits of growth may not be well distributed since the government tries not to distort market incentives through progressive taxes in order to encourage growth.

On the other hand, the macroeconomic goals are interdependent and no one goal can be attained singly without regards for other goals. Growth requires stable environments, with stable prices to encourage long term investments that are usually responsible for long term development. Efficiency would also encourage growth as social welfare is maximized and the

economy runs more smoothly. Equity prevents social unrest, which is vital for creating the stable environment that is required for sustainable growth. Such complex relationships between the macroeconomic goals forces the government to ensure a delicate balance of policy tools to take care of all aspects of the macroeconomy.

As observed, the policy tools to attain the different macroeconomic goals could be fundamentally at odds with each other, even though economic growth may be closely intertwined with the other macroeconomic goals, and if the government allows economic growth to be the central objective of government macroeconomic policy, some sort of compromise in the other areas will have to be achieved. As long the compromise is such that growth is sustainable, the mix of policy tools would be viable. More importantly, as long as growth is not attained in the expense of the well-being of the people, and in fact helps to raise the standard of living for people, it is worthy to be pursued as the central objective of the government macroeconomic policy.

In the context of Singapore, growth forms the central objective because as a developing economy, economic growth affords us with the opportunity to join the ranks of developed economies in the world, and improves our otherwise dire standard of living. More importantly, in Singapore, policies are implemented such that the negative trade-off of growth is minimized. As suggested in the statement quoted, economic growth provides opportunities for the people of Singapore, by providing a good education, a good job, training, and the chance to own a home. All of these opportunities are translated back into growth as human capital is enhanced by education, training, and that allows for rising national income.

More importantly, the small and open nature of our economy allows us to attain growth with little compromise over the other goals. Due to the small size of the domestic economy relative to the size of the national income, inflation is effectively kept low within the domestic economy and sustained at low rates because we are able to appreciate our Singapore Dollar to combat imported inflation. As such our growth is not achieved in the expense of stability. The strategy to appreciate our currency as a bulwark against inflation helps achieve growth as well. As our exports and imports are mainly price inelastic, the appreciation of Singapore Dollar have the effect of both increasing export revenues and lowering import expenditures. Since trade is the economy's main engine of growth, the exchange-centered monetary policy works perfectly for Singapore.

Efficiency in the economy is maintained with regulating bodies setting standards for pollutions, and ingenious traffic, car ownership and vehicle usage curbs (with taxes such as the Electronic Road Pricing). The small size ensures ease of control and correct of market failure that can be internalized. The only trade-off thus far for Singapore is really the problem of equity because growth-oriented policies refuse to distort market incentives through a steep progressive income tax system. Worst, these policies encourage the rich to grow richer (giving tax breaks to the foreign firms situated in Singapore and shifting from direct tax as main revenue source to indirect taxes as main source of revenues) and excluding the poor from the deal. As such, equity is undermined in the pursuit of growth. Nonetheless, the government has presented their stand that they would rather grow the economic pie so that the smallest share is larger than other economy's average, no matter how this economic pie is divided up by the people.

Whether the pursuit of economic growth should be a central objective of government macroeconomic policy really depends on the way the government goes about implementing them and how there are other variables to balance in terms of policy objectives. In general, given the advantages offered by economic growth, it would be foolish to say that growth should not be the central objective of macroeconomic policies.