IBDP HL Economics Internal Assessment

Macroeconomics Commentary

Word Count: 749

Singapore announces new economic stimulus package to tackle pandemic

April 6, 2020 (Mainichi Japan)

SINGAPORE (Kyodo) -- The Singapore government on Monday announced a third economic stimulus package to help tide over the impact of the coronavirus pandemic by pumping in S$5.1 billion (US$3.55 billion), raising the total amount committed to S$59.9 billion, about 12 percent of gross domestic product.

Most of the amount in the third package -- about S$4 billion -- has been earmarked for providing additional support for businesses and workers.

Under the latest package, the government will pay 75 percent on the first S$4,600 of the monthly wage of every local worker for this month as Singapore will be under a month-long partial lockdown starting Tuesday.

Thereafter, as announced in the earlier package, the percentage of wages the government pays will vary based on sectors, with the 75 percent level reserved for the worst-hit airline and tourism industry.

The government will also spend S$1.1 billion under this latest package for a one-off cash payment of S$600 in cash for every Singaporean, in addition to what was announced earlier.

"This is an unprecedented budget, for extraordinary times," Deputy Prime Minister Heng Swee Keat, who is also finance minister, said in announcing the latest package in Parliament.

Under the partial lockdown, nonessential businesses have been ordered closed, while schools and universities will adopt home-based learning as the government tightens its precautionary measures due to signs of a community spread, with a jump in the number of local transmissions.

Singapore had earlier imposed border controls, with short-term visitors banned from the entering or transiting through the city-state.

"The situation remains highly fluid and uncertain. The government stands ready to provide further support, should it become necessary," Heng said.

The number of new infections in Singapore jumped by 120 on Sunday -- the highest for a single day -- to 1,309. Of the new cases, 116 involve local transmissions.

The global pandemic has taken a big economic toll on the small and resource-poor island-state, which depends heavily on trade, tourism, and its position as a regional headquarters for businesses, a financial hub, an air hub and a popular venue for conventions.

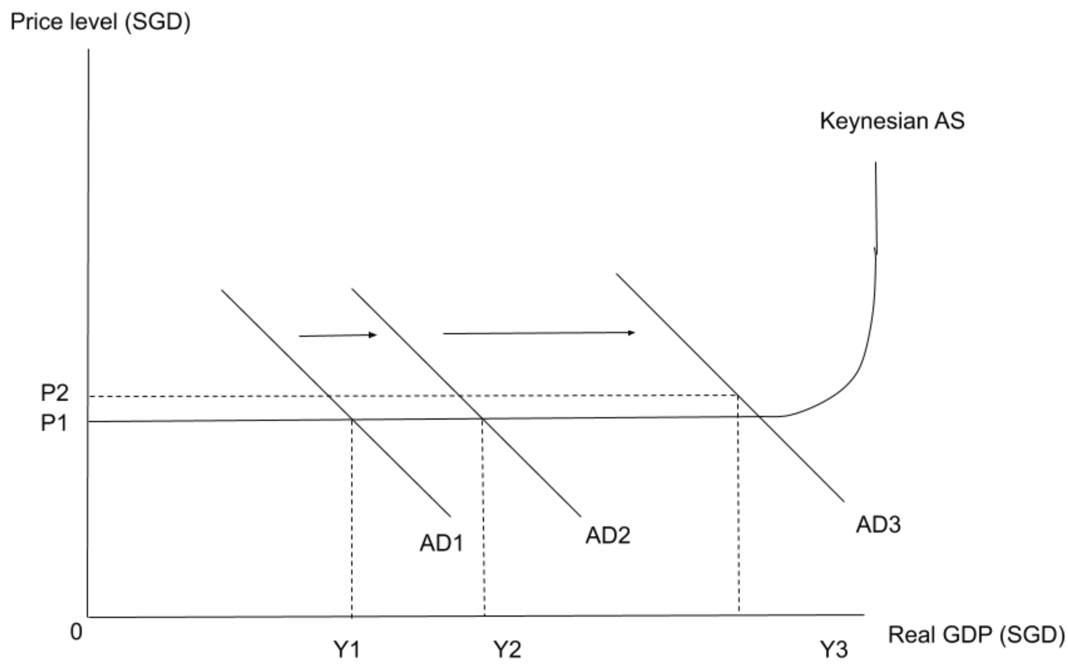
https://mainichi.jp/english/articles/20200406/p2g/00m/0in/087000c

Commentary

This article discusses Singapore's third fiscal spending package amounting S$5.1 billion targeting the recessionary impacts resulting from COVID-19 to the economy.

Government spending - "spending undertaken by the government… to meet particular economic and social objectives" (Tragakes, 2012) is one of the injection elements of fiscal policy. It promotes the growth of aggregate demand in fighting a recession - negative growth of GDP for more than two consecutive quarters. As high economic growth and employment level are imperative objectives, expansionary fiscal policy – "an increase in government spending or a decrease in taxes" (Tragakes, 2012) is effective in fulfilling those objectives by promoting AD for total domestic output and maintaining high employment. Demand for labour is a derived demand which comes from demand for output; maintaining AD for output would also maintain job opportunities and reduce demand deficient unemployment.

Fig 1. Multiplier effect of Singapore's fiscal stimulus package



Shown diagrammatically, expansionary demand-side policy may lead to multiplier effects. Government injection towards the economy ($AD_1 \rightarrow AD_2$) would lead to people spending a proportion of their extra incomes based on their marginal propensity to consume and it will become other peoples' extra incomes, passing on the multiplier expansionary effects. Thus, the net expansion and growth on real GDP ($Y_1 \rightarrow Y_3$) would be multiple of the value of the initial injection ($AD_2 \rightarrow AD_3$), closing the recessionary gap. However, inflation and price change may occur ($P_1 \rightarrow P_2$) if the AD shift reaches the upward-sloping part of the Keynesian AS curve and may bring forth demand-pull inflation if further growth occurs.

The Singaporean government will also pay up to 75% of monthly wage that will "vary based on sectors". This maintains take-home salary for workers and maintains consumption which may prevent AD from falling rapidly. The policy may help to maintain standards of living and social stability, ensuring that workers can afford basic needs and prevent further increases in unemployment levels as firms can afford wage costs and avoid loss of workforce.

Moreover, a "one-off cash payment of S$600", a type of transfer payment, will be paid to every Singaporean regardless of income. This is essential to maintain income and to protect lower-income groups as they may not benefit from the 75% monthly wage due to unemployment. Considering that the marginal propensity to consume among low-income groups is much higher than higher income groups, such payments would ensue most of the subsidies are directly injected into the circular flow of income - this increases effectiveness in boosting AD. More significantly, it would help to avoid poverty and allow meeting of basic standards of living. The distribution of income would also improve as most of the spending is drawn from social resources that are obtained from taxation.

The “total amount committed” to the three COVID-19 fiscal policies amounts to S$50.9 billion, 12% of Singapore’s GDP. To finance the policies, the government would likely have to borrow from the private sector, engaging in deficit spending. Therefore, the demand for money would increase in tandem with the rate of interest, actuating crowding out effects and offsetting the expansionary impact of the fiscal stimulus policies. Firms may also be disincentivized from investing, potentially leading to lower investment spending in the economy in the long run, hindering potential growth. The central bank may use expansionary monetary policy to mitigate the risks of crowding-out effect. As the economy is producing substantially less than potential GDP, inflationary impacts on interest rates are minimal due to plenty of unemployed capital in the financial market. Effects of crowding out may be negated by the lower interest rates brought by expansionary monetary policy.

Additionally, downward sticky price in labour and other factor markets inhibit an economy from returning to full employment level amidst a recession - firms will reduce production and lay-off workers in lieu of reducing pay to cut costs due to sticky wages. Consumption, investment, and employment level would plunge further down due to poor confidence and uncertainty in the market. Companies may be hesitant to hire new workers because of the high short-term cost. Monetary policy may be less effective than fiscal policies as the private sector would not be incentivized to expand in fear that interest rates may go up in the future. However, government subsidization of 75% monthly wages in the short-term could effectively tackle the risks of downward sticky prices and low confidence.

In conclusion, expansionary fiscal policy is effective in the short run, but negative consequences may occur as a result. Implementing expansionary monetary policy may help offset those consequences and promote economic growth and consumption.