

## **SECTION 2: CASE STUDY**

### **Question 1: Impact of Free Trade & Innovation on an Economy**

(a) With reference to Figure 2, compare the UK's trade in goods with trade in services over the period. [2]

- Trade in goods is in deficit whereas trade in services is in surplus
- Both shows an increasing trend i.e, deficit is getting bigger whereas the surplus for trade in services is getting larger

(b) Explain one possible cost and benefit to the UK economy of its exit from the EU. Assess whether they are likely to occur. [8]

#### **Possible cost:**

1) Fall in economic growth due to fall in AD

- As a member of a custom union, UK exports to the EU are not subjected to tariffs
- But now that it exited the custom union, this privilege is withdrawn. UK goods are taxed or subjected to other protectionist measures when sold in the EU as well as in other countries that EU has signed FTAs.

#### **Analysis:**

- A tariff increases the price of UK exports to the EU and other non-EU countries → reduces UK export competitiveness → demand for UK goods likely to be price elastic as there are many substitutes in the EU market → **qty** demanded falls by more than proportionately → **export revenue** falls
- UK will be a less attractive destination for inflow of FDI. Many foreign firms locate production in UK to take advantage of the large EU market but now their exports will be affected by tariffs making their investments less profitable. In addition, cost of production would increase as UK too will impose tariffs on imports raw materials from the EU. This further makes UK exports less competitive.
- Due to the uncertainties with regard to the profitability of firms and the ability to continue to work in the EU, households may cut back on consumption as there is fear of loss of jobs.
- So with fall in C, I and X, AD falls and this will cause economic growth to fall.

#### **Other costs**

2) Higher unemployment

- There could possibly be a rise in demand-deficient unemployment. So when AD falls, firms will retrench workers to cut costs since firms are faced with increase unsold stocks. There is no need to hire additional workers since the demand for workers is a derived demand and the demand for goods has fallen. Over 3 million jobs are linked to exports to the EU and some of these workers will be unemployed.
- In addition, there may be increase in capital outflow due to the uncertainties linked to Brexit. As firms relocate to other countries, more workers will be unemployed.

OR **3) higher inflation rates**

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### Suggested Answers

#### Possible Benefits

- 1) **Higher economic growth** due to increase in exports and increase in Govt spending
- After exiting the EU, UK need not contribute to the EU → money saved can be used for domestic spending → increase in G → increase AD
  - Being in the EU, UK cannot sign FTA with other non-EU member countries on its own which restricts her ability to increase trade **further**
  - But after Brexit, UK can choose to sign FTA with those economies which are of benefit to her such as emerging economies like BRICS. China, for eg, is growing more strongly than the EU. Due to the rising middle income class, their ability to spend may be greater than the EU which has been suffering from slow economic growth. UK's trade with the EU has been declining anyway which shows that even though there is free trade, UK is not benefitting from it. Breaking out of EU in search for high growth economies to trade is more beneficial for its exports → increase in exports → increase in AD
  - UK may not have benefitted from free trade with EU but may benefit more from free trade with non-EU members. A possible reason could be that the opportunity cost difference for the goods traded between EU and UK may not be that big since they may have similar factor endowments or that UK may be losing comparative advantage in manufactured goods to countries like Germany. But this may not be the case between UK and other countries where the difference in factor endowments may be greater and therefore having FTA with them will give UK exports an edge.
  - Overall, with exports and government spending increase, AD increases → higher economic growth

#### Other benefits

- 2) There may be increased economic efficiency as UK may not need to abide by rules and regulations imposed by the EU.

Stringent environment standards such as high tax rates set by the EU may increase UK cost of production making her goods uncompetitive in the world market. But now after exiting EU, UK can set its own environmental standards which may be more in line with its own pollution standards and thereby benefitting domestic firms.

OR 3) **Brexit will reduce trade diversion for UK.**

#### How likely will the UK experience the above cost and benefit?

In the short run, Brexit is more likely to be negative for the UK economy.

- (i) Regardless, the EU is a huge market which is not easily replaced in the short run.
- (ii) (UK would have to negotiate FTA with the EU as well with other non-EU countries which may be a very long and complicated process. The uncertainties with regard to the ability of the UK in signing **favourable** free trade agreements and the extent EU will impose barriers on UK may weigh heavily against firms' decision to invest in the near future.

**(c) With reference to Figure 3, state and account for the relationship between US economic growth and trade deficit. [3]**

When growth rate is high, the trade deficit is large but when growth rate is low, trade deficit becomes smaller. (or increase in growth rate, increase in trade deficit and when growth rate falls, trade deficit falls)

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- Trade deficit is where imports are greater than exports
- High ec growth → bigger trade deficit because rise in imports > rise in exports  
High US econ growth rate → large increase in income → increase in purchasing power →  $YED > 1$  (or high YED) or MPC is very high → increase demand for goods and services including imports → import expenditure increases  
Export revenue did not increase by as much probably due to foreign YED not as high as US demand for goods or protectionist measures or slower economic growth

**(d) Extract 2 mentions that 'Mr Trump has long argued that the trade deficit hinders economic growth, and that reducing it will accelerate American job creation.'**

**How does Figure 3 show that President Trump's concern about the US trade deficit and unemployment is unfounded? Explain why this is so. [4]**

President Trump thinks that the rising trade deficit will cause rising unemployment. As US increase its imports, domestic firms will not be able to compete and so domestic production falls causing the demand for labour to fall as it is a derived demand and firms need to cut costs when revenue falls.

However, Figure 3 shows that trade deficit increases, unemployment rate falls.

#### **Possible reasons:**

- There may be a rise in unemployment in those industries that are producing goods that are close substitutes of imports but there may be rise in production of goods from other industries where cheap imports cannot compete with the US. For example, high tech goods as well as services.
- $(X-M)$  is just one component of AD. There could be rise in both domestic and foreign investments as well as government spending.
- There could be increased capital inflow from those countries that have a trade surplus with the US. If this is long term capital flow in the form of direct investments such as the setting up of plants and offices, more jobs could be created in the US

**(e) With the aid of a diagram, explain how a tariff on steel imports will reduce the comparative advantage that a steel exporting country has over the domestic country. [3]**

Steel exporting country has a comparative advantage in producing steel means that its opportunity cost of producing steel is lower compared to the domestic country. As  $P=MC$  and MC represents the opportunity cost of producing the good, the difference in opportunity cost is reflected by the different price charged for steel by the exporting and domestic country.

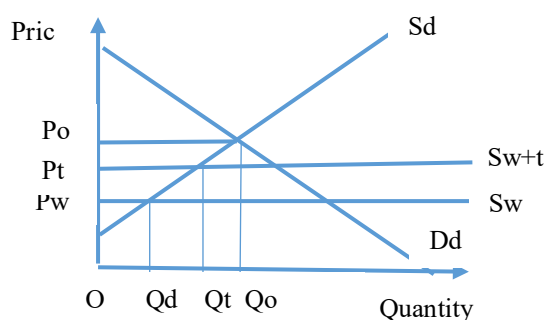
At  $Q_0$ , the opportunity cost of producing steel for the domestic country is  $P_0$  as seen from the  $S_d$  curve. However, for the exporting country, the MC is lower at  $P_w$  as seen from the  $S_w$  curve. The opportunity cost difference which is reflected as price difference is  $P_0P_w$ .

This makes the domestic country's steel uncompetitive. Thus, it imposes a tariff which is a tax on imported steel to reduce this price difference. So when the tariff is imposed, the price of steel now increases to  $P_t$ . The foreign steel is now more expensive by  $P_wP_t$  making it less competitive.

Thus a tariff artificially reduces the comparative advantage the exporting country has over the domestic producers.

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- (f) Given that 'Over the years, America's well-being has been furthered by science and technology', discuss whether an improvement in technology or free trade is the key to achieve a higher level of economic well-being for any country. [10]

### Introduction

A country that has a higher level of economic wellbeing is one where its people have more goods and services to enjoy. This is usually reflected by the real per capita income. Wellbeing includes also the non-material aspects of life such as the quality of the environment and leisure. The production possibility curve can be used to represent wellbeing as it shows the various combinations of two goods that an economy can produce when all resources are fully and efficiently utilized with a given amount of resources and a certain level of technology.

### Body

**P1: Trade based on CA will enable a country to consume beyond its PPC and therefore a higher level of economic wellbeing.**

According to the theory of comparative advantage, even if a country has an absolute advantage in the production of all goods, as long as it is able to produce a good at a lower opportunity cost, specialisation and trade will be mutually beneficial to all countries.

Below shows the PPC of the USA and China. The USA can produce more of both cars and wheat but from the slope of the PPC which measures the opportunity cost of producing cars, its opportunity cost is lower than China (1 car to 1 wheat vs 1 car for 4 wheat) and for wheat production, China's opportunity cost is lower. US will then specialise and export cars and China wheat production. To trade, a mutually acceptable terms of trade must be established. This should lie between the two countries opportunity cost. For eg. 1 car = 2 wheat. So if US were to export all her 1000 cars, it will be able to import 2000 wheat, more than if she were to produce itself. Likewise for China. Figure 1 shows the consumption possibility curve above the PPC. This shows that after trade, both China and US are able to enjoy more of both cars and wheat which means a higher level of economic wellbeing.

Non-material wellbeing increases as well as a country can enjoy a greater variety of goods from imports that come from all over the world.

This is confirmed in Extract 2 which said that globalisation which includes free trade, brought more jobs, higher wages and lower prices - not just for richer countries but also for developing and poorer nations. This shows that specialisation and trade improves welfare.

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**P2: Improvement in technology will shift an economy's PPC outward, enabling the country to enjoy more goods and services and therefore a higher level of wellbeing.**

However, improvement in technology could also give the same result. Technological improvements can increase the quantity and quality of resources and thereby increases a country's productive capacity, thereby shifting the production possibility curve outward. With technological advances, productivity can increase, more and better quality resources can be created and there can be new products invented as well. For example, the development of electronics, robotics, biotechnology and especially the globalisation of the internet have all contributed to ongoing productivity growth in the USA. Robots, for eg, are a new type of capital goods which replace human labour and are more efficient as they can be used continuously without having to take breaks. Advances in IT helps to increase efficiency and more goods can be produced in given time period. Advances in technology make it possible for the USA to discover shale oil. Societies today are able to enjoy better modes of transport such as cars, mass rapid transit, aeroplanes which reduce travelling time, more food due to GM food and Green Revolution, more houses built with less material, more land reclaimed for housing and for commercial purposes. All these are the outcome of technological improvements which shifts the PPC outward allowing the society to enjoy a higher level of wellbeing.

Non-material wellbeing also increases as society has more time for leisure due to higher productivity and development in certain technology also reduces pollution. For eg, the use of solar and wind power replace highly polluting coal generated energy.

**P3: Which is the key in determining welfare is dependent on several factors.**

But between the two, which is the key to a higher level of wellbeing? As analysed above, both increases the wellbeing of a country. However, for some countries, they do not have the factor endowment to develop new technology. For example very poor countries have a high level of illiteracy and lacks a pool of scientists and researchers as well as the necessary infrastructure for research. It is difficult for them to have major new innovations. That is why most of the technological advances come from mainly developed countries like the USA, Japan and Germany as they have the necessary factor endowments. Due to these constraints, for developing countries, trade is the key to a higher level of wellbeing. For example, they can specialise in the production of food products or raw materials if they have in abundance and exchange that for manufactured goods and thereby allowing them to enjoy a higher standard of living.

However, in the long run, a country that has backward technology, through trade, will acquire new technology. Over time, they could adopt the technology of the exporting countries like the US and if they do so, their PPC will shift outwards. Japan for eg used to be very backward but over the years, it learned from the West and eventually it emerged as a country that too has advanced technology.

Secondly, trade is able to increase level of wellbeing in the short run but without technological improvements, well-being is not sustainable as growth itself will not be sustainable. Take the example of the progress Singapore made in terms of standard of living. By the 1980s, Singapore has reached full employment and if there are no technological improvements, with AD rising continuously, inflation will set in and this will cause growth to be unsustainable.

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#### **Conclusion**

In conclusion, for countries that lack the ability to innovate, trade is the key to economic wellbeing in the short run but in the long run, technological advancements will also spread to them and so they too will benefit from it. For countries that have the factor endowments for technological advancements both trade and improvements in technology are both important in increasing welfare

**Question 2: Creeping Protectionism**

- (ai) With reference to Figure 1, summarise the trend in world GDP for the period 2007 to 2013. [2]**

For the period 2007 to 2013, world GDP generally increased except for last qtr 2008 – 3<sup>rd</sup> qtr 2009) which experienced a fall.

- (aii) To what extent does the data in Figure 1 account for the change in trade restrictive measures in Figure 2? [4]**

- Evidence: Figure 1: global output fell for the period of 2008 -2009. Figure 2: there is a greater increase in the number of trade-restrictive measures.
- During recession, households' income fall and their purchasing power fall. Demand for goods and service fall and GDP falls. In order to protect home employment, government attempts to impose trade restrictive measures.
- However, this pattern does not hold throughout the period 2008 to 2013.
- Evidence : Figure 1 - In the years where the GDP is increasing, there is still an increase in the number of trade restrictive measures (2010 - 2013)
- There are other factors that can account for the increase in trade restrictive measures.

- (b) Explain how the shift from traditional protectionist measures to subsidies, as suggested in Extract 2, can impact businesses and governments in the globalised economy. [6]**

Impact on firms [up to 3 marks]

- With a shift from traditional protectionist measures to subsidies, prices of goods of protected firms will fall due to the effects of removal of tariffs on finished goods, lower cost of production from the removal of tariffs from imported inputs and government subsidies to protected firms. This is unlike traditional protectionist measures such as tariffs which “raise business costs” (Ext 2)” Given that demand such goods are price elastic due to close competition from imports, a fall in price will result in a more than proportionate increase in quantity demanded and hence, an increase in total revenue. Profits will increase because total revenues rise as total costs of production fall thus these protected firms will receive a “boost” (Ext 2).

Impact on governments [up to 3 marks]

- Assuming other things remain constant, the shift from traditional protectionistic measures such as tariffs to subsidies is likely to worsen the budget balances of governments because tariff revenues are no longer collected but government spending now rise because of using subsidies to protected industries. Budget balances of governments will worsen, for example, from a large surplus to a smaller surplus or from surplus to deficit or from a smaller deficit to a larger deficit. For governments with reserves accumulated from past budget surpluses, their reserves will fall. For others without reserves, government debt will be incurred as borrowing is required to fund the subsidies.
- [In the long-run, the overall impact on governments' budget balances might be less negative than analysed above if subsidies turn out to be less inimical to trade than tariffs. This is because subsidies are less likely to invite retaliation. If trade volumes and values do rise after the shift, the extra income generated from trade activities (exports and imports) could yield enough tax

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revenues to help the government to finance the subsidies, leaving government budget balances no worse off than before the shift in the mode of protectionism.]

- (c) Discuss the view that “protectionism makes a bad situation worse.” (Extract 1). [8]

#### Perspective 1: Protectionism does make a bad situation worse

**Evidence:** According to Extract 1, economists were worried that ‘the world was repeating the mistakes of the 1930s’. **Theoretical explanation:** When an economy imposes various means of protectionism (say tariff) there is a possibility of the ‘beggar thy neighbour’ effect. An imposition of expenditure switching measure through tariff will reduce the level of exports of her trading partners assuming the demands of these exports are price elastic in the tariff imposing country. With a fall in export revenue the trading partners’ aggregate demand would decrease leading to a fall in their national incomes. This will lead to a fall in demand for imports from the tariff imposing country. Consequently the tariff imposing country will experience a fall in her net-exports and aggregate demand thus further reducing the level of her national income and employment. This will make the bad situation of recession worse.

**Evidence:** According to Extract 2, non-traditional protectionism such as subsidies, ‘buy-national’ restrictions and ‘standards protectionism’ may not benefit the countries if other policies are not doled out to support the sectors that the countries have a true comparative advantage in. **Theoretical explanation:** Often the identification of the sectors to be protected is not according to any potential comparative advantage. In the case of misidentification, the non-traditional protectionism will thus result in only higher cost being incurred without the possibility of enjoying economies of scale in the long run. Hence, in the long run, after the protectionism is lifted, the previously protected industries will no longer be internationally competitive in terms of price. This will lead to a fall in exports from these sectors, decreasing the rate of increase in aggregate demand of the economy and eventually leading to a slower increase in her national income, rendering the bad situation worse.

**Evidence:** According to Extract 2, Brazil and India have been held back because ‘the governments funneled state resources to preferred sectors.... slowing down their growth’. **Theoretical explanation:** Protectionist measures could reduce economic growth as resources have to be funneled to protect these industries. There is a high opportunity cost of these scarce resources especially in emerging economies like Brazil and India. The allocation of resources to these measures would mean fewer resources are available for the development of infrastructure that are necessary to expand the productive capacities of these countries. This has the effect of hindering potential growth and thus prolonging the ongoing slow growth to be even slower in the long run, making the bad situation worse.

#### Perspective 2: Protectionism may not worsen a bad situation.

**Evidence:** According to Figure 2, protectionism increased from 2009 to 2010 and according to Figure 1 world GDP also improved during that period. **Theoretical explanation:** Protectionism measures could help to stabilise the domestic economy through protecting home employment. This will maintain consumers’ and investors’ confidence especially for countries with large domestic markets such as China. Thus, during periods of global recession, such as during 2009, protectionist measures may have benefitted these big economies to garner domestic investments as well as



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domestic consumption to spur actual economic growth. Thus, protectionism may not necessarily worsen a bad situation.

#### **Conclusion / possible evaluation:**

Protectionism may bring benefits if the protectionist measures are temporary. Global growth rate slowed down after initial period of 2010 despite increases in global protectionism as seen from Figure 1 and Figure 2 respectively. This is so because prolonged protectionism could breed inefficiency and hamper growth in the long run. Thus in the long term protectionism will worsen a bad situation.

Level	Descriptors	Marks
L 2	For a well-developed answer with balanced perspective of the possible consequences of imposition of protectionist measures analysed in the context of the case study with good use of evidence.	4 - 6
L 1	For an answer that is limited in analysis and there are limited references to evidence.	1 - 3
E 2	Judgment is based on economic analysis and adequately substantiated.	2
E 1	For an unexplained assessment, or one that is not supported by economic analysis.	1

- (d) **In the light of creeping protectionism, discuss the extent to which supply-side policies on productivity and innovations can maintain high employment in Singapore. [10]**

Intro: With creeping protectionism, there is the likelihood of a fall in exports of goods and services. As Singapore is highly dependent on export to sustain growth and employment, policies are required to address this issue to maintain growth and employment in Singapore

Supply-side policies: Examples of such policies are seen in Extract 3: productivity and innovation scheme, R& D fund, Intellectual Property Rights framework.

Perspective 1: Yes, supply-side policies on productivity and innovations could counter the trend of increasing protectionism thus maintaining growth and employment

Policies on R&D to encourage innovation and improvement in productivity can be effective:

Extract 2: trade protectionist measures tend to be concentrated in sectors that have long been protected: textiles, clothing, footwear, iron, steel, consumer electronics and agriculture.

Extract 3: Through R&D, new knowledge is created and new economic opportunities developed. Examples of new areas: development in water technology, biomedical sciences and clean technologies

These new developments would create new areas of comparative advantage as Singapore loses existing comparative advantage in other areas with the imposition of trade restrictive measures. Given that these products are new and tend to be

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unique in the initial period of production, they tend to be less vulnerable to protectionist measures from other countries.

R&D product innovation includes improvement in the quality, reliability of product or increase in the range of function of products. This will improve non-price competitiveness of exports thus exports will be less affected by protectionist measures.

R&D in process innovation includes more efficient method of production developed. An improvement in productivity of labour units or capital goods will reduce costs of production and maintain or improve price competitiveness of exports which will counter the protectionist measures.

#### Policy on training and retraining

Extract 3: Workforce and training support

New industries will mean a different skill set required. With workforce and training support, workers will be equipped with the new skills to provide an adequate supply of skilled labour for the new industries.

With the success of these measures, there will be higher level of exports which will increase in AD and therefore increase national output (actual growth). There will also be increase in productive capacity due to the development in R&D which will promote potential growth economic growth. With the increase in output, more factors of production will be utilised leading to increase in employment.

#### Policy on intellectual property rights framework

Extract 3: Singapore has an advantage in promoting R&D given that there is a strong intellectual property rights framework.

Able to attract many MNCs to locate their R&D facilities in Singapore as the locations of such activities in Singapore will offer high value jobs without the need to consider trade protectionist measures. Limited protectionist measures imposed on intellectual property thus able to avoid the increasing protectionist trend.

Perspective 2: No, these measures may not be effective or may not be sufficient.

- Structural changes that result from the implementation of these policies may lead to structural unemployment in the immediate period (short run) as workers are not occupationally mobile. Demand management policies such as expansionary fiscal policy are required to allow supply-side policies time to take effect.
- Success depends on the rate of innovation relative to other countries as other countries may also be adopting similar measures.
- Success varies depending on the type of protectionist measures. Improvements in price and non-price competitiveness will be able to counter measures such as tariffs but may not be effective in countering measures such as 'buy national', public procurement requirements.
- To counter the trend in protectionism, there is a greater need to build multi-lateral trade relationships in order to expand the range of markets for Singapore exports – as a member of regional trade bloc, it may help to circumvent protectionism

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**Conclusion / Possible evaluation:**

- In the light of increasing protectionism that tends to be concentrated on protecting existing industries, supply-side policies focusing on creation of new areas of comparative advantage and non-price competitiveness of exports should allow Singapore to create new jobs and maintain employment. Thus supply-side policies should play a large role compared to other measures.

Level	Descriptors	Marks
L 2	For an answer that is well-developed with a balanced perspective of the effectiveness of supply-side policies in achieving the 2 macro-economic objectives in the context of increasing protectionism and good use of evidence.	5-7
L 1	For an answer that is limited in analysis and/or unbalanced perspective of the effectiveness of the policies in the given context of increasing protectionism.	1-4
E 2	Well explained judgement supported with economic analysis	2-3
E 1	Judgement not substantiated.	1

### Question 3: The Rise of the Global Village

- (ai) **Describe the trend in the exports of goods and services as a percentage of GDP for China. [2]**

General Trend: Overall % shows a **falling/decreasing** trend. [1]

Refinement: **Sharp fall** between **2006 and 2009**. (or any period between 06 to 09) [1]

Note: We do not accept the answer: "lowest % in 2009" as it is not a trend. Neither are we accepting any other refinements as they are not nearly as significant as the sharp fall between 06-09.

**Examiners Comments:**

- Some candidates merely describe periodic changes (i.e. from Year X to Year Y without pointing out what was significant)
- A handful gave description of trends i.e. describing it year by year/period by period. They failed to realise that they need to give an overall trend, followed by a refinement.
- Some just went on to compare between years.
- Some did not qualify the extent of the fall from 06 to 09
- Many did not specify the period of sharp fall, and stated that the sharp fall occurred in 2009, which is factually inaccurate.
- A significant handful of scripts pointed out insignificant refinements such as the small increases in some periods.

- (aia) **Consider whether the above trend allows us to make a judgement on China's Balance of Trade. [3]**

Definition of BOT: **Difference** between a country's **export revenue and import expenditure** [1]

Explaining the effect of the fall in X on BOT, ceteris paribus: **Fall in X should lead to a fall in BOT** / worsening of BOT. [1] (BOT deficit will not be accepted.)

Explaining that whether this will lead to an adverse BOT requires us to look at the **relative decrease between export and import values**, i.e. if import values are falling as well, there may not be a fall / decrease in BOT. [1]

(Or

Explaining that data given is merely a **percentage of the overall GDP**: Since the data given only shows BOT as a percentage of the overall GDP, it does not give us enough information to make a judgment on the relative change of the BOT as the percentage change could have arisen due to a change in GDP and not BOT. [1])

Conclusion: We are **unable to make a judgment** on China's BOT based on the above data. [1]

(conclusion mark only given if: both fall in X and the ambiguous change in M were explained)

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#### Examiners Comments:

- Most did not define BOT.
- Many did not explain effect of fall in X on BOT, ceteris paribus.
- Many equated BOT to BOP, failing to realise the difference between the 2. Many also thought that BOT = CA.
- Many used the terms 'exports' and 'imports' to refer to both volumes and revenue/expenditure. This is confusing and students should take notice to use clearer terms (export revenue, import expenditure, volume of exports etc.).
- Some students erroneously thought that exports referred to (X-M).

(b) **With reference to Extract 1, assess if Asian markets should embrace globalization. [6]**

#### Thesis: Globalization is necessary/beneficial for Asian markets.

Benefit: With trade, countries can now import goods from different countries and regions. This enhances consumer choice since there is now a tremendous range and variety of goods that they can choose from.

Evidence: Asian firms face global competition at home. Thanks to social media and the internet, they are now influenced by trends around the world. So in many industries companies in emerging Asia face competition from global firms selling to customers whose tastes are more globally influenced than before.

(Or any other relevant point from extract)

#### Anti-Thesis: Globalization might be harmful/detrimental to Asian markets.

Cost: In order to allow existing domestic firms to go global involves significant restructuring of existing business models. This might lead to an increase in unemployment in certain sectors for locals due to processes such as outsourcing to other emerging economies.

Trying to become a multinational is the hardest path to going global. It involves wrenching change, great risk, lots of scrutiny and the disposal of peripheral businesses in order to concentrate resources.

(Or any other relevant point from extract)

Conclusion: Asian markets need to embrace globalization, as evidenced: "In most industries it is hard to stay competitive without being active worldwide. Insularity does not work."

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Levels	Knowledge, Application, Understanding and Analysis	Marks
L3	Well-balanced answer that clearly analyses the benefits and costs of globalisation in the context of the extracts. It includes both evidence from the extract and economic theory Overall conclusion is required for 6marks.	5-6
L2	Two sided answers with incidental use of economic theory that is not based on the context of the extracts. Also for answers that consists of incorrect economic theories or if explanation is too brief or lacking in evidence.	3-4
L1	One-sided answer that doesn't consider the benefits and costs; "To embrace or not to embrace.	1-2

#### Examiners Comments:

- Most students were able to give 2 sided arguments but failed to explain with the relevant theory or evidence.
- Some just quoted evidence without any links to economic concepts.
- Some also did not synthesise after providing both sides of arguments.
- Many students argued that globalisation was not necessary for China due to their large domestic sector being sustainable instead of focusing on the harmful/detrimental effects of globalization. This answer was accepted but students will need to refer closely to extract evidence that clearly shows this rise in domestic demand being sufficient for sustainable economic growth in China.

#### (c) **Explain two ways in which Free Trade Agreements have benefitted the Singapore Economy. [4]**

**Theory: Increased trade increases GDP, which raises material SOL. [1]**

Evidence: (Extract 2) Total bilateral trade has risen 70 per cent in the same time to US\$67.9 billion. [1]

**Theory: Increased capital flow into Singapore which could lead to an increase in both actual and potential economic growth. [1]**

Evidence: (Extract 2) The US-Singapore Free Trade Agreement (FTA) has raised bilateral trade and made Singapore the largest recipient of US investment in the Asia Pacific as of 2012. [1]

**Theory: Increased employment opportunities for Singaporeans both locally and abroad and the inflow of foreign labour who could share their expertise to help improve the Singapore economy. [1]**

Evidence: (Extract 2) The FTA has raised Singapore's profile in the US and allows easier movement of people between the countries [1]

**Any 2 reasons for 4 marks.**

#### Examiners Comments:

- Most could find the evidence from the extract but were either inaccurate or did not link it clearly to a theoretical explanation of the benefits of FTA.
- Most used the extract evidence of increased bilateral trade by 70%. It should be noted that the rise in bilateral trade may not guarantee that net exports for Singapore had indeed increased. It may have meant that there was more overall trade between the 2 countries. To be more accurate, students need to state the assumption that the rise in bilateral

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trade has led to a growth of exports revenue by more than the import expenditure for Singapore.

- Some only explained benefits of one flow (trade/investment/labour) and gain only half credit. Students should realise that since FTAs affects trade, labour and investment flows. Thus, the discussion of one flow is not enough. Some students provided two different pieces of evidence that points towards only one flow, e.g. trade. Such answers were also only given half credit because of the lack of scope.
- Those who explained labour flows tended not to link to benefits using economic analysis. i.e. increase in LRAS.

**(d) Using AD/AS analysis, explain how a “combination of easy money and a tight labour market” can lead to inflation. [5]**

Inflation is defined as a **sustained increase** in the general price level. General Price Level is defined as the average price of goods and services in an entire economy. It is reflected in the intersection of aggregate demand and aggregate supply.

Easy money as mentioned in the extract leads to a **greater availability of credit** where a rise in global liquidity which leads to a **fall in the interest rate**. This induces greater consumer spending. This **rise in consumption** leads to an **increase in the economy's Aggregate Demand**. [2]

A tight labour market makes it **more difficult to find and hire labour**. This **increase the firm's cost of production** and thus, **decrease the economy's Aggregate Supply**. [2]

The **combined effect of a rise in AD and a fall in AS** will lead to an unambiguous **rise in the General Price Level**, and thus leads to inflation. [1]

**Examiners Comments:**

- Many students could not identify what it meant by 'easy money' or 'tight labour market'. Many related 'easy money' to either 'money that is easily earned' or that somehow consumers now have a higher disposable income due to easy money. Both were not accepted. Others related 'easy money' to 'hot money' or capital inflow, but were not able to explain how this might have resulted in increased money supply could lower interest rates.
- Some related 'tight labour market' to SG being at full employment level. However, given the context of the case material, it is more likely to be a situation of falling LRAS due to increase in cost of production due to falling productivity as a result of the ageing population.
- Some did not label AD/AS diagram properly or did not draw it at all.
- Most students could identify AD increase and AS falling but could not explain the reasons behind the increase or decrease properly.

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

(e) **Discuss the view that “exchange rate policy is still relevant for Singapore”**  
**[10]**

**Introduction** The Singapore economy is a small and open economy, with a small and limited pool of resources and is import-dependent. It has a large reliance on the external sector and a focus on outward oriented policies. Therefore, exchange rate policy has always been relevant for Singapore. This essay seeks to discuss if this is still the case.

**Thesis: Singapore effectively employs the exchange rate policy.**

**Point** Singapore’s small size and lack of natural resources means that most of our basic necessities and raw materials have to be imported. Singapore’s total trade (X+M) is about three times that of GDP. Given Singapore’s small size, it does not influence world prices and is a price taker. Producers and consumers in Singapore have to accept prices dictated by global supply and demand conditions. As a result, the exchange rate directly affects the prices we pay.

**Elaborate and Examples** MAS operates a **managed float regime** for the Singapore dollar. The trade-weighted exchange rate is allowed to fluctuate within a policy band, the level and direction of which is announced semi-annually to the market. The band provides a mechanism to accommodate short-term fluctuations in the foreign exchange markets and flexibility in managing the exchange rate.

In the context of Singapore, an appreciating Singapore dollar results in lower prices of foreign goods and services imported into Singapore. This has the direct effect of lowering the prices that the economy pays for final goods and services imported into Singapore. If the imports are factor inputs, it has the added effect of lowering the cost of production of firms, as evidenced from the extract “... global oil prices have risen by an average of 16 per cent per year between 2010 and last year. But with a strong local currency, local petrol pump prices have increased by only 8 per cent over the period.”

An appreciating Singapore dollar would also help to lower both demand-pull and cost-push inflation. As mentioned in the extracts, “if the MAS did not allow the Singdollar to appreciate, headline inflation would have been about 2.5 percentage points higher than the 4.6 per cent rate last year.”

**Evaluation** However, the effectiveness of exchange rate policy can be undermined by the presence of time lags and lack of perfect knowledge and reliable information. Due to these lags in monetary policy, MAS formulates and conducts monetary policy in a forward looking manner based on reasonable assumptions of economic outlook and possible negative shocks.



## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

Link                      It is important to note that exchange rate policy does not work alone in Singapore, but also include a mix of fiscal and supply-side policies.

#### **Anti-Thesis: Singapore needs to focus more on other policies**

Point                      Singapore should also make full use of its limited resources and maximise their per unit output. The most abundant resource in Singapore would be their labour force and hence, it is crucial to develop and stretch this labour force by using Supply Side policies to raise productivity.

Elaborate and examples                      The increase in productivity will increase the maximum potential of Singapore economy and will lead to an increase in aggregate supply of Singapore. Thus, there will be potential economic growth for Singapore. Increasing the productivity will also increase the average wage rate of the workers and that will increase their ability to consume more.  
In Singapore, "A key prong in our restructuring strategy has been to provide firms with strong support for every investment that can improve productivity." This is done through a variety of measures such as the Productivity and Innovation Credit (PIC) scheme and the Continuing Education and Training (CET) system.

Evaluation                      However, supply side policies may not be effective in curbing inflations for Singapore as training the labour force usually faces large, significant time lags. The training process is also voluntary and it may take a while to complete. Many domestic investors may downsize their production level whereas the foreign investors may look for other neighbouring countries where labour cost is lower and there are more growth opportunities.

Alternative Points                      Students could also consider the below policy but it should not be the focus of the anti-thesis:  
1) Fiscal Policy - In Singapore, policies often also have fiscal effects as they involve large amounts of government spending which can help to increase aggregate demand and hence national income, as can be seen from the extract, "This extension will cost the Government a total of \$3.6 billion." This would result in actual economic growth as well as a fall in cyclical unemployment. However, fiscal policy is rather limited in use in Singapore due to our small multiplier. Although, this may still help in this 'era of slow growth.'  
2) Trade Policy - In addition to domestic-based fiscal and supply side policies, Singapore also needs to continue its stance in taking an outward oriented approach to trade. Beyond simply utilising exchange rates to manage the costs on foreign imports, Singapore needs to also aggressively pursue globalisation measures. One such way is to have multiple long-term partnerships with other trade partners through the signing of Free Trade

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

Agreements. Examples include the US-Singapore FTA, the Sino-Singapore FTA etc.

However, the MAS needs to take care of maintaining a stable exchange rate to ensure the success of trade policies. A rise in the external value of our currency can undermine export competitiveness whilst a fall in the external value may make imports more costly. Fluctuations in exchange rate might lead to investors finding it hard to estimate costs and profits. This will have an impact on businesses dealing with export and import of goods.

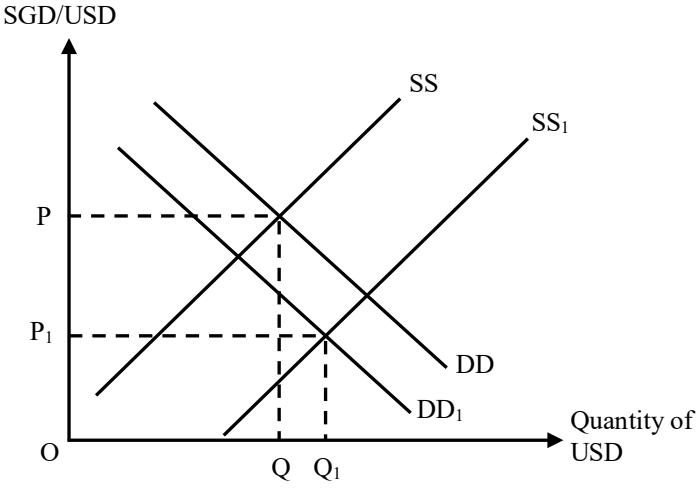
**Conclusion** Thus, exchange rate policy still relevant. However, given the multi-faceted nature of the economy, the government should consider combining its policies. These policies that will have impact on both the AD and the AS for the Singapore economy, Furthermore, the government can also push for greater trade integrations with other countries such as joining economic cooperations and signing FTAs. These trade policies will invariably help to support the existing demand management and supply-side policies and help the government achieve its macroeconomic aims. While currency appreciation in Singapore is able to lower inflation, it does nothing in terms of creating more jobs or to increase the rate of economic growth. The 2 policies will have to be combined for a greater effect.

Levels	Knowledge, Application, Understanding and Analysis	Marks
L2	Well-balanced answer that shows deep analysis in terms of the relevance of both the exchange rate and other policies, in particular supply side policy in the context of Singapore.	5-7
L1	Undeveloped attempt to analyse the relevance of the 2 policies. The answer mainly looks at the pros and cons of exchange rate policy, without bringing in other policies. Or it just brings in policies in a cursory manner, without addressing the idea of whether exchange rate is still relevant	1-4
E2	Judgement is made on the effectiveness of the policy with good substantiation (possible alternative suggestion)	2 -3
E1	Unexplained judgement on the effectiveness of the policy	1

**Examiners Comments:**

- **Many students explained that exchange rate policy reduces AD and thus reduces demand pull inflation. Although this may be true, since (X-M) will fall following an appreciation, this does not touch on the key of why Singapore adopts Exchange rate policy. The key rationale behind the MAS exchange rate policy is primarily meant to prevent imported inflation.** An appreciation of our currency allows us to buy imported goods and services / factor inputs at a cheaper price, given our stronger currency. This is important to us, given our dependency on imports.
- **This meant some students were confused as to whether imported inflation is demand-pull or cost-push inflation. Imported inflation is seen as cost push inflation due to more costly raw materials for Singapore.** Therefore, students need to clearly analyse the relevance of exchange rate policy in terms of its ability to control this particular type of cost push inflation.
- Many students did not give an alternative policy or gave it briefly with little relevance to the context. The context touched on Supply-side policy to a great extent. Unfortunately, this evidence provided was used to a limited extent by many students.
- Many students also analysed by saying that exchange rate policy is relevant as interest rate policy is irrelevant in SG. While this is not conceptually erroneous, students should avoid this as it invariably weakens the essay analysis, making it difficult to reach a L3 standard. Arguments should be made both for and against the policies themselves. The actual 'relevance' or 'effectiveness' of a particular policy cannot be the result of the 'irrelevance' or 'ineffectiveness' of other policies.
- Some students did not realise that **Singapore is unable to employ the interest rate policy or the money supply tool**, due to the Open economy Trilemma.
- An important point for students to note is that it is important to **answer case study questions with the context in mind**. Many students talked about exchange rate and supply side policy and how these policies can be used, as well as their disadvantages. However, they did so without considering the problem we are trying to settle i.e. inflation. For example, many students suggested depreciation of the exchange rate as being relevant to Singapore's economic growth objective. This is problematic as it: Firstly, does not address the question requirement, which is whether exchange rate policy is still relevant to maintaining price stability by lowering inflation. Secondly, it is implied by the case evidence that Singapore's exchange rate policy stance is a gradual appreciating one.

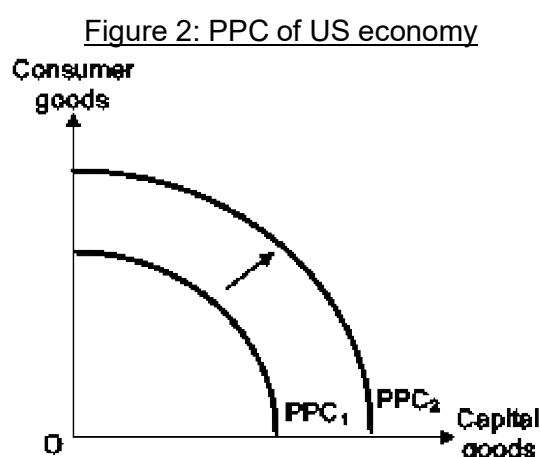
**Question 4: Donald Trump and the US economy [2018 TJC]**

(a)	(i)	<b>Summarise the trend in the US Current Account Balance from 2013 to 2017.</b>	<b>[2]</b>
<ul style="list-style-type: none"> <li>There was an overall worsening of current account deficit by 28.8% [1]</li> <li>The greatest worsening of the deficit was from 2014 to 2015 by 11.7% [1]</li> </ul> <p><u>Marker's comments:</u></p> <ul style="list-style-type: none"> <li>Most students did not indicate a significant refinement from the trend.</li> <li>Students are expected to calculate % changes instead of absolute changes.</li> </ul>			
(a)	(ii)	<b>Using a diagram, explain how the above trend affects the external value of the USD.</b>	<b>[4]</b>
<ul style="list-style-type: none"> <li>The worsening of current account deficit would indicate that there was more outflow of USD than inflow of USD. Since there was less demand for USD by foreigners, DD curve shifted from DD to DD<sub>1</sub> in Figure 1. [1]</li> <li>There was an increase in supply of USD as US residents increased their demand for foreign currency. The supply curve shifted from SS to SS<sub>1</sub>. [1]</li> <li>From Figure 1, the external value of USD fell (or USD has depreciated) as a result of a decrease in demand for USD and an increase in supply of USD. [1]</li> <li>Correctly labelled diagram that matches analysis. [1]</li> </ul> <p style="text-align: center;"><u>Figure 1: Demand &amp; Supply of the USD</u></p>  <p><u>Marker's comments:</u></p> <ul style="list-style-type: none"> <li>Some students failed to determine the focus of this question.</li> <li>Most students did not consider how demand for USD <b>and</b> supply of USD change as a result of a current account deficit.</li> <li>Axes were labelled incorrectly or incompletely. Acceptable Y axis are:             <ol style="list-style-type: none"> <li>SGD/USD</li> <li>Price of USD in terms of SGD</li> <li>Value of USD to SGD</li> <li>Value of SGD per USD.</li> </ol> </li> </ul>			

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

(b)	Using a Production Possibilities Curve, explain how the proposed immigration law will impact the US economy.	[3]
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- The proposed immigration law will slow down the rate of increase of immigrants into the US. Assuming these immigrants take on jobs in the US, this translates to an increase in quantity of labour into the US, increasing her productive capacity, albeit at a slower rate than before. [1]
- As seen in Figure 2, the Production Possibilities Curve thus shifts outwards, from  $PPC_1$  to  $PPC_2$ . [1]
- National output and income of the US economy increases as a result.
- Correctly labelled diagram that matches analysis. [1]



Alternative answer

- Assuming that the rate of inflow and outflow of labour into and out of the US workforce were constant before the law was enacted, the proposed immigration law will decrease the inflow of labour into the US workforce, *ceteris paribus*. This results in the reduction of the quantity of labour in the workforce, thus reducing her productive capacity.
- As seen in Figure 3, the Production Possibilities Curve thus shifts inwards, from  $PPC_1$  to  $PPC_2$ . [1]
- National output and income of the US economy decreases as a result.
- Correctly labelled diagram that matches analysis. [1]

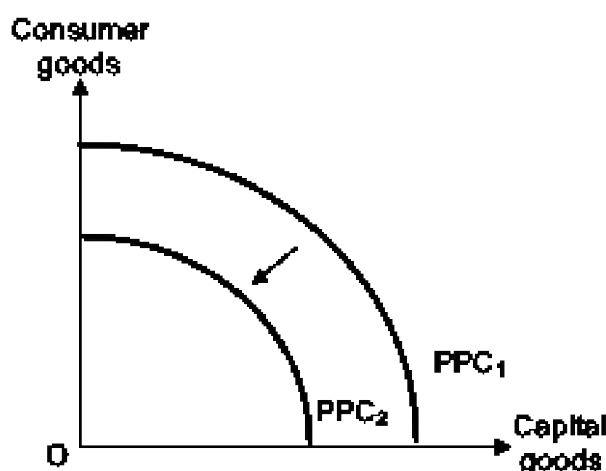


Figure 3: PPC of US economy

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

Note: both answers were accepted and were given full credit if the economic reasoning that accompanied the shift of the PPC was accurate.

#### Marker's comments

- This question was not well done as many students have forgotten the diagram and concepts that are relevant to PPC. A large number of students were not able to draw a complete and accurate PPC diagram. Many students wrongly label the axis, or did not even bother to label the axis.
- Students should recall that a PPC shows different combination of two goods that an economy can produce and both axis should be labelled with quantities of different type of goods, namely consumer and capital goods. The labelling of the axis as quantities of good A and good B would not be as suitable as these are hypothetical and less contextualised to the macroeconomy.
- Students should note that they need to label the PPC curves.
- Many students drew the PPC shifting inwards due to a cut in immigration numbers, which is inaccurate, as there would still be immigrant entering the economy, just at a slower rate each year and hence the PPC should shift outwards by a smaller extent.

(c)		<b>Using Extract 2, explain how automatic stabilisers work.</b>	<b>[3]</b>
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Define automatic stabilisers [1]

- Automatic stabilisers are a form of fiscal policy that offsets fluctuations in aggregate demand during changing economic conditions without policymakers having to take any deliberate action. [1]

Explain how automatic stabilisers work using evidence from Extract 2 [2]

- Extract 2 mentioned that there “fewer Americans applied for unemployment benefits” and “unemployment claims slide by 14000”. This suggests that unemployment benefits fell as there are fewer unemployed workers due to the expansion of the economy, possibly due to an increase in AD. [1]
- As the US government spends less on unemployment benefits, there would be a contractionary effect. Assuming the workers spend these benefits on domestic consumption (C), lesser unemployment benefits given out will prevent further increases in AD. This dampens the initial expansionary effect and stabilises the US economy. [1]

#### Marker's comments:

- Many students were unfamiliar with what automatic stabilisers are and their role in the economy, indicating a need to review this concept.
- A significant proportion of students who were able to explain how automatic stabilisers work, did not explain it based on Extract 2. Such answers explained about progressive tax systems and/or a rise in unemployment benefits during a recession. Students should recognise that the automatic stabiliser mentioned in Extract 2 is unemployment benefits, which fell due to the growing economy. This helps to prevent AD from rising excessively and dampens the expansionary effect felt in the economy.
- A point to note is that automatic stabilisers do not alter the direction of change in AD, but merely reduce the extent of the initial change in AD, thus mitigating the initial contractionary or expansionary effect on the economy.

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

(d)		<b>Comment on whether the data provided is sufficient to conclude that there has been inclusive and sustainable growth in the US economy.</b>	<b>[8]</b>
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Question interpretation

<b>Command word/phrase</b>	Comment on	Provide balanced analysis and make a judgement on whether data provided is sufficient to conclude that there has been inclusive and sustainable growth in US economy
<b>Content</b>	Data provided	Use data to link to inclusive and sustainable growth
	Inclusive and sustainable growth	Two different types of economic growth
<b>Context</b>	US economy	Economy of USA

This answer requires students to utilise the data to explain the parts where the data is able and unable to show that there has been inclusive and sustainable growth in the US economy. The evaluation involves an appropriate and reasoned comment on whether the data is sufficient or insufficient to conclude that there has been inclusive and sustainable growth in the US economy.

**Introduction**

- Inclusive growth indicates a rate of growth that is sustained over a period of time, is broad-based across economic sectors, and creates productive employment opportunities for the majority of the country's population.
- Sustainable economic growth indicates a rate of growth that can be maintained without creating other significant economic problems.
- This response aims to analyse whether the data provided is sufficient to conclude that there has been inclusive and sustainable growth in the US economy.

**Thesis: Explain how the data concludes that there is inclusive growth in US economy**

- The data in Table 1 may be sufficient to conclude that there has been inclusive growth in the US economy.
- The GDP per capita has increased from \$52,726 in 2013 to \$59,535 in 2017. Inflation rates as measured by the change in consumer price index has been positive from 1.46% in 2013 to 2.13% in 2017. The unemployment rate has fallen from 7.38% in 2013 to 4.35% in 2017. These three indicators show that there has been sustained economic growth in US.
- Furthermore the GINI coefficient, which measures the wealth distribution of a country's residents, fell from 0.396 in 2013 to 0.391 in 2017. This reflects that there has been a more even distribution of income in the US economy, thus suggesting that there has been inclusive growth.

**Anti-thesis: Explain how the data may not conclude that there is inclusive and sustainable growth in US economy**

- While there was a fall in unemployment rate, it is not clear from the data if this was due to a rise in productive employment opportunities across a broad range of economic sectors. Also, it cannot be concluded if the employment opportunities were for a majority of the country's population or mainly for the higher-skilled workers. Hence, the data may not be entirely sufficient in showing that there has been inclusive growth in US.
- Despite a fall in the Gini coefficient, the fall is slight and the Gini coefficient remains relatively high. For a more accurate conclusion on inclusive growth, it would be beneficial to know if the Gini coefficient has taken into account taxes and transfers. If the Gini coefficient is significantly lower after taking into account the effects of the redistributive policies, there is clearer evidence of inclusive growth.
- The data provides information on the economic growth situation of the US. However, it does not provide information of how the growth is achieved, which could have been at the expense of the environment. There is no data or indicators on the environmental situation in US, or information on the policies taken by the government to mitigate adverse impacts to the environment, which could have allowed us to determine whether there was sustainable growth.

**Evaluative Conclusion**

- **[Stand]** The data provided is insufficient to conclude that there has been inclusive and sustainable growth in the US economy.
- **[Alternatives]** In order to determine if there was sustainable growth, we would require more data on the impact of economic growth on the environment. Some examples include, the level of carbon taxes, air quality index and the environmental sustainability index. For us to determine accurately if there was inclusive growth, we would require data on the type of employment opportunities created in the economy. Also, we would need to have information on whether the GINI coefficient has taken into account the level of taxes and transfers.

Level	Knowledge, Application/Understanding, and Analysis	Marks
L2	For a well-developed and balanced answer that <ul style="list-style-type: none"> <li>discusses both the sufficiency <b>and</b> insufficiency of the data in concluding inclusive and sustainable growth in the US economy.</li> </ul> <p>*A well-explained one sided response for how the data might be sufficient in concluding inclusive and sustainable growth can score a max of 4 marks.</p>	4 – 6
L1	For an underdeveloped answer that <ul style="list-style-type: none"> <li>is one-sided and only discusses how the data might be sufficient <b>or</b> insufficient in concluding inclusive and sustainable growth in the US economy, OR</li> <li>briefly discusses how the data might be sufficient and insufficient in concluding inclusive and sustainable growth in the US economy.</li> </ul>	1 – 3
E	Up to 2 marks for valid evaluative comment (s) on whether the data provided is sufficient in concluding that there is inclusive and sustainable growth in the US economy.	1 – 2



## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

#### Marker's Comments:

- Many students were confused with the requirements of the question and misinterpreted the question as one of the following:
  - Comment on whether the data shows that there is inclusive and sustainable growth in the US economy.
  - Comment on whether the policies implemented have achieved inclusive and sustainable growth in the US economy.
- It is important to be clear what the issue of contention is in the question - whether there is enough data provided in the case to show that inclusive and sustainable growth exist in the US economy. If it is argued that there is insufficient data, students should clearly point out the limitations of the data present and the data that is lacking in the case.
- Students are reminded to be discerning in their selection of case material as data or evidence to be used to support their arguments.
  - A number of students did not use the data provided in Table 1 at all, though the economic indicators provide the most objective evidence of the growth situation in the US economy. Instead, these responses made often tenuous inferences of the existence of inclusive and sustainable growth from other data present in the case, such as Trump's immigration laws (Extract 1) or the increased protectionism in US (Extract 3). Such responses ended up explaining the possible impact of such policy measures on inclusive and sustainable growth in US instead.

(e)		<b>Discuss the factors that governments should consider when enacting protectionist measures like tariffs.</b>	<b>[10]</b>
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#### Question interpretation

<b>Command word/phrase</b>	Discuss the factors	Discuss the different factors that governments would consider before making the decision to enact protectionist measures
<b>Content</b>	Factors to consider, protectionist measures like tariffs	Factors to consider: benefits, costs, unintended consequences, constraints, information  Protectionist measures: Tariffs, Import quota
<b>Context</b>	No specific context	Students are to set their own context

This question requires students to consider the different factors in the government's decision making process before enacting protectionist measures like tariffs. The evaluation would require a well-reasoned judgement on which factor (s) is/are more important to the government in making the decision.

#### **Introduction**

- Protectionism is defined as the act of imposing economic policies aimed at restricting or restraining trade between countries, designed primarily to protect domestic producers and workers from foreign competition.
- Protectionist measures can be implemented to give domestic producers an advantage in the international market or to narrow a trade gap.
- An import tariff is a tax levied on imported goods or factor inputs.

## Chapters 10-12: Globalisation and the International Economy

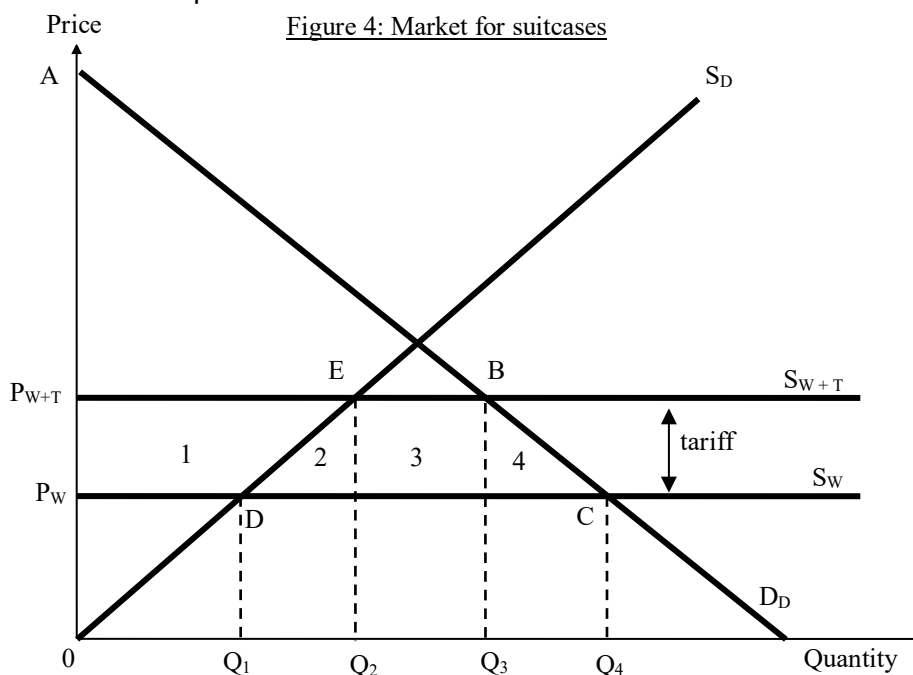
### Suggested Answers

- This answer aims to discuss the different factors that governments should consider when enacting protectionist measures like tariffs.

#### Body

#### Key Argument 1: The government should consider the benefits of enacting protectionist measures

- When making a decision to enact protectionist measures like tariff, governments would consider the higher profits, increased producer surplus enjoyed by domestic producers, and the sheltering of domestic industries from foreign competition.
  - From Figure 4, if the country produces a good like suitcases on its own without free trade, the domestic demand and supply curves for suitcases are represented by  $D_D$  and  $S_D$  respectively.
  - When the country is open to free trade, and assuming that the country is too small to affect world markets and prices, the country faces the perfectly price inelastic world supply for suitcases,  $S_W$ . Price of suitcases is now at  $P_W$ , domestic consumers consume  $0Q_4$  units of suitcases while domestic producers produce  $0Q_1$  units. The remaining  $Q_1Q_4$  units of suitcases are imported.
  - When a specific import tariff on suitcases is enacted, the supply curve for suitcases shift upwards by the amount of tariff per unit of suitcase, to  $S_{W+T}$ . The price of suitcases now increases to  $P_{W+T}$ , where domestic consumers consume  $0Q_3$  units of suitcases while domestic producers produce  $0Q_2$  units. The remaining  $Q_2Q_3$  units of suitcases are imported.



- These are the benefits for that the governments have to consider:
  - Domestic producers gain from higher producer surplus, as it increases from  $0P_WD$  before the tariff to  $0P_{W+T}E$  after the tariff.
  - In addition, they benefit from higher revenue as the price  $P_{W+T}$  and the quantity  $Q_2$  are both higher than before ( $P_W$  and  $Q_1$ ). Assuming costs remain constant, they will earn higher profits as a result of the tariffs.
  - Industries that tariffs are implemented on benefit from being sheltered from foreign competition.

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

- When tariffs are implemented on an infant industry, it has time and room to develop its comparative advantage. They can therefore grow to a point where they become internationally competitive.
- When tariffs are implemented on a sunset industry, it slows down the contraction of the industry, allowing workers more time to acquire skills to transit into another industry, thus lowering structural unemployment.
- Government achieves their macroeconomic goals of actual growth and low unemployment.
  - With tariffs and assuming demand for imports is price elastic, import expenditure (M) falls (price of imports increase, quantity demanded decrease) as domestic consumers switch to cheaper domestic products. As M falls and domestic consumption increases, there is an increase in AD.
  - As AD increases, real national output increases, and actual growth is achieved. Demand-deficient unemployment decreases as the higher output requires firms to demand more labour.

#### **Key Argument 2: The government should consider the costs of enacting protectionist measures**

- When making a decision to enact protectionist measures like tariff, governments would consider the costs of the decision, like higher prices, reduced consumer surplus, welfare loss, negative growth and unemployment.
- The costs that governments should consider are:
  - With a tariff, consumers now pay a higher price to consume the good ( $P_{W+T}$ ) compared to  $P_W$  before the tariff.
  - Consumers suffer from lower consumer surplus, as it decreases from  $ACP_W$  before the tariff to  $ABP_{W+T}$  after the tariff.
  - There is also a welfare loss of Areas 2 and 4 after the tariff is imposed, thus resulting allocative inefficiency.
    - Area 2 is incurred due to the higher price that consumers pay after the tariff is imposed, and area 4 is incurred because the less efficient domestic producers are producing the extra  $Q_1Q_2$  units of the good in the market.
  - There would also be a 'beggar-thy-neighbour' effect, preventing the government from achieving their macroeconomic goals.
    - When a country imposes tariffs, her import expenditure falls and hence the export revenue of her trading partner falls. As a result, the trading partner's ( $X - M$ ) and hence AD falls, leading to a fall in national income.
    - With a lower income, the trading partner will reduce demand for the exports of the country that imposed the tariffs. With reduced export revenue, AD falls, leading to negative growth and demand-deficient unemployment.

\*Note: you may decide to include this following argument to broaden the scope of discussion. Other possible arguments would include: constraints that the government face, and information that they require in their decision making.

#### **Key Argument 3: The government should consider the unintended consequences of enacting protectionist measures**

- When making a decision to enact protectionist measures like tariff, governments would consider the unintended consequences of the decision.
- When a country imposes a tariff, there may be potential unintended consequences like retaliation. Trading partners may retaliate with similar tariffs on that country's goods and services.

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### Suggested Answers

- From Extract 4, it can be seen that China retaliated with tariffs after US imposed tariffs on Chinese goods.
- When China retaliates with tariff on US goods, US export revenue will fall, leading to a fall in her AD. This may offset the initial benefits reaped by the US from imposing tariffs on Chinese goods.

#### Evaluative Conclusion

- **[Stand]** Governments would have to first weigh the benefits and the costs before enacting protectionist measures like tariffs. When the benefits outweigh the costs, protectionist measures should be enacted. When the costs outweigh the benefits, they should not be enacted.
- **[Situation + Magnitude]** A country's reliance on its imports and exports could determine whether the benefits outweigh the costs, or vice versa.
  - A small and open country like Singapore is likely to be very dependent on her trade sector, hence protectionist measures would incur higher costs than benefits.
    - As Singapore lacks natural resources, tariffs imposed on imported factor inputs would raise their prices and hence the economy wide cost of production, leading to the high costs of inflation and negative growth.
    - Furthermore, Singapore relies heavily on her exports as the driver of her economic growth. With protectionist measures in place, the high costs incurred due to her trading partners' loss of income would severely impact her economy.
  - A large country with a big domestic market on the other hand, may reap greater benefits than costs when enacting protectionist measures.
    - Countries like China have abundance of resources and are likely incur lesser costs from enacting protectionist measures as they tend to not be reliant on imported factor inputs.
    - Moreover, they may not be dependent on their exports as they can tap on their large domestic market to drive their economic growth.
    - **[Magnitude]** Furthermore, as the trade sector is likely to take up a smaller proportion of their AD relative to other components, the costs and negative unintended consequences incurred by enacting protectionist measures (like the 'beggar-thy-neighbour' effect and retaliation) are likely to be less significant.

Level	Knowledge, Application/Understanding, and Analysis	Marks
L2	For a well-developed and balanced answer that <ul style="list-style-type: none"> <li>• rigorously discusses different factors that governments have to consider before enacting protectionist measures</li> </ul>	5 – 7
L1	For an underdeveloped answer that <ul style="list-style-type: none"> <li>• lacks sufficient scope of discussion (e.g. only discusses one factor), OR</li> <li>• has sufficient scope but lacks rigour in analysing different factors that governments should consider when enacting protectionist measures</li> </ul>	1 – 4
E	Up to 3 marks for valid evaluative comment (s) on the most significant factor that governments should consider when enacting protectionist measures.	1 – 3

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

#### Marker's comments:

- This question was fairly well attempted, with a good number of students scoring L2 marks.
- Students who did not do as well mainly listed factors that the government should consider and vaguely described them without much economic concepts. These weaker answers lacked rigour in explanation.
- For questions on protectionism, students are reminded that the tariff diagram is a powerful tool as it is able to help them explain **both** benefits and costs of these policies. As such, they should make it a point to learn how to describe the workings of a tariff and how to use it to discuss both benefits and costs of such a policy.
- The evaluation for similar decision making styled questions could involve a weighing of the factors: benefits vs costs, or a progressive ranking of the factors: consider benefits and costs first, then constraints, then unintended consequences.

**Question 5: Globalisation and Deglobalisation**

- a Describe the trend in merchandise trade as a percentage of world GDP [1]**  
**from 2000 to 2014.**

The merchandise trade as a percentage of world GDP generally increased. (1m)

- b Using the concept of opportunity cost, explain one effect on firms and [6]**  
**one effect on the government in the home country arising from dumping**  
**by a foreign country.**

Effect on firms in the home country:

Consumers in the home country turn to the cheaper goods dumped by the foreign country. As demand for the goods by the foreign firm is price elastic, the lower price charged will result in a more than proportionate increase in quantity demanded for foreign goods, increasing expenditure on these goods. Demand for domestically-produced goods will fall, lowering total revenue received by firms in the home country. (1m) The opportunity cost of continuing operation is forgone revenue from selling alternative goods that require similar inputs to production. (2m) **OR** the opportunity cost of shutting down operation is totally forgoing the revenue generated from selling the good and the brand image that the firms may have built up. (2m)

Effect on government in the home country:

As consumers spend less on domestically-produced goods, AD falls and hence real national income falls. The government will therefore receive lower tax revenue. (1m) The opportunity cost of cutting spending on infrastructure due to the lower revenue is forgoing higher rate of growth from better connectivity. (2m) **OR** the opportunity cost of imposing tariffs on the foreign goods is forgoing good trade relations between the countries. (2m)

- c (i) What evidence suggests that the world is heading towards [1]**  
**deglobalisation?**

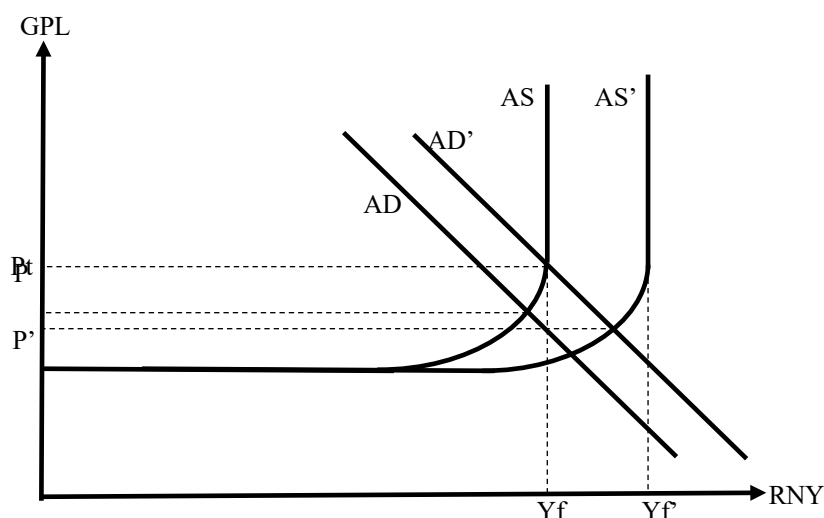
From 2011 onwards, there is a consistent decline in merchandise trade as a percentage of GDP. (1m)

- c (ii) With the aid of a diagram, explain why in 2015 there was deflation [4]**  
**despite an improvement in the trade balance as shown in Table 1.**

An improvement in the trade balance, which means an increase in  $X-M$ , will result in an increase in AD, as illustrated by a rightward shift in AD curve from AD to AD' as shown in the diagram below. This is expected to result in an increase in GPL from P to Pt. (1m)

However, Extract 2 implied that Singapore has been embracing globalisation and technology, and firms and workers are encouraged to improve and upskill themselves. With better productivity due to advancement of technology and better quality of labour, the country's productive capacity increases as illustrated by the shift of LRAS from AS to AS'. The deflation observed must have occurred due to the increase in LRAS outweighing the increase in AD, causing the GPL to fall from P to P'. (2m) Hence the observed deflation from P to P' occurs.

(1m for dig.)



- d. **Discuss how the change in exchange rate in Table 1 and measures undertaken in Extract 2 might impact Singapore's export competitiveness.** [8]

Table 1 showed that Singapore dollar depreciated against US dollar.

As the demand for Singapore's exports is likely to be price elastic given the availability of substitutes in the global market, reduction in foreign price of exports due to the depreciation will result in a more than proportionate increase in the quantity demanded of exports, increasing Singapore's export revenue as our price competitiveness improve.

However, given that Singapore has limited resources, demand for imported inputs is price inelastic. As depreciation will result in an increase in domestic price of imported inputs, the increase in price will result in a less than proportionate fall in quantity demanded of inputs. This results in an increase in expenditure on imported inputs, increasing cost of production. This will result in a fall in SRAS and hence a rise in GPL. Assuming Singapore's inflation rate is higher than other countries', Singapore will lose export price competitiveness.

**EV:** Overall, the depreciation is likely to cause an improvement in Singapore's export price competitiveness. Cost of production may have risen due to increase in price of imported inputs. However, the firms' total cost of production does not only comprise cost of imported inputs – there are rental and cost of labour as well. Hence the increase in cost of production is unlikely to totally offset the reduction in foreign price of exports due to the depreciation. The increase in cost of production will **reduce the extent of fall in the foreign price of exports** due to the depreciation, hence still maintaining export price competitiveness.

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Examples of the supply-side policies mentioned in Extract 2 are 'creating the basic conditions for the markets to operate properly' and the model of tripartite partnership between unions, employers and the government.

Creating basic conditions for the markets to work properly such as protection of property rights and granting of patents to R&D outcomes encourage investment. As firms are more willing to carry out investment spending, better capital equipment in the long run will reduce cost per unit of output, improving price competitiveness of exports. The same granting of patents could also encourage R&D in product innovation, improving non-price competitiveness.

However, these measures may only impact Singapore's export competitiveness in the long run. In addition, the stated measures alone may not suffice in encouraging positive outcomes on R&D. **EV:** Other measures such as deliberate efforts to improve the quality of human capital may enhance the success of the R&D efforts.

The model of tripartite partnership between unions, employers and the government ensures that the rate of wage increase is in line with the rate of productivity improvements, hence helping to maintain competitive wages and cost and eventually, competitive prices of goods and services.

However, despite our tripartite arrangement, as stated in Extract 2, Singapore continues to face competition from both developing and developed countries. It stated that starting salaries for graduates in Japan are lower than in Singapore, making us lose price competitiveness to an extent, as our wage cost is still higher. In addition, Singapore is facing a tight labour market, making it difficult to prevent wage increases as we move towards the full employment level. Hence there is a limited extent to which such tripartite arrangement can continue to contribute to Singapore's export competitiveness.

**EV:** Overall, though it has been argued earlier that depreciation may help improve Singapore's export competitiveness, particularly for the service sector, it is not a long-term measure. The supply-side policies raised may have a longer-lasting positive outcome on Singapore's export competitiveness in the long-run. That being said, a range of supply-side policies should be adopted and modified to continually address the main challenges facing Singapore so as to better maintain Singapore's competitiveness in the long-run.

Knowledge, Application, Understanding and Analysis		
L2	For an answer with well-balanced approach and accurate economic analysis. Good use of Case study evidence.	4-6m
L1	For an answer that is balanced but limited/underdeveloped in explanation. Or one-sided answer.	1-3m
Allow up to 2 additional marks for Evaluation		
E2	Evaluative comments with justification.	2m
E1	Evaluative comments, unexplained.	1m



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### Suggested Answers

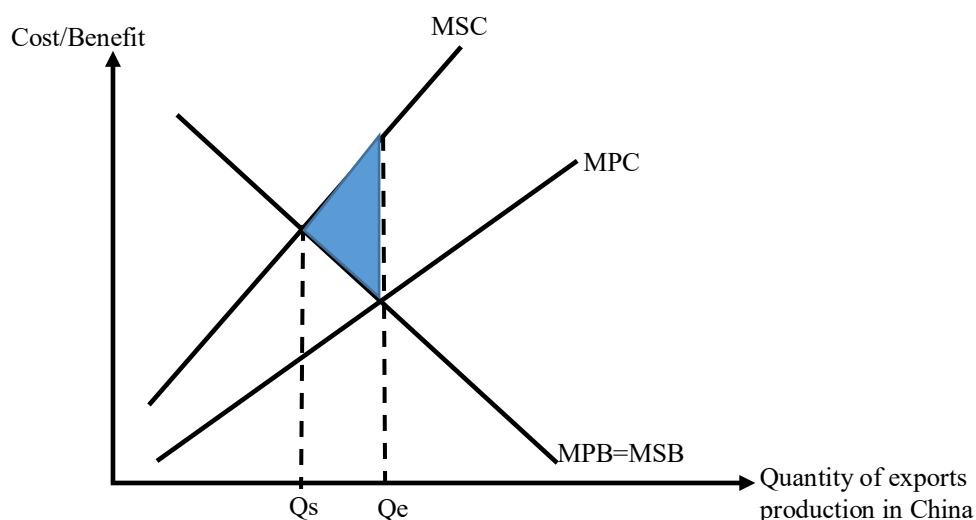
- e. With reference to the data, do you agree that “economic decisions cannot be left to the market”? [10]

Thesis: Certain economic decisions cannot be left to the market.

As stated in Extract 3, gases and particulates that Chinese factories pumped out in their production of export goods affected the health and well-being of many people in many countries who are not involved in the production process in China. These are the external costs that are not taken into consideration by those who undertake the economic activity. The producers in China only consider their private cost and private benefit such as the cost of raw material and expected profits from the sale of the good respectively.

If left to the free market, the level of production will be at  $Q_e$ , where MPB equates PMC, as shown in the diagram below. As the producers do not take into account the external cost inflicted to third parties as a result of their production, there is a divergence between social marginal cost and private marginal cost. At  $Q_e$ , MSC is greater than MSB, indicating that society values an additional unit of the good produced less than what it costs society to produce it.

The socially optimum level of production is at  $Q_s$  where MSB equates MSC. There is therefore a situation of over-production and this caused deadweight loss shown by the shaded area below. Hence there is a need for the government to intervene and regulate the industry.



Extract 2 also stated that globalisation and technological advances are disrupting industries and displacing workers. In light of globalisation, as another country acquire comparative advantage in the good that we're producing, Singapore will lose price competitiveness and our workers will be retrenched. Technological advances means that better capital equipment can now replace manual labour and employers may be willing to purchase those capital equipment as it can generate higher output per unit of time with less human error and also because of the rising labour costs in the country. If left to the free market, workers are who are displaced from their jobs will face structural unemployment due to occupational immobility. There is allocative inefficiency as the unemployed resource are not utilised to generate output.

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This situation may not self-correct itself in the free market due to imperfect knowledge of the areas of expansion in the economy or due to lack of financial ability to go for retraining. The government, having an overall view of the areas of expansion in the economy will need to step in to encourage retraining of workers in the relevant industries by lowering the cost of such retraining.

Optional: Students can also talk about income inequality as a source of market failure.

Anti-thesis: Other than intervening to address market failure, economic decisions should largely be left to the market.

Imposing quotas and tariffs to protect the local economy (Extract 5), for example will result in complacency as firms rely on the government to lower its cost and face no competitive pressure to be productively efficient. In contrast, as supported in Extract 6, with free markets, due to high degree of competition, efficiency can be attained as economic agents are under pressure to perform, and both businesses and workers have the incentives to improve. Due to the competition, firms face pressure to adopt the least-cost technique of production. This is productively efficient. As the same time, some firms may be willing to undergo R&D to improve quality of products. This will achieve dynamic efficiency.

The government may also have imperfect information in making economic decisions, possibly leading to government failure. In Extract 8, though it was stated that government funded or instigated initiatives have resulted in the emergence of successful, job-creating new industries, this approach is increasingly questioned and subjected to various cost-benefit analysis issues. As stated in Extract 4, it is difficult to determine the criteria that define sectors of high potential, difficult to identify the method to help those sectors grow, difficult to decide on the outcomes that need to be seen to justify government funding and to hold someone accountable. All these difficulties mean that it is highly possible that a lot of government funding may be allocated to certain sectors (than is necessary) and that these sectors may not generate high enough returns to justify the use of government revenue. And this inevitably means that the country would incur a high opportunity cost of the use of such funds, crippling the country's ability to improve other aspects of living such as spending on healthcare and education.

In addition, as stated in Extract 4, too much of government focus on short-term innovation may damage long-term ability to innovate and grow. This could possibly be due to high amount of government revenue required to fund such industries, as analysed earlier. This could 'damage long-term ability to innovate' due to either of the following reasons: the government's ability to maintain such government-driven approach is limited in the long run due to rapid use of government budget and lack of returns on funding or the fact that too much government-driven projects make it hard for innovation to come from the private sector as there isn't much support for free market innovations through appropriate grants or incentives.

Conclusion: Though there is certainly a case for government intervention in the free market especially when it comes to addressing market failure and attaining macroeconomic objectives especially in periods of poor economic outlook or in situations of unfair competition like dumping, there is a limit to

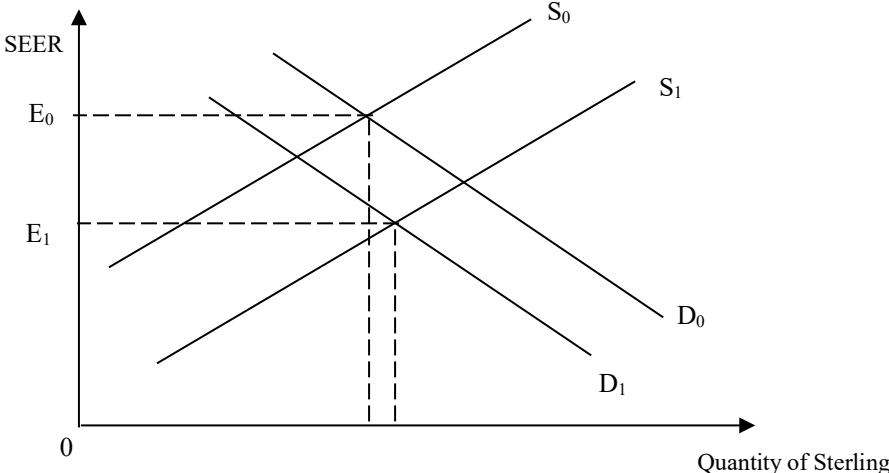
## Chapters 10-12: Globalisation and the International Economy

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which the government should intervene under other circumstances as it may still be subjected to government failure due to imperfect information. In addition, as stated in Extract 2, governments cannot generate wealth by themselves and need to use the power of free markets to their advantage. This means that certain economic decisions should still be left to the free market. Nevertheless, even so, **the government's role of creating "the basic conditions for the markets to operate properly" (Extract 2) stays.**

<b>Knowledge, Application, Understanding and Analysis</b>		
L2	For an answer with well-balanced approach. There is good reference to case material, backed with adequate economic analysis.	5-7m
L1	For an answer that is balanced but limited/underdeveloped in explanation. There is some reference to case material.	3-4m
	Very superficial analysis. Mere listing of points. Inaccurate knowledge of concepts. Or one-sided answer.	1-2m
<b>Allow up to 3 additional marks for Evaluation</b>		
E2	Evaluative comments with justification.	2-3m
E1	Evaluative comments, unexplained.	1m

**Question 6: Looming Threats to Globalisation [2018 NJC]**

(a)	(i) State what happened to the British pound sterling effective exchange rate between the Q1 2014 and Q4 2016.	<b>[2]</b>
	The British pound sterling effective exchange rate depreciated in value between Q1 2014 and Q4 2016. [1 mark]. However, it was rising over the period Q1 2014 to Q3 2015 [1 mark] before decreasing thereafter.	
	(ii) Using a demand and supply diagram, explain the cause of the trend observed in the Sterling Effective Exchange Rate Index in 2016.	<b>[4]</b>
	<p>The main cause was a loss of investor confidence due to Britain's decision to exit from the EU (Brexit). [1 mark] This resulted in capital flight from the UK. This caused an increase in SS of sterling pound [1 mark] from <math>S_0</math> to <math>S_1</math> in the foreign exchange market. At the same time, as fewer foreign investors would want to invest in the UK. This means a decrease in the demand for UK sterling pounds from <math>D_0</math> to <math>D_1</math>. [1 mark]</p>  <p style="text-align: center;">Figure 1: Market for Sterling Pound</p>	
(b)	With reference to Table 2, calculate and compare the net income flow (including transfers) in the UK current account balance with that of the US.	<b>[2]</b>
	<p>UK's current account balance is -5.8% of GDP while its balance of trade is -2% of GDP. Hence, its net income flow should be -3.8% of GDP.</p> <p>US's current account balance is -2.4% of GDP while its balance of trade is -2.8% of GDP. Hence its net income flow should be +0.4% of GDP.</p> <p>This shows that UK experienced a net income outflow, while US had a net income inflow.</p>	
(c)	Explain how a free trade agreement between the EU and Canada might affect a small dairy farmer in Belgium.	<b>[4]</b>
	<p>Since a free trade agreement would mean a removal or reduction of tariffs on imports, dairy farmers in Belgium will now have to compete with cheaper imports from Canada, thus forcing them to lower their price as well ie. "selling their milk at world price". [1 mark] Given that the demand for milk is likely to be price inelastic, the revenue of dairy farmers will fall [1 mark] as price decreases, resulting in a decline in profit. Moreover, small dairy farmers</p>	

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**Suggested Answers**

	tend to have higher costs compared to large multi-nationals, due to their lack of economies of scale. [1 mark] Coupled with the higher taxes in Belgium, the small dairy farmers may end up incurring losses [1 mark].	
(d)	Given that membership in the EU means free movement of goods, labour and capital among member countries, assess the possible impact of Brexit on the UK economy.	[8]
<p><b>Introduction:</b></p> <ul style="list-style-type: none"> <li>The departure of UK from the EU (Brexit) would mean that firms in UK would no longer have free access to European markets and that labour and capital might not be allowed to move freely between UK and EU countries.</li> </ul> <p><b>Body:</b></p> <p><b>Negative Impact</b></p> <ul style="list-style-type: none"> <li>Loss of confidence and capital outflow – One of the major effects of Brexit is the loss of investor confidence, as mentioned in Extract 1. Brexit means that UK firms would no longer have free access to European markets and may thus face tariff barriers in exporting to EU countries. This could cause a fall in exports. This also cause investors to have a pessimistic outlook of the UK economy. The fall in exports as well as capital flight would thus cause a worsening of UK's Balance of Payments.</li> <li>Fall in AD and economic growth –The fall in X and I leads to a fall in AD, which results in a fall in real output and hence economic growth. With the fall in real output, less labour will be needed, and an increase in unemployment. As shown in Fig 2 below, the fall in AD due to fall in X and I causes real output to decrease from <math>Y_0</math> to <math>Y_1</math>, resulting in lower or even negative economic growth.</li> </ul> <div data-bbox="312 1193 1174 1662" data-label="Figure"> </div> <p style="text-align: center;">Figure 2</p> <ul style="list-style-type: none"> <li>Labour outflow – In addition, the loss of confidence and negative outlook could also cause people in UK to relocate to the EU. The fall in LRAS can lead to a rise in general price level in the long term, as productive capacity becomes a constraint.</li> <li>Currency depreciation and cost of imports – With the capital outflow due to pessimistic outlook and fall in net exports, the exchange rate of the sterling pound will depreciate, causing imports to be more expensive in SGD, leading to cost-push inflation</li> </ul>		

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### Suggested Answers

#### Positive Impact

- Fall in exchange rate and improvement in BoT –This leads to an improvement in Balance of Trade and increase in AD, resulting in a more than proportionate increase in real national income via the multiplier effect, and hence an increase in economic growth rate.
- Greater autonomy to establish Free Trade Agreements with other countries. This can allow UK to tap new opportunities in other foreign markets and expand its trade with the rest of the world. This can help to boost its exports and hence spur economic growth.
- While the movement of UK firms to Europe or other countries may worsen its balance of payments in the short run, it can generate higher profits which are repatriated back to UK in future, thus improvement in its Balance of Payments.
- Brexit also means that UK can now restrict the influx of immigrants into the country. This reduces the social problems caused by migrant workers, thus contributing to an improvement in non-material aspect of standard of living.

#### Conclusion

- As discussed above, Brexit can have both positive and negative impact on the UK economy. In the short term, the impact is likely to be more negative as the loss of investor confidence as well as increase in barriers to trade with the EU could lead to a decline in UK's economic growth and worsen its balance of payments position.

Level	Descriptors
<b>Level 2 4-6</b>	<p>For an answer that demonstrates knowledge, understanding, application and analysis:</p> <ul style="list-style-type: none"> <li>• EXCELLENT <b>breadth</b> that considers the following economic concepts in explaining multiple and balanced perspectives, viewpoints, relationships and factors. ALL points chosen should be of <b>relevance</b> and <b>significance</b> in answering the question.</li> <li>• EXCELLENT <b>depth</b> in economic analysis that reflects the following in ALL explanations. <ul style="list-style-type: none"> <li>✓ <b>Accurate</b> use of economic concepts, <b>clear</b> elaboration, and <b>precise</b> use of economic terminologies, language and phrasing..</li> </ul> </li> </ul> <p>The answer should also be supported by:</p> <ul style="list-style-type: none"> <li>• Well-labelled and well-referred to diagram(s) drawn with <b>precision</b> (where appropriate).</li> <li>• <b>Relevant</b> examples and <b>accurate</b> use of facts.</li> <li>• <b>Logical</b> structure.</li> </ul>
<b>Level 1 1-3</b>	<p>For an answer that demonstrates knowledge, understanding, application and analysis:</p> <ul style="list-style-type: none"> <li>• GOOD <b>breadth</b> that considers the following economic concepts in explaining multiple and balanced perspectives, viewpoints, relationships and factors. ALL points chosen should be of <b>relevance</b> and <b>significance</b> in answering the question.</li> <li>• GOOD <b>depth</b> in economic analysis that reflects the following in ALL explanations.</li> </ul>

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		<p>The answer should also be supported by:</p> <ul style="list-style-type: none"><li>• Diagram(s) that may not be well-labelled, may not be well-referred to and may not be drawn with precision (where appropriate).</li><li>• Example(s).</li><li>• <b>Logical</b> structure.</li></ul>
	<b>E2 2 marks</b>	<p>For an evaluation that contains</p> <ul style="list-style-type: none"><li>➤ A synthesis of earlier economic arguments to arrive at <b>relevant</b> judgements/decisions (i.e. answer the question).</li><li>➤ Well-explained criteria-based evaluative comments supported by <b>accurate</b> and <b>clear</b> analysis to provide <b>fairness</b> in views.</li><li>➤ A good summative conclusion.</li></ul>
	<b>E1 1 mark</b>	<p>For an evaluation that contains</p> <ul style="list-style-type: none"><li>➤ <b>Relevant</b> but unexplained evaluative judgement(s) / statement(s) i.e. evaluative judgement(s) / statement(s) not supported by analysis.</li></ul> <p><u><b>OR</b></u></p> <ul style="list-style-type: none"><li>➤ A <b>relevant</b> conclusion.</li></ul>
<b>(e)</b>	Discuss the factors that determine the extent to which globalisation is beneficial to different countries.	
	<b>[10]</b>	
<p><b>Introduction:</b></p> <ul style="list-style-type: none"><li>• Explain that globalisation refers to the increasing integration of national economies in terms of financial flows, trade, movement of factors of production, flow of information and technology.</li></ul> <p><b>Body:</b></p> <p><b>Possible benefits of globalisation include:</b></p> <ul style="list-style-type: none"><li>• Increase AD due to increase in net exports and FDI → economic growth and fall in unemployment</li><li>• Lower prices due to cheaper imports and increased variety of goods → increase in consumer welfare</li><li>• Outsourcing and offshoring increases profitability of firms → higher profits and higher wages in home country</li><li>• Technology and labour flows improve efficiency and reduce costs in recipient countries.</li></ul> <p><b>The extent of benefit to different countries depends on various factors</b></p> <p><b>1. Nature of economy</b></p> <ul style="list-style-type: none"><li>• Globalisation allows countries to gain access to foreign markets → increase in exports → BoT improve and (X-M) increases → AD increases → more than proportionate increase in real output.</li><li>• Moreover, the increase in real output → fall in unemployment.</li><li>• One key factor determining the extent to which globalisation is beneficial to a country is the nature of its economy.</li><li>• Being small in size and population, Singapore has a relatively small domestic market. This means there is limited scope for domestic firms in the country to expand if they were to focus only on the domestic market. With globalisation, Singapore is able to export its goods and services to the rest of the world. The increase in export revenue is a key driver of growth, as AD increases leading to an increase in real output and hence economic growth.</li></ul>		

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### Suggested Answers

- Globalisation also benefits consumers as it allows a country to import goods at lower prices (compared to domestic goods) and increases the variety of goods available to consumers.

#### **2. State of economy or state of development**

- Globalisation also cause increase in FDI flows between countries. Developing countries like China and Vietnam experience FDI inflow → increase in AD → increase in real output. Increase in capital also leads to increase in productive capacity → increase in LRAS → potential growth
- Countries like Mexico operating in the Keynesian range where there is substantial spare capacity, will likely benefit more from globalisation, as the increase in AD due to the increase in X and I, will lead to an increase in real output.
- By contrast, developed countries which operate near full employment will gain less from globalisation, as the increase in AD will lead to demand-pull inflation.

#### **3. Terms of Trade/Type of goods that the country has comparative advantage**

- While globalisation increases the volume of trade between countries and allows a country to increase its exports and imports, the extent to which a country gains from trade depends on its terms of trade, which is the ratio between its export price to import price.
- Countries may face unfavourable terms of trade if the price of their exports is much lower compared to prices of imports. The revenue earned from exports may be lower than the expenditure on imports which are much more expensive, leading to a deficit in the country's balance of trade.

#### **4. Trading relations / Trade policies**

- The extent to which countries benefit from globalisation also depends on its trade policies and trading relations with other countries
- Countries that embrace free trade will benefit more in terms of allowing more imports into the country, thus enabling consumers to enjoy wider variety of goods as well as possibly cheaper goods. As mentioned in Extract 3, "trade with China alone put \$250 a year into the pocket of every American by 2008 due to cheaper goods."
- Conversely, if the country imposes tariff barriers on imports, it will result in higher prices of imports, thus reducing the welfare of consumers as well as increasing the cost of imported inputs for producers.

#### **Conclusion / Overall Evaluation:**

- As discussed above, globalisation can be beneficial to some countries but can also cause challenges to other countries. The extent to which globalisation is beneficial to different countries depends on various factors such as the nature of the economy, the state of development, the terms of trade, the trade policies of countries concerned.



**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

Level	Descriptors
<b>L2</b> <b>5-7</b> <b>marks</b>	<p>For an answer that demonstrates knowledge, understanding, application and analysis:</p> <ul style="list-style-type: none"> <li>• EXCELLENT <b>breadth</b> that considers the following economic concepts in explaining multiple and balanced perspectives, viewpoints, relationships and factors. ALL points chosen should be of <b>relevance</b> and <b>significance</b> in answering the question.</li> <li>• EXCELLENT <b>depth</b> in economic analysis that reflects the following in ALL explanations. <ul style="list-style-type: none"> <li>✓ <b>Accurate</b> use of economic concepts, <b>clear</b> elaboration, and <b>precise</b> use of economic terminologies, language and phrasing.</li> </ul> </li> </ul> <p>The answer should also be supported by:</p> <ul style="list-style-type: none"> <li>• Well-labelled and well-referred to diagram(s) drawn with <b>precision</b> (where appropriate).</li> <li>• <b>Relevant</b> examples and <b>accurate</b> use of facts.</li> <li>• <b>Logical</b> structure.</li> </ul>
<b>L1</b> <b>1-4</b> <b>marks</b>	<p>For an answer that demonstrates knowledge, understanding, application and analysis:</p> <ul style="list-style-type: none"> <li>• GOOD <b>breadth</b> that considers the following economic concepts in explaining multiple and balanced perspectives, viewpoints, relationships and factors. ALL points chosen should be of <b>relevance</b> and <b>significance</b> in answering the question.</li> <li>• GOOD <b>depth</b> in economic analysis that reflects the following in ALL explanations.</li> </ul> <p>The answer should also be supported by:</p> <ul style="list-style-type: none"> <li>• Diagram(s) that may not be well-labelled, may not be well-referred to and may not be drawn with precision (where appropriate).</li> <li>• Example(s).</li> <li>• <b>Logical</b> structure.</li> </ul>
<b>Evaluation</b>	
<b>E2</b> <b>2</b> <b>marks</b>	<p>For an evaluation that contains</p> <ul style="list-style-type: none"> <li>➤ A synthesis of earlier economic arguments to arrive at <b>relevant</b> judgements/decisions (i.e. answer the question).</li> <li>➤ Well-explained criteria-based evaluative comments supported by <b>accurate</b> and <b>clear</b> analysis to provide <b>fairness</b> in views.</li> <li>➤ A good summative conclusion.</li> </ul>
<b>E1</b> <b>1</b> <b>mark</b>	<p>For an evaluation that contains</p> <ul style="list-style-type: none"> <li>➤ <b>Relevant</b> but unexplained evaluative judgement(s) / statement(s) i.e. evaluative judgement(s) / statement(s) not supported by analysis.</li> </ul> <p><b>OR</b></p> <ul style="list-style-type: none"> <li>➤ A <b>relevant</b> conclusion.</li> </ul>

### **SECTION 3: ESSAY QUESTIONS**

#### **SECTION 3A: BASIC QUESTIONS**

1. "One reason for the decline in traditional protectionism is that countries hit by recession are able to let their exchange rates fall."

Source: The Economist, 12 October 2013

- (a) Explain why a country might get into balance of payments deficit due to a recession in another part of the world. [10]
- (b) Assess the view that in correcting balance of payments deficit, letting the exchange rate fall is a more appropriate policy than adopting traditional protectionism. [15]  
[ACJC 2014]

**Answer requirements:**

- (a) Briefly explain the types of balances and economic transactions in the balance of payments & what a balance of payments deficit means →briefly explain the characteristics of recession in terms of national income and unemployment →explain why the weakening of economic conditions in another part of the world can cause a country to run into balance of payments deficit. Emphasise that globalisation causes these causal effects to be both direct (with others with recession) and indirect (with others similarly affected by the recession).
- (b) Briefly explain how each policy works in correcting balance of payments deficit →use chosen criterion/criteria as basis of 'appropriateness' to compare the two policies in relation to the deficit correction. End with a considered response on whether depreciation is more appropriate than tariffs/non-tariff barriers.

#### **Suggested Answer for part (a)**

- The balance of payments (BOP) – definition & balances
  - The accounts record the transactions that take place between the residents of a country and the rest of the world over a given period, usually one year. These transactions take the form of trade in goods and services and investment and portfolio (financial) capital movements.
  - Trade in goods and services recorded in current account while investment and portfolio capital movements recorded in capital account.
  - The BOP position is summation of current and capital accounts. If this overall balance is in surplus or a deficit, the balance of payments is said to be in disequilibrium.
- BOP deficit
  - When the value of payments made to other countries, from imports, outflow of investment and financial capital, exceeds the earnings made from exports and inflows of investment and financial capital.
  - The deficit can originate from current account or capital account. A country can have a current account deficit and yet having overall surplus due to a surplus in the capital account that exceeds the current account deficit.
- Recession in another part of the world
  - Recession is an economic condition when a country experiences a decline in Gross Domestic Product (GDP) over two consecutive quarters (six months). Define GDP.

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

- Recession is usually accompanied with rising unemployment rate and falling or negative rate of inflation.
- How recession in another part of the world causes a deficit BOP in another country
  - Likely to be a recession in a large economy, such as US or the Eurozone.
  - Falling GDP, rising unemployment → falling imports (imports directly related to national income) + falling investment and portfolio capital outflows to other countries → falling exports and investment & capital inflows for other countries
  - Globalisation has made countries' economies internationally interconnected. The effects of recession elsewhere on a country are both direct and indirect, eg. when US goes into a recession → imports less from Singapore and other countries → Singapore will see falling exports to US and to other countries which also suffer from the decline in exports to US.
  - The widespread effects of a recession in US are significantly caused by global supply chain in today's manufacturing and trade patterns. Most goods are now produced in different countries/ parts of the world before imported to a country – the reason why a recession in US would affect more than just the country it imports goods from.
  - Accompanying the global supply chains is the significance of foreign direct investment and portfolio capital flows. Hence when US suffers a recession, American firms will also be investing less or placing less funds in other countries, thus affecting their capital accounts.

	Knowledge, Understanding, Application & Analysis	Marks
L3	<ul style="list-style-type: none"> <li>▪ Causes cover <b>factors affecting both</b> current and capital account</li> <li>▪ Explanation with sound conceptual clarity</li> <li>▪ Clear linkage of factors to external recession in a different region/ part of the world (eg. recession in US/ EU on Asian or Emerging economies)</li> </ul>	10
	<ul style="list-style-type: none"> <li>▪ Conceptually accurate explanation covering mainly <b>current account only</b></li> <li>▪ Makes links to external recession although <b>elaboration may be lacking</b></li> </ul>	8-9
L2	<ul style="list-style-type: none"> <li>▪ Conceptually not sufficient, eg. key terms such as BOP deficit and recession used but not defined</li> <li>▪ Linkage to recession in another part of the world minimal/incidentally mentioned</li> </ul>	5-7
L1	<ul style="list-style-type: none"> <li>▪ Very skeletal answer</li> <li>▪ Many conceptual inaccuracies</li> </ul>	3-4
	<ul style="list-style-type: none"> <li>▪ Primarily irrelevant in most parts of answer</li> </ul>	1-2

**Suggested Answer for part (b)**

**Introduction on both policies and notion of ‘appropriateness’**

- Letting the exchange rate fall (depreciation): Currency becomes cheaper in terms of foreign currencies → country's goods and services become cheaper in foreign currencies & its imports more expensive in the domestic currency. A currency may depreciate when demand for it is falling due to declining exports and inflows of capital and FDI are falling due to weakening economic performance.
- Traditional protectionism refers to trade policy of reducing imports through tariffs and non-tariff barriers (NTBs) and raising exports through government subsidy schemes on export industries.
- In the correction of current account deficit, both are expenditure switching but while traditional protectionism is mainly raising aggregate demand (AD) by switching domestic expenditure from foreign goods to domestic goods, depreciation not only reduces imports but raising exports as well. Hence depreciation has a greater expansionary effect on AD through the expansion on export demand and even inflows of FDI.
- There are a few criteria that can be considered in the notion of appropriateness in question, such as the economic characteristics of a country, its economic conditions or with respect to efficiency considerations. [answer can select one or two for discussion]

**Thesis: Exchange rate depreciation can be considered more appropriate than traditional protectionism because it is caused by weakening economic fundamentals of a country and not a deliberate policy of reducing imports**

**Argument 1:** Depreciation is more appropriate because it offers greater expansionary effects on AD, needed when country is facing both BOP deficit and slowdown in economic growth

With growth slowdown, country needs to raise AD to close deflationary gap. Depreciation has broader effects, on both exports and FDI, than tariffs NTBs. With traditional protection, government can only switch domestic expenditure whereas with depreciation, foreign markets may be more receptive to country's goods and services.

**Argument 2:** While depreciation helps to make domestic production more competitive at home or overseas, this happens through market forces and not deliberate protection of home market

Exchange rate depreciation is market-led, not the result of tampering of trade policy by the government. Other countries will be more receptive to weakening exchange rate than the use of tariffs and NTBs which are recognized as unfair trade practices. With depreciation it is harder for foreign governments to fault this expansionary policy.

**Anti-thesis:** **However, depreciation becomes inappropriate when it has been caused by deliberate manipulation of the country's central bank to achieve healthy trade position and economic growth**

**Argument 1:** Prolonged depreciation can be considered a protectionist approach too as it would have involved continual central bank's intervention to weaken currency

Depreciation should be just a short term market-led adjustment for country to improve BOP. It is not appropriate as a long term strategy because just like traditional protectionism, domestic producers will grow reliant on depreciation for competitiveness. Depreciation cannot replace the need for restructuring measures to improve competitiveness such as upgrading of labour skills and technology.

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

**Argument 2:** Depreciation causes rising domestic inflation which will eventually weaken the country's trade position and economic condition

- Depreciation will cause rising cost-driven domestic inflation if country is import-reliant for food, raw materials and even industrial components. This import reliance will make it difficult for a country to achieve the Marshall-Lerner condition (for sum of price elasticity of demand for import and export demand exceeds one). Thus resulting difficulties in correction of the country's trading position.
- Rising domestic inflation due to depreciation poses similar welfare effects as tariffs and NTBs which will cause rising domestic business costs and cost of living due to higher import prices.
- Rising domestic inflation will weaken the effect of depreciation on correcting BOP deficit. For countries with highly price inelastic demand, the deficit may even worsen.

### Synthesis

- While both policies offer some potential for correcting BOP deficit, each has limitations and cannot be considered to be a sound way for dealing with chronic deficits which require structural supply-side measures for improving country's competitiveness for foreign demand and foreign investment.
- Being market-led, exchange rate depreciation can be considered more appropriate than the deliberate, and internationally seen as unfair, traditional protectionist trade policy against foreign goods. However, prolonged depreciation due to central bank's manipulation becomes a deliberate protectionist policy too and cannot be considered a more appropriate policy than tariffs and NTBs.

**Note to students:** An answer can bring together thesis and anti-thesis on a particular core idea, for example in arguing that depreciation is appropriate because it is market-determined the answer can then counter-argue that it is possible for a central bank to engineer a prolonged depreciation by continuous buying over of foreign currencies and selling its currency (case of China during the period of undervalued yuan). In this approach, the flow could be as follows:

- Depreciation is more appropriate because it is market-led without the deliberate measures of raising import prices or reducing import access in home market. However, a prolonged depreciation is also possible due to central bank's intervention, which can be considered a protectionist economic policy.
- Depreciation is more appropriate when a country is facing both the BOP deficit and growth slowdown. However, depreciation will inject imported inflation, which will also harm trade and economic growth, especially if country is import reliant.

	Knowledge, Understanding, Application & Analysis	Marks
L3	<ul style="list-style-type: none"><li>▪ <b>Compares both policies</b> in terms of how each comes about (market-led vs deliberate), extent of expansion on AD or efficiency effects</li><li>▪ <b>Conceptually sound and elaborated explanation</b> using economic concepts/terms such as<ul style="list-style-type: none"><li>○ Expenditure switching</li><li>○ Price elasticity of demand</li></ul></li></ul>	8-10
L2	Conceptually accurate and elaborated but <b>non-comparative</b> : only explaining how both policies work on correcting deficit balance of payments and not attempting to consider whether and how depreciation is more appropriate than traditional protection	5-7
L1	<ul style="list-style-type: none"><li>▪ <b>Primarily descriptive</b>, not using economic concepts/terms in reasoning</li><li>▪ Very skeletal</li><li>▪ <b>Major errors</b> although there is relevance to question</li></ul>	1-4

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

<b>Evaluation</b>		
E3	Uses economic analysis to substantiate comparative evaluations made.	4-5
E2	Uses criterion/criteria for comparative evaluation and giving a considered judgment at closure. Example: Depreciation is more appropriate than traditional protectionism because it is market-led and economic fundamentals are weak but if the depreciation is engineered through continual central bank's intervention, it will have severe economic effects just such as traditional protectionism.	2-3
E1	Random evaluation of the measures, without criterion/criteria. Leaves two sides of arguments suspended without considered judgement at the end.	1

2. **Different economists tend to recommend different macroeconomic policies to the government when tasked to address a balance of payments deficit.**

**Explain the possible causes of a balance of payments deficit and discuss the factors an economist would consider when deciding on his recommendation.**

[25]  
[SAJC 2017]

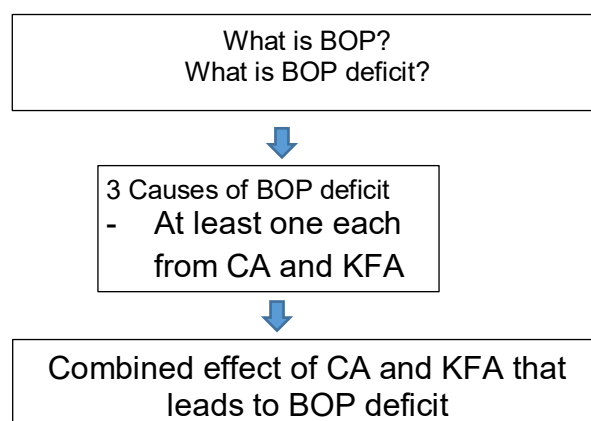
**Question Analysis (Explain portion)**

<b>Command</b>	Explain – use economic analysis to make clear the outcome expected.
<b>Content</b>	BOP deficit
<b>Context</b>	Nil

**Question Analysis (Discuss portion)**

<b>Command</b>	Discuss – present two sides, evaluate
<b>Content</b>	Factors affecting policy-making when addressing BOP deficit
<b>Context</b>	Nil

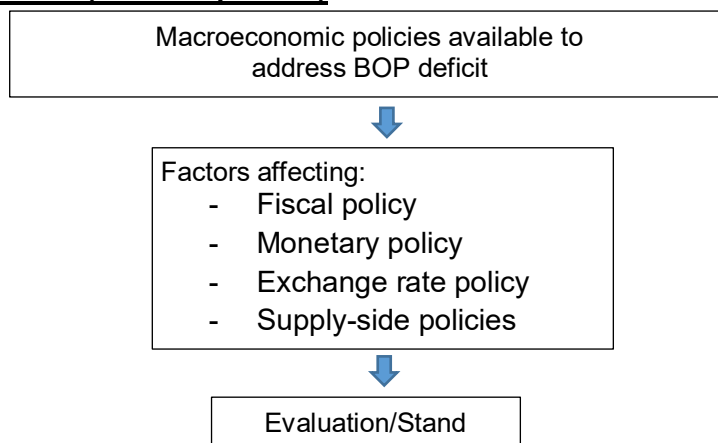
**Schematic Plan (Explain portion)**



## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

#### Schematic Plan (Discuss portion)



#### Suggested Answer

##### Introduction

- There are various causes of BOP deficit, some affecting via current account and others affecting via capital and financial account.
- When recommending policies to address the BOP deficit, an economist will need to consider various factors, such as availability of budget, reliance on imports, likelihood of negating factors, root cause of deficit, etc.
- Not all factors weigh equally in influencing the ultimate policy-making decision due to the nature and circumstances faced by each economy.

##### Body – Part #1

- Explain what is meant by BOP
  - o inflow and outflow of funds due to international transactions
  - o CA + KFA
- Explain what is meant by BOP deficit (total inflow < total outflow)
- Causes of CA deficit (need to specify categories of causes e.g. one internal; one external **OR** one for exports and one for imports)
  - o Appreciation of domestic currency
  - o Economic downturn experienced by trading partners (export destination economies)
  - o Loss of comparative advantage due to higher COP
- Causes of KFA deficit (need to specify categories of causes e.g. one internal; one external **OR** one for hot money and one for FDI)
  - o Fall in interest rates due to expansionary monetary policy
  - o Income tax hike due to austerity measures → deterring FDI inflows
  - o Stronger competitor for FDI inflow (e.g. China's opening up of its doors, tax competition among competing economies)

##### IMPORTANT:

- o Student needs to recognise it is the COMBINED balance of CA and KFA that should produce a deficit; BOP deficit does not require both CA and KFA to be in deficit.

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

#### **Body – Part #2 – Discuss Factors**

- State at least three policies which could address BOP deficit (combination of those that address CA and KFA).

##### **Factor #1 – Availability of budget**

- Govt attempts to use SS-side policy (subsidise R&D or retraining of workers) to improve quality of exports or to attract more FDI.
- Govt needs funds.
- Limited by availability of budget.
- Example: Greece

##### **Factor #2 – Reliance on imports**

- Govt attempts to reduce import expenditure through tariff or quota
- If economy relies heavily on imports for goods and services or factors of production, then such a policy may not be feasible → will significantly affect material SOL if imports are severely restricted due to high tariff or low quota set.
- Example: Singapore

##### **Factor #3 – Likelihood of negating factors**

- Govt attempts to depreciate domestic currency to boost X and reduce M → BOT improves → BOP improves.
- If competitors are likely to also depreciate their currency, intended effect will be very limited.
- Example: economies around the world during global financial crisis

##### **Factor #4 – Root cause of deficit**

- Govt needs to have data on the source of deficit, i.e. CA or KFA. Specifically, which components of CA and which components of KFA.
- Govt ought not to implement 'generic' policies which will expand the CA surplus so as to compensate for KFA deficit, at least not to do so in the long run.
- Such inherent extended imbalance will create unintended consequences in the long run. For example, KFA deficit widens → hollowing out of an entire industry, leading to severe loss in jobs and comparative advantage.

#### **Evaluation/Conclusion**

- Multiple factors need to be taken into consideration simultaneously – the more comprehensive set of factors considered, the less unintended consequence or the more effective the set of policies will be.
  - o E.g. if only look at availability of budget but not the root cause of deficit → may not be effective in addressing BOP deficit
- Timely and constant review of policies may be needed as such weights of factors in influencing effectiveness of policies may also change.
  - o E.g. previously reduced reliance on imports → now, heavier reliance on imports. Hence, import-restricting policies may become more effective in reducing BOP deficit.



**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

<b>Level</b>	<b>Knowledge, Application/understanding and Analysis</b>
<b>L3</b> <b>(15 – 20)</b>	<ul style="list-style-type: none"> <li>- Strong economic analysis employed throughout (e.g. use of appropriate terminology ; proper cause-effect explanation)</li> <li>- Breadth/Scope provided demonstrated mastery of content</li> <li>- Good use of examples, where relevant, to illustrate real-world applications.</li> </ul>
<b>L2</b> <b>(9 – 14)</b>	<ul style="list-style-type: none"> <li>- Answer written in a sufficiently economics fashion though minor gaps/errors may exist sporadically throughout.</li> <li>- Narrow scope of answers which reveal passable content/knowledge in response to the question posed.</li> </ul>
<b>L1</b> <b>(1 – 8)</b>	<ul style="list-style-type: none"> <li>- Answer does not convey sufficient grasp of question requirement.</li> <li>- Descriptive answers (lack of technical terms used) with major errors (e.g. confused BOP with budget deficit) ought to be given lowest marks.</li> </ul>
<b>Evaluation</b>	
<b>E3</b> <b>(4 – 5)</b>	<ul style="list-style-type: none"> <li>- Stand provided together with strong evaluative comments such as to question assumptions, status quo of circumstances faced by economies in making policy decisions.</li> <li>- Evaluation clearly weighed/questioned the validity of different factors brought up in the essay.</li> </ul>
<b>E2</b> <b>(2 – 3)</b>	<ul style="list-style-type: none"> <li>- Stand provided together with substantiation using weak/erroneous elaboration. Substantiation reads more like a summary of essay.</li> </ul>
<b>E1</b> <b>(1)</b>	<ul style="list-style-type: none"> <li>- Mere stand provided without any substantiation.</li> </ul>

3. (a) Explain how a country's deficit on its balance of payments could affect its standard of living. [10]
- (b) Discuss how best a government should address potential concerns arising from a persistent deficit on its balance of payments. [15]

(a)

### Introduction

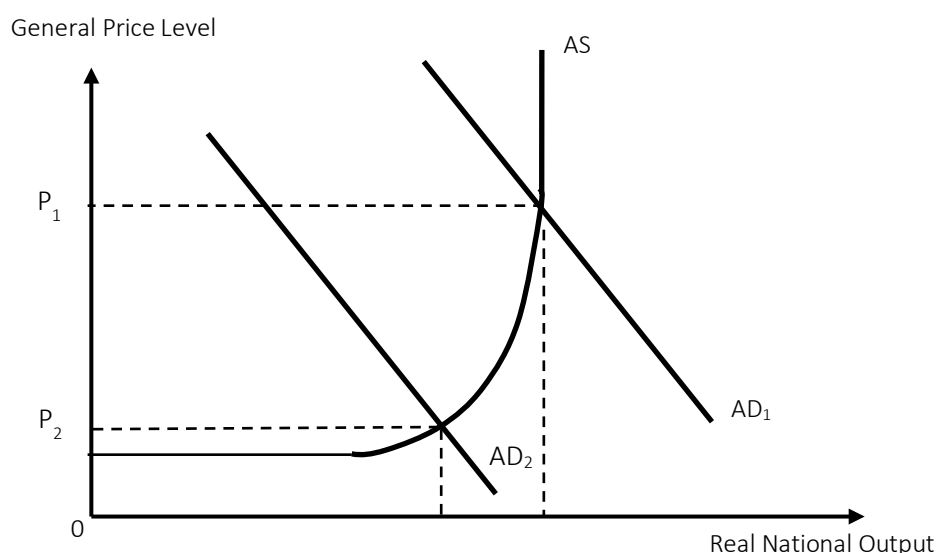
The Balance of Payments (BOP) is a summary record of all the international transactions between the residents of a country and the rest of the world over a period of time, usually one year. The BOP is made up of the Current Account (CA), Capital and Financial Account (KFA) and the Official Reserves Transaction Account. A BOP deficit occurs when the total international receipts of a nation from abroad are less than its total international payments to abroad over a period of time. This could happen when there is a deficit in the CA or in the KFA or in both.

### Body

#### Negative Impact on SOL

1. A balance of payments deficit can have a contractionary effect on the economy. For example, a balance of payments deficit caused by a CA deficit brought about by a fall in export earnings and rise in import expenditure reduces the level of aggregate demand.
2. Assuming the economy is at or near full employment, this fall in aggregate demand, ceteris paribus, will cause a fall in national output from  $Y_1$  to  $Y_2$ , a fall in general price level from  $P_1$  to  $P_2$  and an increase in unemployment due to lower output levels as illustrated in Figure 1. Eventually, the initial fall in net exports will result in a greater decrease in national income through the multiplier process, leading to negative economic growth.

The fall in national income will induce a fall in consumption by households because household incomes have fallen thus they have lower purchasing power. A lower level of consumption of goods and services could lead a reduction in households' **current material standard of living**.



3. If households feel pessimistic about the economic outlook, they may decide to save more in anticipation of the possibility of a further reduction in income in the future. This uncertainty and anxiety could also affect **non-material standard of living**.

4. A fall in investment level and production level will lead to rising unemployment in the economy, as firms reduce their demand for labour and other factors of production. Unemployed workers might face anxiety and stress if they continue facing difficulties in looking for a job. As their household income falls, both their **material and non-material standard of living** might worsen.
5. If the BOP deficit was due to a deficit in the KFA arising from a fall in FDI and foreign investors pulling out FDI from the country, LRAS might shift to the left, reducing the productive capacity of the economy. This would negatively affect **future standard of living** as the potential output of the economy decreases.
6. Under a flexible/managed float exchange rate regime, a persistent balance of payments deficit will result in a depreciation of the country's currency as this would lead to a fall in the demand for and an increase in the supply of the domestic currency in the foreign exchange market. With the depreciation, imported inflation may result if the economy is heavily dependent on imports, leading to higher cost of living. This would affect consumers' purchasing power and hence negatively affect their **material standard of living**.
7. If the BOP deficit was due to a CA deficit caused by huge quantities of undesirable imports such as tobacco, alcohol and drugs, the non-material standard of living might be affected.

**Positive Impact on SOL**

1. However, if the BOP deficit was due to large import expenditure on consumer goods that outweigh export revenue, consumers might be enjoying a wide variety of imported goods. This might, in the short run, lead to an increase in **current non-material standard of living**.
2. If the BOP deficit was due to large import expenditure on capital goods, the LRAS might shift to the right, bringing about potential growth. For example, developing countries might import machines and technology to increase production. The increase in productive capacity means that the **future standard of living** would increase as the potential amount of goods and services that can be produced and enjoyed in the future would increase.
3. Unemployed workers might see an increase in leisure time which might improve their **non-material standard of living** temporarily, as they spend more time with family and friends, reducing the stress levels related to work.
4. The fall in economic activity in the economy might also lead to a fall in pollution levels as factories reduce their production levels and hence, their emissions. This might also lead to improvement in **non-material standard of living**.

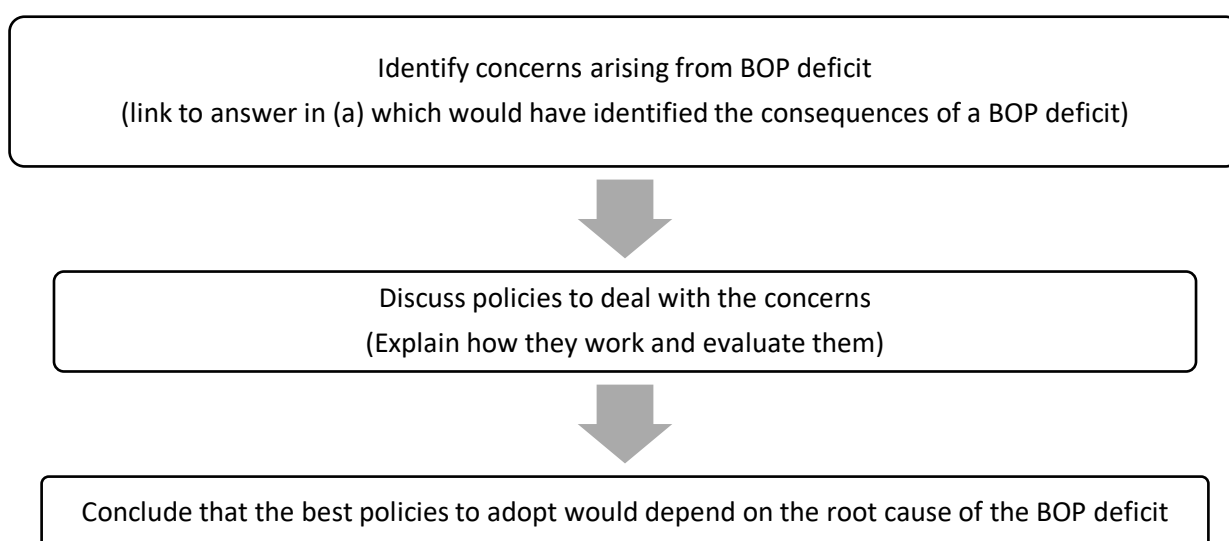
**Conclusion**

To conclude, how standard of living is affected by the BOP deficit would depend on what caused the BOP deficit. Also in the short run, there might be some positive impact on standard of living, especially in the non-material aspect. But in the long run, a persistent BOP deficit is likely to negatively impact standard of living.

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

<p><b>Level 3</b> <b>8 - 10</b></p>	<p>Answer shows thorough knowledge and an excellent ability to explain the consequences of a BOP deficit and its impact on SOL in a precise, logical and reasoned manner. The answer recognises all of the following:</p> <ul style="list-style-type: none"> <li>- A BOP deficit could both positively and negatively impact SOL</li> <li>- A BOP deficit could affect both material and non-material SOL <b>OR</b> current and future SOL</li> </ul> <p>Note for markers: For full 10m, the answer should recognise BOP deficit could affect material and non-material SOL <b>AND</b> current and future SOL.</p>
<p><b>Level 2</b> <b>5 - 7</b></p>	<p>Answer explains the consequences of a BOP deficit but might not have made clear links to SOL.          Answer is mostly accurate but there may be undeveloped explanation of facts and theory.</p> <p>Answer has achieved some balance (e.g. considers material and non-material aspect of SOL, or positive and negative impact on SOL, or current and future SOL)</p> <p>Note for makers:          As long as any one type of balance is recognised, the answer can be awarded L2.</p> <ul style="list-style-type: none"> <li>- Answer explains both positive and negative impact on SOL</li> <li>- Answer explains impact on both material and non material aspect of SOL</li> <li>- Answer explains impact on both current and future SOL</li> </ul>
<p><b>Level 1</b> <b>1 - 4</b></p>	<p>Answer shows some knowledge of BOP but might not have recognised that the question is on the consequences of a BOP deficit. There may be basic errors in theory, in adequate explanations or contain only a few valid points. The answer could be mostly irrelevant or inaccurate.</p>

**(b)**



## **Introduction**

In view of the possible detrimental effects on the macro-economy and hence, standard of living, as explained in (a), governments generally adopt the following types of policies: (i) Expenditure-Reducing Policies, (ii) Expenditure-Switching Policies, (iii) Supply-Side Policies, to improve the BOP so as to address potential concerns.

## **Body**

### **Policy #1:**

#### **Cause of BOP Deficit:**

CA deficit due to rising import expenditure (in excess of export revenue), because of rising domestic incomes

#### **Concern Arising from BOP Deficit:**

Currency Depreciation which might lead to imported inflation

#### **Assumptions about the economy:**

- Economy is operating at full employment level
- Economy is under a flexible/managed float exchange rate regime

An expenditure reducing policy aims to reduce the demand and limit spending on imports by reducing overall expenditure in the economy. This results a fall in aggregate demand and in turn, national income falls. When national income falls, the demand for imports will also fall, since import expenditure is income induced. This in turn reduces the balance of payments deficit.

For example, contractionary fiscal policy might be adopted. Taxes (e.g. personal income taxes, corporate income taxes) might be raised and government expenditure reduced. An increase in personal income taxes will lead to a fall in disposable income. This will lead to a fall in the level of consumption expenditure (C). An increase in corporate income taxes will lead to a fall in post-tax profits which results in a fall in the level of investment (I).

The fall in the level of government expenditure (G), consumption expenditure (C) and investment expenditure (I) will reduce the level of aggregate demand (AD), resulting in a fall in national income. This will induce a fall in demand for imports, hence leading to a fall in total import expenditure. Balance of trade and current account deficit would thus be reduced, thereby improving the overall BOP position.

In the longer term, the reduction in AD is deflationary and would reduce the general price level especially if the country is near full employment level of income. The downward pressure on general price level improves the price competitiveness of exports and increases demand for exports.

Assuming the demand for exports is price elastic, a rise in export earnings will reduce the balance of trade and current account deficit, hence improving the overall BOP position in the long run.

### **Evaluation**

However, this policy would not be appropriate if the economy was not operating at full employment and there are concerns about falling national income and rising unemployment. This policy would further worsen these concerns.

**Policy #2 (to address concerns of falling national income, rising unemployment due to a fall in demand for exports):**

**Cause of BOP Deficit:**

CA deficit due to rising import expenditure (in excess of export revenue), because of increasing price competitiveness of imports relative to domestic goods.

**Concern Arising from BOP Deficit:**

Fall in AD, national income and employment levels

**Assumptions about the economy:**

Economy is NOT operating at full employment level

The aim of this policy is to change the relative price of domestic goods and foreign goods (imports) so that people will substitute foreign goods with domestic goods.

An example of such a policy is to depreciate the currency. This would make country's exports cheaper in terms of foreign currency and imports more expensive in terms of the domestic currency. Since imports are more expensive in domestic currency, people will switch away from imports to consume more domestically produced goods and services. At the same time, this makes exports more competitive and the demand for exports would rise.

Assuming Marshall Lerner condition (i.e.  $PED_X + PED_M > 1$ ), balance of trade and current account deficit would be reduced, thereby improving the BOP position.

**Evaluation**

However, this policy might not be appropriate if there are concerns about inflation in the economy. Currency depreciation would result in imported inflation (especially if the country is highly dependent on imported raw materials) and could also lead to demand-pull inflation as AD increases.

This policy would also only be appropriate if Marshall Lerner condition holds. If the demand for both their exports and imports were very price inelastic and the summation of elasticities was less than 1, then the BOP would not improve.

Currency depreciation should also be a short term policy because a continual fall in the value of the currency could lead to a fall in investor confidence, resulting in a withdrawals of FDI. This would worsen the KFA deficit and also lead to a fall in LRAS, worsening the initial concerns of slower actual and potential growth.

**Policy #3 (to address concerns of falling national income, rising unemployment, falling productive capacity due to a lack of competitiveness):**

**Cause of BOP Deficit:**

KFA deficit due to a fall in attractiveness of country as a destination for FDI, possibly because of falling labour productivity

CA deficit due to fall in export revenue, because of falling competitiveness of exports, possibly due to falling labour productivity

**Concern Arising from BOP Deficit:**

Fall in AD, national income and employment levels

Fall in LRAS

**Assumptions about the economy:**

Economy is NOT operating at full employment level

For example, investment in training could improve the quality of the labour force and raise the labour productivity and hence lead to a rise in LRAS. Government could provide subsidies to encourage firms to upgrade the skills of their workers. Assuming the increase in labour productivity brings about a fall in per unit labour cost, cost of production decreases and this causes an increase in SRAS. This would bring about a fall in the general price level of domestically produced goods and services and in turn lead to a rise in the price competitiveness of exports. Additionally, the quality of exports might also rise due to innovation arising from a higher quality labour force. This will increase export revenue and reduce the current account deficit. Furthermore, as domestically produced goods and services are more attractive relative to foreign goods and services. There could be a reduction in import expenditure as consumers switch from imported goods and services to domestic goods and services. The balance of trade and current account deficit will be reduced.

At the same time, foreign investors might be encouraged to invest because of the high labour productivity, this would also increase LRAS as well as improve the capital and financial account, improving the BOP position.

Evaluation

Supply-side policies are not easily implemented as firms might not be willing to send workers for training as there will be loss of output during training. Firms may also underestimate the true benefits of education and training. Hence, the amount of training undertaken may be less than socially optimal. Workers also face difficulties in learning new skills, especially the older workers. In most cases, the government needs to increase its spending on subsidies on training and incentives for research and development. As such, these policies can drain the government's resources, diverting resources away from other areas of competing needs. There is a time lag in the implementation of supply-side policies, which may compromise its effectiveness as economic conditions are very dynamic.

Conclusion

The best policies a government should adopt to address potential concerns arising from the deficit would depend on the root cause of the deficit. Depending on the root cause of the deficit, the concerns arising from a BOP deficit could be very different.

If the BOP deficit is persistent and is a result of a loss of competitiveness of a country, both in terms of its exports as well as its attractiveness for FDI, structural changes might be required in the economy. Otherwise, the detrimental effects on actual and potential growth, and current and future SOL, as outlined in (a), would be a serious cause for concern. In such instances, supply-side policies to improve productivity would likely be the best policy. Expenditure reducing policy would not be appropriate as it would further reduce actual growth. Expenditure switching policy could help in the short term but would probably not be sustainable in the long run. Taking the example of currency depreciation, it would not be possible for a currency to keep depreciating as investors might lose confidence in the economy, causing further withdrawals of FDI.

However, if the BOP deficit is due to large import expenditure on capital goods, then as outlined in (a), there might not be a cause for concern as the country's productive capacity might grow. This could lead to an increase in export competitiveness in the future as prices fall and quality increases. Similarly, if the BOP deficit is due to large amounts of local firms investing overseas, thus leading to a net outflow of FDI, in the long run, these investments may yield positive returns and eventually there will be receipts of interest, profits or dividends from investments abroad,

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

resulting in an eventual currency inflow in the current account. In these cases, the government might choose not to adopt any policy to correct the BOP deficit.

<b>Level 3</b> <b>8 - 10</b>	<p>Answer shows thorough knowledge and an excellent ability to explain at least 2 policies to correct a BOP deficit, in view of the specific concerns arising from the deficit. There should be a clear explanation of how the policy would address those concerns and hence, a recognition that the best policy would depend on the cause of the BOP deficit.</p> <p>Answer should have demonstrated balance by discussing how the policies could work well to correct BOP deficit but at the same time, have limitations. The arguments should be made in a precise, logical and reasoned manner.</p> <p>Note for makers: For top L3 marks (i.e. 10marks), the answer must have discussed 3 policies.</p>
<b>Level 2</b> <b>5 - 7</b>	<p>Answer explains policies to correct a BOP deficit but might not have made clear links to how each policy addresses specific concerns arising from the deficit.</p> <p>Answer is mostly accurate but there may be undeveloped explanation of facts and theory.</p> <p>Answer has achieved some balance (e.g. discussed how a policy might work well as well as recognised its limitations or discussed how different policies work for different causes of a BOP deficit)</p> <p>Note for makers: For top L2 marks (i.e. 7marks), the answer must have discussed at least 2 policies which address different causes of a BOP deficit and discussed some limitations of the policies.</p>
<b>Level 1</b> <b>1 - 4</b>	<p>Answer shows some knowledge of macroeconomic policies. There may be basic errors in theory, in adequate explanations or contain only a few valid points. The answer could be mostly irrelevant or inaccurate.</p>

<b>E3</b> <b>4 - 5</b>	<p>There is a critical evaluation of the policies discussed and economic arguments are synthesised to arrive at well-reasoned judgements in a good summative conclusion.</p> <p>There is recognition that the best policies would depend on the concerns arising from the BOP deficit, which in turn, depends on the cause of the BOP deficit.</p>
<b>E2</b> <b>2 - 3</b>	<p>There is some attempt at evaluation or a summative conclusion. While the judgement is relevant to the question, it may not be well-explained or based on relevant analysis</p>
<b>E1</b> <b>1</b>	<p>Unsupported or unexplained evaluative statement(s) or judgements are made.</p> <p>Note to markers: As long as there is attempt to explain limitations of a policy, even if there is no summative conclusion, give 1m.</p>



## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

4.

- (a) Explain why exchange rates rather than interest rates are the preferred choice as the instrument of monetary policy in Singapore. [10]
- (b) Discuss whether changes in domestic or foreign factors are more likely to influence the exchange rate of the Singapore economy. [15]

#### Suggested Answer for part (a)

Answer synopsis: Students should explain the reasons behind choosing exchange rate rather than interest rate as the instrument of MP by explaining the benefits of using exchange rate and the limitations of using interest rate in the context of Singapore being a small and open economy.

Intro-

- Define MP
- Explain that MP can work via interest rate changes or exchange rate changes

Body

- Explain how MP works- how changing any MP tool like varying the bank rate or varying CRR can cause the money supply to change and hence cause interest rate to change.-use KTM diagram to illustrate the effects of MP. (Better to explain in the context of 2009 recession where expansionary MP is useful)
- **Explain the limitations** of using interest rate in the context of Singapore-(implication of small and open financial centre)
  - ❖ Because of Singapore's role as an international financial centre, small changes in the difference between domestic and foreign interest rates would lead to large and quick movements of capital. This makes it difficult to control money supply in Singapore since net flows of funds from abroad can easily affect domestic money supply.
  - ❖ Interest taker--Singapore has to allow interest rates to be determined competitively by market forces in order to compete with other financial centres in the world
  - ❖ The undeveloped domestic capital and money market as well as the small quantity of government bonds issued make the use of open market operation very limited. Hence MAS's ability to control money supply is weak.
- Can use the 2009 illustration to explain if Singapore wants to use interest rate to expand the economy why it may not be successful because of the above limitations.
- Explain the working of the expansionary policy using Exchange rate (Use the 2009 context to show how depreciating the currency can help the economy to come out of recession)
- **Explain the advantages** of using exchange rate:
  - ❖ Illustrate using example how a weak exchange rate can erode the export competitiveness and create severe implications because Singapore's economic growth has largely been export driven.
  - ❖ High dependency on import which makes Singapore susceptible to imported inflation –Illustrate how exchange rate policy helps us to control it.

Conclusion –The Singapore Government chooses the policy tools keeping in view the macroeconomic goals. Singapore is a trade dependent, resource scarce country. Hence keeping a stable & strong Sing dollar helps the economy to maintain its goal of price stability and achieving sustained economic growth along with a healthy BOP surplus. Using

## Chapters 10-12: Globalisation and the International Economy

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exchange rate as its preferred tool the Govt can ensure that inflation is kept at its minimum so that it doesn't erode the export competitiveness as well as keeping the domestic cost of living low.

Level	Knowledge, Understanding, Application & Analysis	Marks
L3	A <b>well-developed answer</b> that justify the choice of using exchange rate rather than interest rate by Singapore by considering the characteristics of economy, impact and the ease of implementation.	8-10
L2	An answer that <b>sufficiently</b> explain how exchange rate impact on the economy without justifying why exchange rate is preferred over interest rate.	5-7
L1	An answer that is <b>poorly developed</b> and may be <b>inaccurate</b> .	1-4

### Suggested Answer for part (b)

- (b) Discuss whether changes in domestic or foreign factors are more likely to influence the exchange rate of the Singapore economy. [15]

#### Command words

Discuss involves evaluating alternative explanation and perspective of economic issues.

#### Key words

Domestic factors → internal factors such as level of competitiveness, inflation/growth rate of Singapore and domestic government policies

External factors → external factors such as foreign interest rates, foreign inflation rates/growth rates and expectations of speculators

#### Question Requirement

The question requires students to explain how domestic and foreign factors affect the exchange rate of Singapore currency and to weigh which has a stronger effect.

Thinking Process	Essay (content, analysis and evaluation)
Introduction:	Singapore operates a managed ER system whereby her ER of the S\$ is influenced by both market forces of demand and supply and also government intervention. Being a small and open economy, foreign factors such as foreign inflation rate, growth rate, interest rate and expectation of foreign speculators play an important role in determining her ER. However, with a strong foreign currency reserves, MAS plays an equally important in ensuring a strong and stable exchange rate of S\$. Thus, domestic factors such as government policies which help to keep her inflation rate low and her exports competitive also play an important role in determining the exchange rate as well.
Explain how foreign factors influence ER of S\$	One of the main foreign factor affecting the ER of S\$ is the rate of foreign inflation. As mentioned in part (a), Singapore relies heavily on foreign imports for raw materials and foodstuff. The demand for

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

Thinking Process	Essay (content, analysis and evaluation)
	<p>such goods is price inelastic due to lack of substitutes and the need for these goods. Hence, when price of raw materials and foodstuff rose (as in 2007/8), given the inelastic demand of imports, the quantity demanded for these imports fall less than proportionately and hence her import expenditure will rise. Thus, SS of our currency will rise and ER of S\$ falls, ceteris paribus. The fall in ER of S\$ may worsen our imported inflation further. Hence, to keep the price of foreign imports from increasing the domestic inflation rate of Singapore, MAS will use its foreign currency reserves to buy back S\$ and sell foreign currency, thus pushing up the ER of S\$. Thus, while foreign factors play an important part to influence her ER, domestic factor such as intervention of MAS is also important in influencing her ER.</p> <p>Other foreign factors such as foreign interest rate and foreign economic growth rates are equally important. Recently, due to a fall in global income, major economies such as US and UK lowered their interest rate to stimulate their economies. The fall in foreign interest rate led to more capital inflow into the Singapore economy and hence increased the demand for S\$ causing it to appreciate. However, MAS intervened once again to keep the ER of S\$ low so as to stimulate the growth of our exports which might be falling due to a fall in foreign income. Once again, this shows that foreign factors influence the ER of S\$ but MAS will closely monitor the ER to ensure that the ER of S\$ does not change and affect our economy negatively. Thus, both domestic and foreign factors influence the ER of S\$</p> <p>Lastly, expectation of foreign speculators has a strong effect on the ER of S\$. In 1997, the ER of S\$ depreciated by a large extent due to the Asian Financial Crisis which caused speculators to lose confidence of the Asian currencies. Thus, the huge amount of capital outflow caused the supply of S\$ to rise leading to a sharp depreciation of the S\$.</p>
<p>Explain how domestic factor influence ER of S\$</p>	<p>Since Singapore cannot control our domestic i/r, she needs to influence investors' confidence of our currency to maintain a strong ER. Thus, a sound financial sector, strong reserves and stable economy have helped to infuse greater confidence in the S\$ which enabled the ER of S\$ to remain strong and stable over the years. Even during the Asian Financial Crisis, while the S\$ depreciated together with the other Asian currencies, the extent of depreciation of the S\$ is lesser than the other Asian currencies due to the greater stability of Singapore's financial sector.</p> <p>The stable ER of S\$ together with government policies which led to a low inflation rate, productive workforce, efficient infrastructure and social and political stability help to attract many foreign direct investment in Singapore and promote export competitiveness. With a healthy current and capital account, the ER of S\$ is kept stable and strong over the years. Thus, domestic factors play a strong role in influencing the ER of S\$ as well.</p>

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**Suggested Answers**

Thinking Process	Essay (content, analysis and evaluation)
Conclusion	Both domestic and foreign factors are important in influencing the ER of the S\$. Being a small and open economy, the ER of S\$ is strongly affected by foreign factors which is beyond the control of the Singapore government. This may often give rise to instability of the ER of S\$ which will affect our trade and investment adversely. Thus, it is necessary for the Singapore government to ensure macroeconomic stability and maintain a strong reserve of foreign currency to achieve a stable and strong ER of S\$, thus showing that domestic factors are equally, if not more, important in influencing the ER of S\$ for a small and open economy.

Level	Knowledge, Understanding, Application & Analysis	Marks
L3	An answer that correctly identifies and explains the domestic and foreign factors affecting Singapore ER and compare the effects of domestic and foreign factors on the Singapore ER	8-10
L2	An answer that clearly explains the domestic and foreign factors affecting Singapore ER. However, the students may have identified some of the domestic and foreign factors wrongly. Comparison of domestic and foreign factors may also be weak.	5-7
L1	An answer that gives an inaccurate explanation of the various factors affecting Singapore ER. Domestic and foreign factors may also be wrongly identified and comparison is not done.	1-4
Evaluation		
E3	Evaluative comments are well explained and supported by economic analysis	4-5
E2	Incomplete or partially incorrect evaluative comments	2-3
E1	Evaluative comments are unexplained and not supported by economic analysis	1

5. The United States (US) economy is showing signs of improvements, even as trade concerns loom. In the hope of reducing its trade deficit and unemployment, the US government has imposed high tariffs on imports from China and the European Union (EU).

a) Explain why an economy's pattern of trade might change over time. [10]

**Approach to Question 5a:**

- Explain what is meant by pattern of trade
- Explain how comparative advantage principle explains an economy's pattern of trade
- Analyse the factors that can lead to change in an economy's pattern of trade using relevant examples

**Introduction**

**Pattern of trade refers to the direction, volume and composition of trade between countries.** Composition of trade refers to what is being exported or imported, while volume of trade refers to the real value of goods and services that is being exchanged. Lastly, direction of trade refers to the direction of exports and import flows.

**Body:**

- **Change in pattern of trade due to change in comparative advantage (Supply factor)**
  - One factor that causes a change in an economy's pattern of trade is the **change in its comparative advantage**. According to the principle of comparative advantage, a country should specialise in the good it has comparative advantage in, i.e. the good it can produce at lower opportunity cost than its trading partners, ceteris paribus.
  - Change in comparative advantage can be **due to changes in factor endowment, technological advancement and government policies**.
    - A change in an economy's pattern of trade due to **changes in its or its trading partner's state of technology**. The US, for example, may have lost its CA on manufactured products due to China's rapid technological development and advancement enabling China to produce some manufactured goods at lower opportunity cost than its trading partners.
    - **Government policies to encourage the development of certain industries** can also change the economy's pattern of trade. China's government policies in subsidising firms in its manufacturing industry to innovate and develop new technology advancement has helped to change the economy's pattern of trade from being a export of cheap labour-intensive manufactured goods to being an exporter of high-end manufactured goods.
    - China's **rising number of highly skilled and efficient workers** has led to rising productivity and hence the ability to produce high quality goods at lower opportunity cost than its trading partner, making it an exporter of higher end manufactured goods instead of being largely an importer in precious years.
- **Changes in demand preferences (demand factor)**

**Increase in economic growth** is a factor that can change an economy's pattern of trade. For China, the high economic growth in the last decade or so has led to a rising number of middle income earners, hence rising affluence and changing lifestyles. The higher income group has changed the economy's consumption pattern in favour of high-end branded luxury goods e.g. the luxurious Mercedes and B&W cars as well as Louis Vuitton luxury leather products. The **large increasing in the volume of import** of such exclusive luxury brands has changed in China's pattern of trade to being **a major importer** of luxury goods.

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

- **FTAs and government trade policies**

- **Bilateral and regional free trade agreements** such as ASEAN Economic Community (AEC), North America Free Trade Agreement (NAFTA) and the EU Customs Union have led to **trade creation** between member countries, thereby **changing the direction of patterns of trade** of member countries.
  - The Zero-tariff policy agreement among members of NAFTA, for example, has seen greater trade among the north American countries and less trade between north and south American countries.
  - EU's common high tariff on non-members has artificially increased the prices of imports from non-member countries, enabling them to be each other's major trading partners.
- **Increase in protectionist policies** such as increase in import tariffs and increase in subsidies to stimulate domestic firms' production, will **artificially increase import prices and lower domestically produced goods**, leading to a fall in import of the affected goods. For example, an US increase in import tariffs of solar glass panels will artificially raise the price of imported solar glass panels as consumers' demand shift to the domestically produced one. This will **lower its import** of solar glass panels, hence changing the direction of its trade pattern.

	Knowledge, Application / Understanding and Analysis	
<b>L 3</b>	Well-developed answer that <b>thoroughly analyses</b> the factors that change an economy's pattern of trade, with <b>scope and rigour</b> , with goods use of concept of comparative advantage and other relevant economic concepts, and good use of relevant examples.	8 – 10
<b>L 2</b>	Answer that explains the factors that change an economy's pattern of trade, using relevant economic concepts and some relevant examples but is not developed.	5 – 7
<b>L 1</b>	For an answer that shows some basic but largely unexplained knowledge of pattern of trade.	1 – 4

#### b) Assess whether the use of protectionist policies to correct the country's trade deficit and employment can ever be justified. [15]

##### **Approach to Question 5b:**

- Explain what is meant by trade deficit and unemployment and how protectionist policy can help to correct trade deficit and unemployment.
- Explain and assess the conditions in which protectionist policy to correct trade deficit can be justified and the conditions in which protectionist policy is not justifiable.

##### **Introduction:**

- **Trade deficit occurs when a country's import expenditure is greater than its export revenue. Trade deficit is a cause of concern** as it affects both the country's domestic and external economy. Trade deficit leads to a worsening of BOP and eventually the stability of its currency. It also leads to falling AD, falling production, rising unemployment as well as economic slowdown.
- **Unemployment is a situation where workers are able and willing to work at the going wage rate but cannot find paid employment** despite an active search for work. High unemployment means that the economy is producing below full capacity, i.e. there

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

is low output being produced in the economy leading to low economic growth hence lowers material standard of living.

- Hence measures have to be taken in correcting trade deficit and rising unemployment in the economy. One such measure is the use of **protectionist tools** such as imposing import tariffs and subsidising domestic firms **to make imports artificially more expensive** than domestically produced goods.
- **Provision of subsidies to domestic firm** will lower the cost of production of goods for exports, thereby reducing price of export and making export more competitive both in the domestic market as well as in the international market. At the same time, **tariff on imports** will artificially increase import prices, leading to fall in demand for import as consumers switch their demand to domestically-produced substitutes. These two policies will improve the economy's trade balance.

### Thesis: Conditions in which protectionist policies is justifiable to correct trade balance

- **Domestic economic performance is affected by trading partner's unfair trade practices**
  - Protectionist policies is justifiable when the country's trade deficit is caused by its trading partner's **unfair trade practices, e.g. superficially low currency, large subsidies given to firms in export industries**. Such unfair practices will lower the economy's exports competitiveness both in its own domestic market and the global market.
  - Protectionist policies are also necessary **to prevent dumping** by foreign producers that can **affects the domestic firms' ability to increase production and enjoy economies of scale**. The lack of demand in its own domestic market, and the inability to enjoy economies of scale to reduce their costs will affect the domestic firms' ability to survive as they cannot compete against the cheaper imports. The shut-down of many of these domestic firms will not only lead to **worsening of trade deficit but also high unemployment**. Therefore, protectionist policies to protect against such unfair competition to address the current trade deficit and high unemployment is certainly justifiable.
  - **Evaluation:**  
Imposing import tariff in response to a perceived unfair competition can **lead counter-retaliation** from trading partners and **eventually leading to trade wars, reducing the country's export**, hence affecting the effectiveness of the protectionist policy to correct its trade deficit.
- **Government support is required for certain potential industries to grow and contribute to the economy's positive economic performance in the long run**
  - In the case of developing countries, **trade deficit occurs as large imports of resources and technology are required for economic development**. Protectionism is needed **to protect their growing industries** with the potential to develop comparative advantage so that they will be able to compete in the global market in the long run. Such infant industries incur very high initial start-up costs and take time to develop, and will need the domestic market demand to develop itself, to gain the revenue to cover their costs and to gain economies of scale and experience in production. Without protectionism these firms may not be able to survive to compete against the strong competition from imports. Protecting these industries for a period of time will **give the firms time to restructure themselves and sharpen their comparative advantage**.
  - Protectionist policies can also help to **develop import-substitute industries** so that the country **can be self-sufficient in those industries**, and perhaps even **develop new industries**. The artificially higher-priced imports may encourage residents to switch from imports to locally-produced substitutes,

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

thus boosting production in this local industry and protecting jobs at the same time.

- **Evaluation:**

The lack of competition in the economy can lead to **complacencies hence breed inefficiencies among the firms**.

Hence, protecting these industries **should only be a short-term policy** to give the firms time to develop the comparative advantage to compete effectively in the global market. Prolonged protectionism on these firms can lead to inefficiencies in production and inability to compete in the global market and not helping to improve the country's trade balance.

### Conditions in which protectionist policies is not justifiable

- When the trade deficit and unemployment are **caused by falling export due to loss of comparative advantage and lack of export competitiveness**

- Protectionism is not appropriate in the case where the trade deficit is mainly due to falling export rather than rising imports. This could be due to loss of comparative advantage or inefficiencies in production in the export industries that lowers the country's export competitiveness.

- **Evaluation**

A better option for the government to address its trade deficit in this situation is to impose **supply-side policies** via improving technology and innovations **to improve productivity and the quality of its products to improve its export competitiveness** in the global market. This may incur **high cost and longer time is taken to correct its trade balance**, but the effective of policies to improve AS and enhance export competitiveness would be **more long-term** than protectionist policy can ever be.

### Antithesis:

- Protectionist measures such as Import tariffs and large subsidies for domestic production is a quick-fix that **improves the trade balance in the short run** by switching domestic consumers to locally-produced goods, reducing import spending to improve trade balance.
  - Protectionist policies to correct the country's trade deficit **at the expense of its trading partners' exports** does not seem fair to the other economies and may **instigate them to retaliate** by imposing tariffs on the country's exports hence dampening the effectiveness of its protectionist policy to correct its trade deficit.
  - Protectionist policies to correct trade balance and reduce unemployment may **back-fire** on the economy if import tariffs it impose on its trading partners include **tariffs on imported resources** and intermediate goods that are heavily required in some essential industries such as steel and energy. Such tariffs will cause the firms in these industries to **face higher costs of production forcing them to raise prices** in order to stay afloat. This will **affect the country's export competitiveness**, worsening the country's trade deficit.
  - Protectionist measure may be to the advantage of the domestic firms and help to protect the economy's employment, but this is at the expense of the domestic consumers. Tariffs and lack of competition will **increase consumer prices and reduce consumer welfare**.
  - The high government spending on subsidising domestic firms to protect them against competition can be a **strain on the government's budget**, and may increasing the already high government debt, like the US and UK. Protecting the inefficient firms in labour-intensive low-end manufacturing products to protect employment is very **likely to be a long-term burden** or the government is little or



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no effort is made to the economy's export-competitiveness or in training the workers the skills required to move to other industries.

### Synthesis / overall evaluation

- Protectionist policy may not seem justifiable to solve the economy's own economic woes at the expense of its trading partners as it may seem **an unfair punishment to its trading partners for having healthier trade balance**. However, protectionist policy is **justifiable if it is implemented as a short-term measure**, for example to give time for potential industries to grow and develop the comparative advantage to compete more effectively in the global market in the future hence ensuring an improvement in trade balance in long run.
- However, there is a **need to be mindful of the possibility of retaliations** from other economies that can reduce the effectiveness of the policies in correcting trade deficit.
- Furthermore, the **improvement in trade deficit** brought about by the protectionist policy is **likely to be short-lived if the root-cause for the trade deficit is not addressed**.

Protectionist policy is aimed at artificially raising the price of imports so that domestic demand would be in favour of the domestic producers. This will increase domestic production, employment and economic growth. Unfortunately, **unless there are other government policies to increase export competitiveness and hence increase export**, the increase in income will lead to higher import demand, **worsening trade balance again**.

Level	Knowledge, Application, Understanding and Analysis	Marks
<b>L3</b>	<ul style="list-style-type: none"> <li>For a balanced well-developed answer on whether protectionist policies to correct trade deficit is justifiable, with good use of relevant economic concepts and illustrated with good relevant examples.</li> <li>High L3 for answers that pays equal attention in discussing trade deficit and unemployment.</li> </ul>	<b>8 – 10</b>
<b>L2</b>	<ul style="list-style-type: none"> <li>For an answer that explains whether protectionist policies to correct trade deficit is justified using economic analysis but not developed and limited in scope.</li> <li>Attempt as some use of relevant examples as illustration If a balanced argument is given, it is probably limited in depth</li> <li>Maximum of 6 marks for a one-sided answer.</li> </ul>	<b>5 – 7</b>
<b>L1</b>	Irrelevant answer; points are incidental; major conceptual errors	<b>1 – 4</b>
<b>Evaluation</b>		
<b>E3</b>	For an answer that is able to judgement on the conditions that affects the extent of the justification of protectionist policies to correct trade deficit e.g. despite the condition that makes protectionist policies justifiable, retaliation from trading partners may dampen the effectiveness the policies in correcting trade deficit.	<b>4-5</b>
<b>E2</b>	For an evaluative assessment which weighs conditions for protectionist policies to be justifiable/unjustifiable e.g. for answer that weigh the net benefit of protectionist policies to correct trade deficit.	<b>2-3</b>
<b>E1</b>	For an answer that makes some attempt at an evaluative weighing of the benefits and costs of globalisation in different countries.	<b>1</b>

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

6. Free trade agreements are treaties which make trade and investment between two or more economies easier. International business is now simpler with Singapore's network of over 22 implemented agreements.

Source: Enterprise Singapore

Discuss the impact of free trade agreements on different economies. [25]  
[VJC 2018]

### Introduction

With globalisation, economies around the world are becoming more integrated and interdependent on each other for economic growth. This comes as **goods and services** become more mobile with trade integration, **capital flows** become easier with financial integration; and **labour flows** between countries become more mobile with international migration.

Free trade agreements (FTA) are official treaties between **member countries** to **abolish tariff barriers** among themselves but may maintain their individual tariffs against non-members. Such agreements that **boost trade and investments** between member countries will enhance the benefits of globalisation to member countries.

### Body

**FTA enhances trade between member nations leading to improvement in consumers' welfare.**

As seen from Figure 1,  $P_t$  shows the domestic price in the home country when there is a tariff imposed on the good. With the tariff, the domestic demand is at OC while the domestic supply is OB. This means that imports is restricted to BC as a result of the tariff.

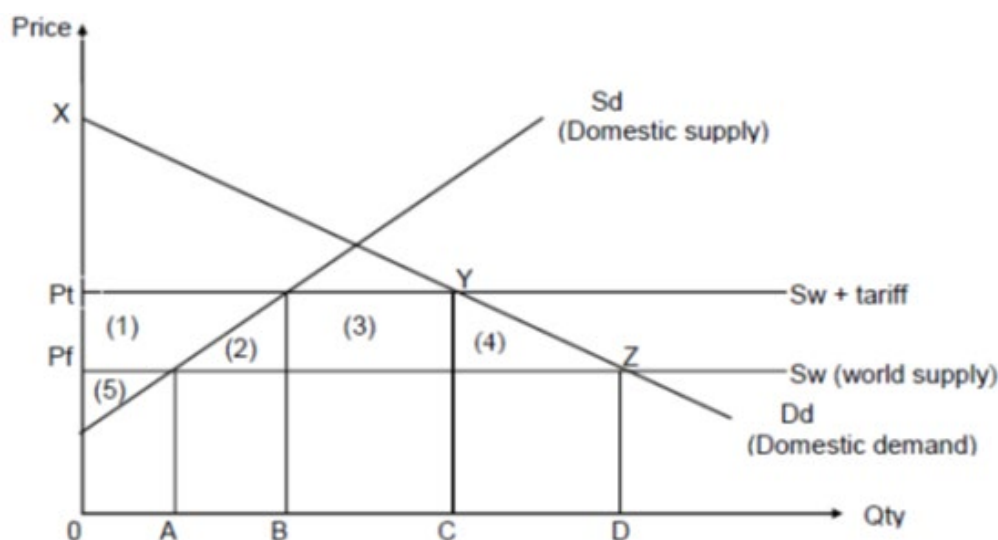
The signing of FTA will result in the abolishment of tariffs. When the tariff is abolished, the fall in price of the good from  $P_t$  to  $P_f$  allows domestic consumers to consume the goods at a **lower price**. Domestic quantity demanded rises from OC to OD while domestic quantity supplied falls from OB to OA. Import now rises from BC to AD. As a result of the fall in price and rise in imports, **consumer surplus increased** by areas (1), (2), (3) and (4); while producer surplus reduced by area (1).

In addition, the access to other markets with the signing of FTA would **increase the variety** of goods and services to consumers. The greater degree of choice would also increase consumers' welfare.

### Evaluation:

The extent of this benefit to domestic consumers in the different economies will depend on the **degree of reliance** on foreign consumer goods. For example, developed countries (DC) such as the US could be heavily reliant on imported basic textiles and food-stuff from less developed countries (LDC). In such instances, the FTA that removes the import tariff would benefit US consumers' welfare substantially.

Figure 1. Abolishment of tariff lowers domestic price for consumers



**FTA provides access to larger markets for producers, leading to higher profits.**

Such trade cooperation that reduces any trade barriers between member countries, allow domestic firms better access to each other's markets. This brings about **larger revenues** for firms in the member countries as a result of the **larger market size** that firms can sell their goods to. As a result, a larger scale of production can bring about **economies of scale**, lowering the average cost of production. The larger revenues and lower costs can bring about **higher profits** for the firms.

#### Evaluation:

The extent of benefit between member countries would depend on the **degree of similarity of the goods produced**. This would allow member countries to specialise and reap the benefits from their **comparative advantages**. If the member countries produce very similar goods, the level of competitiveness will be high since domestic firms would need to compete both in terms of price and quality in order to secure the market. Product differentiation could alleviate the degree of competition to cater to **difference in tastes and preferences**. An example would be textiles where the fashion design and materials may be different. This allows for firms in DCs to sell their goods to LDCs despite both having similar industries.

In other instances, the less efficient firms may have to close down as a result of the competition from other member countries. Domestic firms facing such predicament and are unable to differentiate their product would suffer. In the long run, these will close down; increasing the import reliance on member countries for such goods.

In the long run, there is **greater efficiency in the allocation** of resources within the FTA because each of the member countries is able to apply their comparative advantage and trade freely. The respective **factor endowment** will determine the comparative advantage of the country. For example, a country with an abundance of arable land will be able to provide food crops with lower opportunity cost vis-à-vis a member country with huge desert land mass. Barring any transport costs and mobility of factors of production, there would be greater production (from specialisation) and consumption for the FTA countries.

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

#### FTA helps achieve economic growth and employment

Trade can be a driver of growth. Signing of FTA reduces trade barriers between member countries allowing countries to **increase the size of their export markets**. Ceteris paribus, if planned export value rises by more than that for import, the resulting rise in aggregate demand will lead to a rise in equilibrium national output as long as there is availability of **spare capacity** in the economy. Otherwise, the rise in aggregate demand (AD) may increase the pressure on scarce resources, causing upward pressure on prices, leading to DD-pull inflation. Thus, the **state of the economy** determines the extent of benefit from the FTA.

The increased access to other markets allows the home country to **overcome their domestic demand constraints** to actual growth (e.g. small size of domestic market) by exporting excess resources or goods to member countries. This enables fuller utilization of otherwise under-employed or unemployed resources, raising the level of output, income and employment in the home country. The extent of the rise in national income is dependent on the **size of the multiplier** and the extent of the injection from trade.

#### Evaluation:

The extent of impact from the rise in net exports will depend on the **nature of the economy**; the **reliance and openness to trade** of the member country. If net exports contribute significantly to the country's GDP, the rise in this component will result in a more significant rise in the country's output and employment. For example, a small economy like Singapore constrained by the small size of its domestic market is highly open and reliant on trade to boost its national income; the total value of exports and imports comprise more than 300% of its national income. As a result, the country relies heavily on the contribution from trade for its economic growth and hence the increase in size of export markets that FTA brings about is a significant benefit for Singapore.

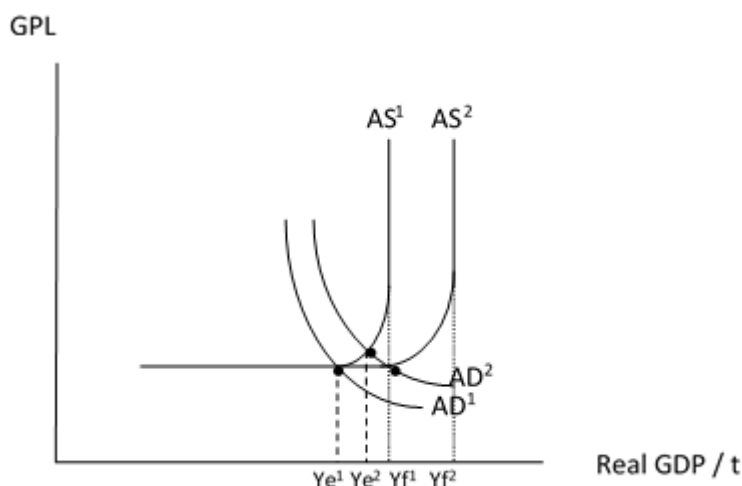
The extent of impact from the rise in net exports will also depend on the **terms of trade** between the member country. DCs generally produce higher value-added goods and services while LDCs, where their production is generally more labour-intensive, tend to produce goods and services that are low in value-add. Under such trade arrangements, the terms of trade will favour DCs more than LDCs. The **stage of development** thus determines the degree of value-add in the production. DCs have a higher technological and infrastructural advantage compared to LDCs. Coupled with a more educated and skilled workforce, DCs are able to produce higher value-added goods and services.

FTA may facilitate and allow **greater capital flow** between member countries. This comes about as a result of the reduced regulatory restrictions of the free trade agreement. These capital inflows in the form of foreign direct investments (FDI) will boost the AD of the home country in the short run since investment is a component of AD.

The increase in investment and trade, ceteris paribus will result in an increase in the AD of the home country since  $I$  and  $(X-M)$  are components of AD. This results in a rightward shift of AD from  $AD^1$  to  $AD^2$ . The increase in AD will result in AD being higher than the real national output; firms face an unplanned fall inventories, causing them to increase production, increasing national income by a multiple through the multiplier effect, resulting in actual growth.

In the long run, capital inflows in the form FDI leads to capital accumulation and could also result in increases in quality of the factors of production. This leads to an increase in productive capacity of the economy (assuming the rate of capital accumulation exceeds that of capital depreciation), causing the aggregate supply (AS) to shift rightwards from  $AS^1$  to  $AS^2$ , leading to potential growth.

Figure 2. Economic growth as AD and AS rises



As seen in Figure 2, the rightward shift in the AD curve from  $AD^1$  to  $AD^2$  results in a rise in GPL as output rises from  $Ye^1$  to  $Ye^2$ . However, when AS curve shifts rightwards from  $AS^1$  to  $AS^2$ , the GPL falls and real GDP now rises from  $Ye^2$  to  $Yf^1$ .

### Evaluation

The rise in the AS curve as the AD curve rises will help to mitigate any inflationary pressure as the economy reaches close to the full employment output level, bringing about **sustained economic growth**. The rise in AS as a result of greater FDI inflows would especially be beneficial for emerging economies that are growing very rapidly like China as there is higher possibility of inflationary pressures given the rapid rise in AD. Thus, the **state of economy** determines the extent of benefits from FTA.

In addition, the more dissimilar the industries (difference in comparative advantage or **stage of development**) are in the member countries, the more positive the impact since there will be less competition amongst them.

FDI inflows also helps to enhance the depth and scope of investments in the receiving country. For example, the FTA may allow more high-tech investment inflow to boost a primarily agricultural economy, introducing new and better methods of farming that boosts productivity and yields. These investments may also then be made available to other industries, increasing the depth and scope in terms of the use of technology.

### Evaluation:

Such inflows of FDI will be more beneficial for developing economies or economies at a lower **stage of production** as it brings in new technology to help the economy progress. This increases efficiency and helps domestic industries move into production of higher value-added goods. The extent of benefits from FDI inflow thus depends on the initial stage of development of the country. A country with a high level of development and technology may not benefit as much from FDI inflow since the value-add to the productivity may be low.

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

#### FTA may increase structural unemployment

Structural unemployment occurs when displaced workers do not have the required skill sets to be engaged in another job. As a result of the FTA, domestic firms may be subjected to increased competition from similar firms within the member countries. If these domestic firms are less efficient and are unable to compete, they may outsource their production resulting in unemployment for the industry in the home country.

For example, commercial banks in Singapore make use of the services of call centres located in India for their provision of customer-support services. As a result, workers who used to work in the call centres in Singapore will become unemployed. For certain types of labour to be transferred from one industry to another, extensive retraining is often required. Such retraining may be very costly or at times, even impossible. A considerable time period may also be required for such retraining resulting in structural unemployment.

#### Evaluation:

The extent of structural unemployment may be dependent on **nature of the economy** such as factors like the level of education of the population. In developing countries like Indonesia where the majority of the population has a low level of education, acquiring new skills may take a longer time and workers may be less receptive to training.

#### FTA may lead to trade diversion

Trade diversion occurs when trade is diverted from a more efficient exporter towards a less efficient one as a result of the formation of free trade agreement or a customs union. While the cost of goods and services become cheaper as a result of the abolishment of tariffs within the member countries, it is undesirable as it concentrates production in countries with higher opportunity cost and lower comparative advantage, resulting in inefficient allocation of resources.

For example, if there are two countries that can produce apples for sale. Country A is able to offer apples for sale at \$1.00 each, while Country B is able to offer apples for sale at \$1.05. Let us assume that home country imposes a 10% tariff on apples. Buying apples from Country A would now cost \$1.10, while those from Country B would cost \$1.16. Without any trade agreement, the home country would buy from Country A. If the home country signs a free trade agreement with Country B and the tariff is abolished, apples would now cost only \$1.05. As a result of the free trade agreement, the home country has to buy from a less efficient source at a higher price. As a result of the higher price of apples that consumers in the home country has to pay, there will be a welfare loss as resources become inefficiently allocated.

#### Evaluation:

The extent of welfare loss is dependent on **the proportion of all the goods and services** affected by the trade diversion. For example, if the trade diversion affects only a small basket or a small proportion of goods and services, these negative impacts may actually be offset by gains in other areas that have a greater impact on the welfare of society.

#### FTA may cause balance of payments disequilibrium

In the current account balance of the BOP, member countries may experience increased volume and value of trade if there are mutual benefits. However, it could also worsen the current account deficit from trade if a particular member country is unable to compete for exports. It could also worsen the current account if a particular member country imports more

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

than it is able to export, resulting in trade deficit.

Prolonged deterioration in the current account could lead to a depreciation of the external currency for the home country. A current account deficit will result in an excess of the home country's currency in the Forex market. As such, there will be downward pressure on the external value of the home country currency. In addition, when the country consumes beyond its means, additional borrowing is needed to fund these consumption, leading to an increased burden in future repayment.

#### Evaluation:

The impact of the current account deterioration is dependent on both the price and quality of goods and services available in the home country. If the goods lose their competitiveness due to poorer quality, the extent and duration of such a current account deterioration would be more severe. Countries with a higher **stage of development** is more likely to have the resources and funding to ensure that the quality of their products.

The extent of the impact on current account is also dependent on repatriation of profits and dividends. When FDIs flow from DCs into LDCs to tap on the cheaper labour costs for production, profits from these investments will be repatriated to the DCs. This will help offset any trade deficit that DCs may suffer as a result of importing from LDCs.

In the capital account, FDI will flow into the member country with a more positive business outlook and out of the member country with poor business sentiments. Prolonged FDI outflow will result in the 'hollowing out' of the economy in terms of productive capacity. This will affect the potential growth of the country as the dearth of investment leads to lower output and productivity over time.

#### Evaluation:

The extent of the FDI inflow will depend on the **factor endowment** of the receiving country. DCs tend to invest in LDCs to tap on the cheaper labour that is abundantly available.

#### Conclusion:

[Stand] While free trade agreements bring about more benefits than costs, the extent is dependent on the characteristics of different economies. The resource endowment, state and nature of the economies can determine the extent of the benefits from signing the FTA.

For economies with a small domestic market, they are likely to benefit from the expansion of their production. As such, they may gain most significantly from the access to larger markets to trade for economic growth.

For countries with a lack of natural resources, the benefit of being able to obtain factor inputs and other consumption goods more cheaply with the abolishment of tariff would be a significant benefit for consumers from signing the FTA.

For developing countries, the increased flow of capital as a result of the FTA would be most important since it allows for greater transfer of technology. This would enable the economy to progress from low value-add production to higher value-added goods and services.

The more dissimilar the member countries, the greater the benefits from trade creation, economic growth and development. The benefits from specialisation will allow member countries to achieve sustained economic growth as access to both markets and resources is

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

enlarged.

Level	Descriptors	Marks
L3	Accurate and precise explanations of the benefits and costs; and recognises the question requirement that the extent of these impact is dependent on the context of the different economies (e.g. characteristics and nature of economy).	18 – 20
	Answer that recognises the question requirement of the benefits and costs of FTA; and attempts to contextualise their justification with examples and illustrations.	15 - 17
L2	For an answer that either gives an under-developed explanation of benefits or costs of FTA with attempts to use examples / diagrams to illustrate (demonstrate technical rigour in answers).	12 – 14
	For an answer that is mostly relevant, but explanation of the benefits or cost is either undeveloped or descriptive.	9 - 11
L1	For an answer that shows some relevance and listing of possible benefits and costs.	5 – 8
	For an answer that is mostly irrelevant and some knowledge of free trade agreements.	1 - 4
E3	For an answer that uses <b>contextualised analysis</b> / <b>examples</b> to support an evaluative conclusion (e.g. benefits and costs may be of different degrees; short run versus long run effects etc.).	4 - 5
E2	For an answer which shows <b>some attempt</b> to explain and support evaluative statement(s) made.	2 – 3
E1	For an answer that gives an <b>unsupported</b> evaluative statements	1



**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

7. (a) Explain how an economy is affected by globalisation. [10]
- (b) Assess whether protectionism is the best approach to minimise the adverse impact of globalisation. [15]  
 [IJC 2015]

**Suggested Answer for part (a)**

**Introduction:** Define globalisation as characterised by greater movement of goods, capital and labour.

**Body:**

Positive impact of globalization	Negative impact of globalization
<p><b><u>Improve BOP</u></b></p> <ul style="list-style-type: none"> <li>Increased trade flows (both exports and imports) → assuming that the increase in export revenue outweighs the increase in import expenditure, <math>(X - M)</math> increases → improve BOT and BOP, ceteris paribus. (e.g. countries such as China and Singapore which have depended on trade for growth have maintained many years of BOP surplus)</li> <li>There is greater inflows of FDIs → improves the capital financial account and hence BOP.</li> <li>Building up of BOP surplus → accumulates foreign reserves → strengthen the economy</li> </ul>	<p><b><u>Worsen BOP</u></b></p> <ul style="list-style-type: none"> <li>Loss of CA to foreign countries → exports lose price competitiveness → fall in (net) exports → worsen BOT and BOP, ceteris paribus (e.g. countries like the United States has lost its CA in production of labor-intensive goods to China and hence experienced many years of trade deficit)</li> <li>FDIs may fall with increased outsourcing of low to mid value-added manufacturing activities to emerging low-cost countries → worsen capital financial account and hence BOP</li> </ul>
<p><b><u>Economic growth &amp; Lower Unemployment</u></b></p> <ul style="list-style-type: none"> <li>Increased net exports &amp; FDI → AD increases → RNY increase → actual economic growth</li> <li>Transfer of more advanced technology, knowledge and skills from FDIs + inflow of high-skilled and low-skilled foreign labour → enhance productive capacity → increase LRAS → potential economic growth</li> <li>Greater production of goods and services → firms increase demand for factors of production i.e. labour → reduces cyclical unemployment</li> </ul>	<p><b><u>Fall in economic growth</u></b></p> <ul style="list-style-type: none"> <li>Susceptible to external economic conditions → e.g. major trading partners experience economic recession → reduce external demand for (net) exports → fall in AD and RNY</li> <li>Loss of CA to foreign countries → exports lose price competitiveness → fall in (net) exports → fall in AD and RNY (and increase cyclical unemployment)</li> <li>Outflow of local talents (brain drain) → slow down potential growth</li> </ul> <p><b><u>Rising domestic unemployment</u></b></p> <ul style="list-style-type: none"> <li>Greater foreign competition (e.g. may suffer from dumping from foreign producers) → domestic inefficient/uncompetitive producers that cannot match the competition in terms of price or quality will be forced to shut down → rising unemployment</li> <li>Workers who are displaced in sunset industries may not have the necessary</li> </ul>

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

	skillsets to shift to growing sunrise industries → structural unemployment
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Positive impact of globalization	Negative impact of globalization
<u>Lower general price level</u> <ul style="list-style-type: none"> <li>Free-trade → Cheaper imported raw materials and intermediate goods → reduces unit cost of production → increases SRAS → lower GPL</li> <li>Transfer of more advanced technology, knowledge and skills from FDI + inflow of high-skilled and low-skilled foreign labour → enhance productive capacity → increase LRAS → reduces GPL in the long run.</li> </ul>	<u>Higher general price level</u> <ul style="list-style-type: none"> <li>Global supply shocks → increase in prices of imported primary commodities → increase in unit COP → fall in SRAS → imported cost-push inflation</li> <li>Rapid increase in trade flows may boost AD beyond the productive capacity of the economy. If AD persistently increases more than AS, demand-pull inflation may occur in the SR</li> </ul>

Conclusion: Countries may benefit and suffer from globalization. Some countries may benefit more than others. It is important for countries to adopt appropriate policies to maximize the benefits and minimize the costs of globalization.

Level	Knowledge, Application, Understanding and Analysis	Marks
L3	For a well-developed analysis of BOTH positive and negative effects of globalization on economies, with the use of relevant real-world examples.	8-10
L2	For an underdeveloped analysis of both positive and negative effects of globalization on economies. For an analysis of EITHER positive OR negative effects of globalization on economies.	5-7
L1	For a superficial analysis of the effects of globalization on economies with largely a smattering/listing of points.	1-4

### Suggested Answer for part (b)

**Thesis: Explain how protectionism minimize (some) of the negative impacts of globalization**

- Illustrate with the use of diagram how the use of import tariffs and/or quotas can be used to correct trade deficit/ achieve higher EG/ lower (cyclical) unemployment
  - Increase price of imports → reduce Q<sub>dd</sub> of imports → assuming PED<sub>m</sub> > 1 → import expenditure falls → increase net exports ceteris paribus → improve current account + increase AD and hence RNY + reduce cyclical unemployment
  - As consumers switch from imports to buy domestically-produced goods → increase domestic production and hence employment

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

#### Anti-thesis 1: Explain the limitations of protectionism

- Retaliation by trading partners might lead to a fall in export revenue of host country
- Not solving the root cause of the problem such as loss of CA and inefficiencies. Hence, inefficient firms have no incentive to restructure to improve the competitiveness of their products.
- Unable to resolve the outflow of FDI due to loss of CA as protectionist measures mainly target imports to protect domestic industries, rather than preventing the outflow of capital. Instead, protectionism will inevitably lead to inefficiencies and higher costs of production, which discourage FDI → fall in the inflow of capital/ increase in capital outflow will worsen capital account, making efforts to correct BOP deficit counterproductive.

#### Anti-thesis 2: Explain (any 2) of the other approaches and their limitations – depending on the negative impact of globalization that students choose to address

- 1) Fiscal Policy
- 2) Monetary policy
- 3) Supply-side policies

#### Conclusion:

Students are required to compare across policies to decide which policy is the best to tackle the specific problem identified

E.g. While the use of protectionist measures is effective in correcting BOT deficit/ increase domestic employment/ increase real national output in the short run, they are unable to solve the issue of the loss of CA. The use of such measures could be counterproductive in the long run as it impedes efficiencies. In this case, the use of appropriate supply-side would be a better solution albeit more time is needed for these measures to make a positive impact on the economy.

Level	Knowledge, Application, Understanding and Analysis	Marks
L3	<ul style="list-style-type: none"><li>• Well-developed explanation of how protectionism and at least 2 other policies minimize the costs of globalisation as well as their limitations with the use of relevant real-world examples.</li><li>• Max 9m for well-developed and balanced analysis of 2 policies inclusive of protectionism.</li></ul>	8-10
L2	<ul style="list-style-type: none"><li>• Undeveloped explanation of how protectionism and other policies minimize the costs of globalisation as well as their limitations</li><li>• One-sided explanation of policies (either effectiveness or limitations are discussed)</li><li>• Max 6m for well-developed and balanced analysis of protectionism only</li></ul>	5-7
L1	An answer that is largely irrelevant/ has conceptual errors/ mere smattering of points	1-4
<b>Evaluation</b>		
E3	Well explained judgement that builds on appropriate economic analysis and synthesizes economic arguments to arrive at well – reasoned arguments and decisions.	4 – 5
E2	Some attempt at evaluation or a conclusion that answers the question but does not explain the judgement or base it on economic analysis	2 – 3
E1	Unexplained judgement	1

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

8. (a) Explain the potential challenges that might arise when a country loses competitiveness in an increasingly globalized world. [10]

(b) Discuss whether protectionism is the most appropriate measure to manage the challenges when a country loses its competitiveness. [15]  
[RI 2018]

### Part (a)

#### Introduction

- Clarify the meaning of “competitiveness”
  - Competitiveness for Trade – the ability of an economy to compete fairly and successfully in the markets for internationally traded goods and services to earn export revenue
  - Competitiveness for FDI – the ability to attract FDI which funds I in an economy. This in turn is dependent on the expected rate of return (expected profitability) on investment projects as perceived by the potential investor.
  - Competitiveness for Labour – the ability to attract foreign talent yet retaining domestic skilled talented workers.
- Clarify the “challenges” that may arise when a country loses competitiveness
  - adverse impact on the macroeconomic goals of a country
    - slowdown or negative economic growth (actual), limited potential growth which will impact SOL over time
    - rise in unemployment
    - external instability

#### Body

##### **1. Loss of trade competitiveness (Aspect of Trade Flows)**

- A country may lose its price competitiveness in the goods it exports because of
  - a loss in its comparative advantage (CA) → become inefficient in the production of its good → incur higher costs in production.
- The higher costs would be passed on in the form of higher prices of their goods → reduces the price competitiveness of exports → fall in demand for exports → fall in export revenue.
- Consumers of the exporting country may also switch to the relatively cheaper import substitutes → domestic consumers purchase more of the cheaper imports → rise in import expenditure
- Fall in net X revenue and hence a worsening of the country's balance of trade.

##### **2. A country may experience a loss in business competitiveness in terms of a loss of FDI. (Aspect of Capital Flows)**

- This could arise because of:
  - fall in labour productivity
  - excessive burdensome rules and regulations regarding business start-ups, expansion of businesses and employment of workers
  - weak infrastructural support
- The above would generate poorer expected profit potential from investments in the country → deter inward FDI flows and may lead to more FDI outflows as well → net FDI outflows occur as a result.

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

#### 3. A country may experience a loss in labour competitiveness (Aspect of Labour Flows)

- If labour costs grow faster than rise in productivity → increases unit labour costs and hence unit COP for the firm → cost competitiveness of an economy will suffer *ceteris paribus*.

#### 4. Challenges arising from loss in competitiveness

##### SR effects

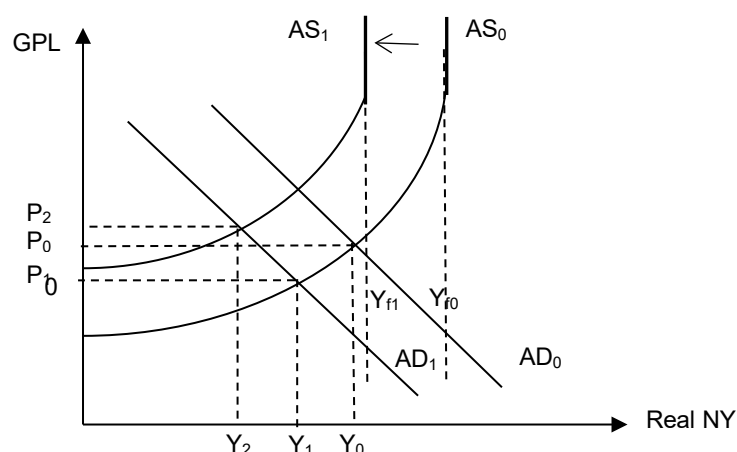
- As net X and I are components of AD, a fall in net X and I, *ceteris paribus*, will bring about a fall in the level of AD (from  $AD_0$  to  $AD_1$ ) → a more than proportionate fall in real national income (from  $Y_0$  to  $Y_1$ ) → reducing actual growth. The economy has moved further away from the full employment output ( $Y_{f0}$ ) level.
- As real output falls, firms hire less factors of production → fall in derived demand for labour → this would also increase unemployment levels (demand deficient unemployment).
- The retrenched workers from the affected industries may not have the appropriate skills to be re-employed in high value-added industries in the country → results in a mismatch between job opportunities and skills offered.
- The fall in net X revenue and net FDI outflow worsen both the current and capital and financial accounts respectively → worsens the country's overall BOP position.

##### Other possible effects:

- A fall in real national income means less income will be earned by households → reduces their ability to purchase and consume goods and services → fall in material SOL.
- Export oriented industries in the economy that continue to enjoy a CA will experience increase in demand for their goods and services → increase in demand for labour in these industries → wages of workers employed in these industries increase. Industries that have lost their CA, on the other hand, lag behind experience a fall in the demand for their goods and services → reduce the demand for workers → a fall in wage growth → increase in wage and income inequality.

##### LR effects

- A fall in investment would also contribute to slower capital formation in the economy while the loss in labour productivity is seen as a deterioration in the quality of labour. There is a fall in both quantity and quality of resources → effect of limiting the growth in the country's productive → causes the AS curve to shift to the left from  $AS_0$  to  $AS_1$  with the full employment output level falling from  $Y_{f0}$  to  $Y_{f1}$ . Potential growth is lowered → impacting future SOL



## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

- A worsening of the country's BOP position, if persistent, could lead to a downward pressure on country's exchange rate → depreciation of the country's exchange rate → may fuel imported inflation and deter potential FDI

### Conclusion

Knowledge, Application, Understanding, Analysis		
<b>L1</b>	<ul style="list-style-type: none"><li>- Lack of economic framework in explanation</li><li>- Irrelevancies in explanation.</li><li>- Substantial and glaring conceptual errors.</li><li>- Listing of points.</li></ul>	<b>1 – 4</b>
<b>L2</b>	<ul style="list-style-type: none"><li>- Evidence of use of economic analysis</li><li>- Lapses in analysis evident.</li><li>- Depth in analysis could be improved</li></ul>	<b>5 - 7</b>
<b>L3</b>	<ul style="list-style-type: none"><li>- A well-developed answer</li><li>- Presence of clear economic analysis and appropriate categorisation of the possible challenges posed by loss of competitiveness.</li></ul>	<b>8 - 10</b>

### Part (b)

#### Introduction

- The adverse consequences arising from a loss in competitiveness have been used by governments to justify the use of protectionist measures.
- Define protectionism
  - refers to actions undertaken by governments to shelter the domestic industries from foreign competition.
  - These actions can be categorized into tariff vs non-tariff barriers to trade.

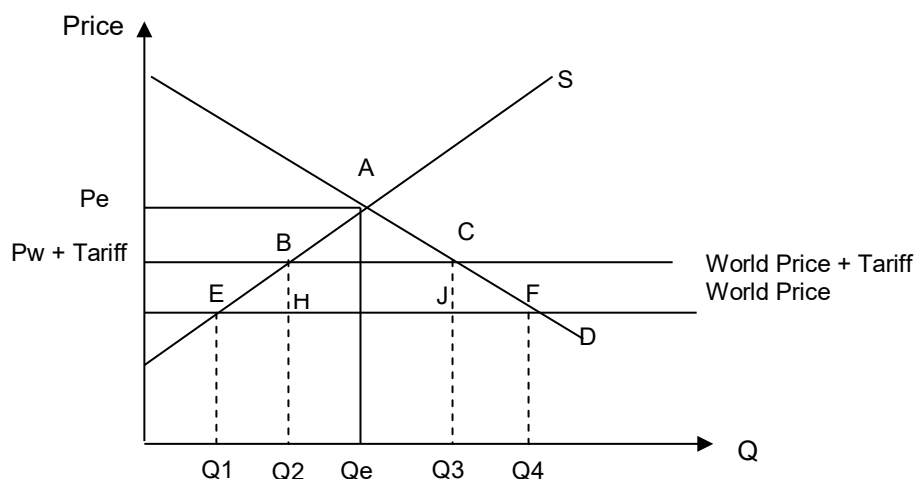
#### Body

**Thesis: Protectionism is an appropriate measure in addressing the challenges arising from the loss in competitiveness**

- **Explain how protectionism via trade barriers such as import tariffs can help address some of these challenges**
  - Objective: to address the loss in trade competitiveness (in particular, price competitiveness) and worsening of the BOP position
    - Through import tariff restrictions, a temporary protection (SR) is provided → allows workers in the sunset industries to adjust to new conditions in the economy.

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers



- Explain how tariff works using a tariff diagram
  - The import tariff raises the price of imports from  $P_w$  to  $P_w + \text{tariff}$ .
  - This decreases quantity demanded of imports from  $Q_4Q_1$  to  $Q_3Q_2$
  - Due to the fall in quantity demanded of imports, M expenditure would decrease and hence X-M value would increase which mitigates the worsening of the BOT and the BOP caused by the loss in trade competitiveness.
- Objective: to address structural unemployment arising from loss in trade competitiveness
  - Moreover, there is a rise in domestic production from  $Q_1$  to  $Q_2$ .
  - This helps to retain workers in the industry and buy time for workers to retrain.
  - As these workers pick up new skills to move into other industries, the extent of structural unemployment that would have otherwise occurred would decrease.

**Anti-thesis: Protectionism is not an appropriate measure to manage loss in competitiveness especially in trade.**

#### - Explain limitations of protectionist measures

- The use of tariff on imports leads to misallocation of scarce resources
  - The protected domestic industry can no longer compete with foreign counterparts even in their domestic markets due to a loss of CA → domestic good has been priced out of the market.
- Protectionism merely perpetuates domestic inefficiency as it prolongs the inefficient use of the economy's resources and leads to allocative inefficiency.
  - Areas EBH and JFC represent deadweight loss to society or efficiency losses. They arise because tariffs distort incentives to consumers and producers.
- More importantly, the use of import tariffs does not address the root causes of the rise in unemployment → protectionist measures are often misdirected.
- Protectionist measures, if carried out over the long term, tend to lead to a fall in world output and trade. Especially if it invites retaliation from trading partners hence resulting in a slowdown in economic growth for the countries involved
- It is important to note that implementation of protectionist measures to resolve worsening BOP is at best a short-term measure

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

- does not necessarily address the root cause of the worsening BOP position.
- In the long run, better to look at the root causes of a worsening BOP position

**Analyse the use of other measures that may be more appropriate to address the loss in competitiveness and manage the challenges (2 alternative policies)**

- **Policies to improve competitiveness of country's X industry**

- Wage policies
  - Establish wage guidelines to ensure wage growth does not outstrip productivity growth → reduce unit COP and hence price competitiveness of X

Evaluation:

- Wage guidelines are non-mandatory and may not be implemented by the private sector.
- Subsidies for upgrading of technological level
  - to encourage productivity and innovation activities in the country → helps to lower unit COP as well as bring about improvement in the quality of exports &/or introduce new products

- Subsidies for retraining of workers as well as sourcing for relevant skills based modular courses that help equip workers with the relevant skills to support CA industries

- workers are more occupationally mobile, reduce labour market rigidities
- increase labour productivity helps to lower unit COP for firms → pass on lower costs in the form of lower prices → improve price competitiveness of the country's exports

Evaluation:

- Initiatives are only effective if workers are receptive to the idea of life long skills retraining and upgrading
- Courses must be relevant

- **Policies to attract FDI and top talent**

- Tax incentives, offering of competitive corporate tax rates can all contribute to increase in the post-tax profits of firms, thus incentivising them to locate their operations in the country → helps to increase FDI flows into the economy..
- Likewise, the top tier marginal income tax rates can also be made competitive. By adopting a low personal income tax regime → this serves to attract top labour talent to the country
- Enhancement of infrastructure to increase productivity of businesses

- Eg: road network, sea-ports and airports □ allows firms to transport their goods in a faster, reliable and efficient manner which helps to improve productivity and lower COP

Evaluation:

- Such policies have an impact on the government budget. The government has to trim its other expenditures or find alternative sources of revenue to finance its expenditure

- **Free trade policy to improve “global competitiveness”**

- Signing bilateral and multi-lateral FTAs will see a reduction / elimination of trade barriers (import tariffs) on the country's exports → this helps to improve export price competitiveness → increase demand and hence X revenue



## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

- FTAs also allow the country's industries to obtain imported raw materials from its new trading partners at lowest cost.
- FTAs also facilitate FDI into the country by reducing / eliminating regulations which serves as BTE for foreign firms.
- Explain how the above alternative policy measures have the effect of increasing AD and AS and hence manage the challenges faced by a country as a result of a loss in competitiveness

### Conclusion

- Protectionism may be appropriate in the SR but the LR negative consequences will eventually outweigh the benefits → it is, at best, a temporary measure.
- Global competitiveness is crucial for any open economy especially for those who are heavily reliant on X and FDI for its economic performance.
- As each policy measure has its limitations, a combination of policies is required for a country to be competitive in the globalised economy.
- Other long run factors that can determine the LR international competitiveness of a country would include quality of education, healthcare, and well established and efficient institutions and network systems in the economy.

Knowledge, Application, Understanding, Analysis		
<b>L1</b>	- Mere smattering of points without clear economic analysis. - Presence of conceptual errors.	<b>1 – 4</b>
<b>L2</b>	- Clear linkages are made between measures and how they manage the challenges brought about by the loss of competitiveness. - Answer could improve in scope and depth	<b>5 - 7</b>
<b>L3</b>	- Well-balanced answer with discussion of alternative measures	<b>8 - 10</b>
Evaluation		
<b>E1</b>	- An unexplained judgement	<b>1</b>
<b>E2</b>	- Evaluative assessment of the appropriateness of the policies	<b>2 - 3</b>
<b>E3</b>	- Substantiated judgement - Able to provide appropriate assumptions in executing judgement	<b>4 - 5</b>

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

9. (a) Explain the factors that will influence a government's decision to open up their economy to globalization. [10]

(b) Assess the measures adopted by the Singapore government to improve Singapore's global competitiveness. [15]  
[YJC 2017]

#### Suggested Answer for part (a)

- 1) Benefits of trade
  - Enjoy greater consumer welfare from importing products it may or may not have Comparative Advantage to produce.
    - If country has the comparative advantage in the production of one good, trade enables the consumers to enjoy a larger variety of products that they do not have comparative advantage to produce
  - Enable a small and open economy, such as Singapore, to maintain its export-competitiveness
    - Openness enables imports of cheaper raw materials which is crucial for small and open economies which lacks natural resources → maintain/reduce the cost of production → upward sloping AS curve to shift right → lower general price level → cheaper exports (this is a movement along AD, not a shift) → stimulating economic growth, reduce unemployment
- 2) Benefits of entry of both foreign labour and talents
  - Entry of foreign talent → improve the quality of the labour force → shift the productive capacity to the right → enables the country to move into high-tech, capital intensive manufacturing and services.
  - Entry of foreign labour → increase the pool of low-wage workers to employ → increase the quantity of the labour force → shift the whole AS to the right
  - Entry of foreign talents and labour → help economies cope with the challenges of aging population on labour forces, especially for countries with an ageing workforce and low fertility rates
- 3) Benefits of entry of foreign funds and FDI
  - FDI inflow → increase in investment → increase in AD → multiplier effect → increase in EG, fall in unemployment.
  - FDI inflows → transfer of skills and technology → improve labour productivity, total factor productivity → increase in QQT → increase in potential growth
  - Increase in AD and LRAS ensure sustainable economic growth

Accept also any explanation on costs influencing the government's decision

- The level of competitiveness in the economy in order for the benefits to outweigh the costs of globalisation
- the extent or frequency of shocks which can increase the country's vulnerability to these external factors
- performance of global economy e.g. when the world economy is facing a recession, there will be an adverse impact on a globalised and open economy

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

Level	Knowledge, Application, Understanding and Analysis	Marks
L3	At least 2 factors/ benefits of opening up are well-developed, explained and illustrated using real-world examples. Answers that provide more than 2 factors are able to score L3-9 to L3-10.	8-10
L2	An under-developed explanation (i.e. lacking examples, some gaps in the theory) Or A well-developed explanation but lacking scope (i.e. only 2 factors)	5-7
L1	Answer has many conceptual errors or is very brief	1-4

### Suggested Answer for part (b)

- 1) Supply-side policies<sup>[1][1]</sup><sub>SEP</sub>
  - reduction of income and corporate tax<sup>[1][1]</sup><sub>SEP</sub> → Increase in supply of labour & Investment to increase the productive capacity of the economy
  - reduction of corporate tax → firms will have more after tax profits which enable them to invest in R&D, resulting in dynamic efficiency → improve price and non-price competitiveness of exports (with better technology)
    - Limitation: falling govt tax revenue – limits expenditure on other areas e.g. welfare. But not a big problem for Singapore as the government can always draw from their reserves to spend or run a short-term budget deficit to support such supply-side policies
  - Enforcing strong Intellectual Property Right Law/ environment → increase confidence and willingness for firms to engage in R&D activities → attract skills & knowledge-based FDI to Singapore to carry out R&D, since innovative products & ideas can be patented & protected → help Singapore to develop new comparative advantage
    - Limitation: compliance and monitoring costs may be incurred → but for smaller geographical countries like Singapore, this enforcement may be more feasible as compared to larger countries
  - Subsidise education → new courses such as Information Technology, School of the Arts (SOTA) etc that specialise in niche areas to groom students so as to compete globally → develop new areas of comparative advantage to boost our export competitiveness
  - skills upgrading/training/re-training for those who are structurally unemployed → Government's SPUR Program in providing training & re-training → enable workers to be updated on latest developments and new skills → increase quality of labour → improves both price and non-price competitiveness of our exports, improves our attractiveness as an investment location for FDI
    - Limitation: strain on govt budget → in S'pore, a co-payment system between firms and govt is instead adopted → mitigates the drain on the fiscal resources. However, this is an important area for our long-term growth and Singapore government can always draw from our reserves or run short-term budget deficit to support skill upgrading
  - Immigration policy - openness to foreign talent → This will supplement our limited pool of aging population in terms of skilled labour → increasing our attractiveness to FDI
  - Immigration policy - Openness to Unskilled labour e.g. domestic maids & construction workers will help to lower wage rate of blue collar workers as well as supplement shortages in manual workers → help to reduce cost of production in Singapore
    - Limitation: may pose a strain on existing infrastructure as seen in the congestion situations in the public transport networks

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

#### 2) Free trade policy

- Free trade policy introduce greater foreign competition → Possible erosion of market power for domestic firms → incentivises firms to engage in both price and non-price competition → more competitive prices and better quality/variety of products → increase in consumers welfare
- FTA → Improve global competitiveness as price of exports will be more competitive since no tariff is imposed.
  - Limitation: vulnerable to external shocks when the economy is so open

#### 3) Exchange rate policy

- Maintaining export competitiveness using exchange rate policy → due to our import reliance, Singapore has been adopting a policy of gradual appreciation → manage the increase in cost of production
  - Limitation: an appreciation will hurt our export price competitiveness

### Conclusion:

- Supply-side policies take a long time to take effect; thus other policies like exchange rate policy or trade policy is needed to raise our competitiveness in the short run
- Comparison of measures e.g. pursuit of global competitiveness may entail trade-offs in the achievement of other economic goals if it is pursued predominantly through demand-management policies
- E.g. the pursuit of global competitiveness allows the achievement of economic growth and balance of payments surplus but may lead to greater income inequality and structural unemployment.
- Prioritising the importance of global competitiveness depending on the current economic situation e.g. the focus for an already competitive economy may be ensuring a lower income gap in its society through active redistribution policies

Level	Knowledge, Application, Understanding and Analysis	Marks
L3	Answer is well-developed and covers at least 2 policy measures [accept even if the 2 measures are within the same policy], with good use of SG examples	8-10
L2	An under-developed explanation (i.e. lack of depth/clarity in explanation, lacking use of examples)  Answers that do not address the questions but linked to the achievement of macroeconomic goals with strong AD/AS analysis – Cap L2-5.	5-7
L1	Answer with many conceptual errors or is very brief	1-4
<b>Evaluation</b>		
E3	Judgment on the relative effectiveness/appropriateness of the measures is well supported by clearly presented arguments with illustrations using examples.	4-5
E2	Judgment on the relative effectiveness/appropriateness of the measures is supported by at least 1 clearly presented argument and illustrated with an example.	2-3
E1	An unsupported judgement of the relative effectiveness/appropriateness of the measures	1

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

10. Globalisation often has influences on economic agents in an economy. Consumers, producers and government are affected by the increase in trade, labour and capital mobility from globalisation.

**Discuss whether globalisation will always be desirable to the different economic agents in an economy.**

**[25]**

**[IJC 2018]**

Command: Discuss

Content: Consequences of globalization

Context: General context but answers should be linked to different economic agents, government, consumers and producers.

Question requirement:

- 1) Effects of globalization
  - a. Increase in Trade
  - b. Increase in capital
  - c. Increase in labour
- 2) Considerations of the different economic agents
  - a. Government
  - b. Consumers
  - c. Producers
- 3) Desirability
  - a. Government: Achieving microeconomic (Efficiency, SOL, equity) or macroeconomic goals (Economic Growth, low inflation, low unemployment and satisfactory BOP).

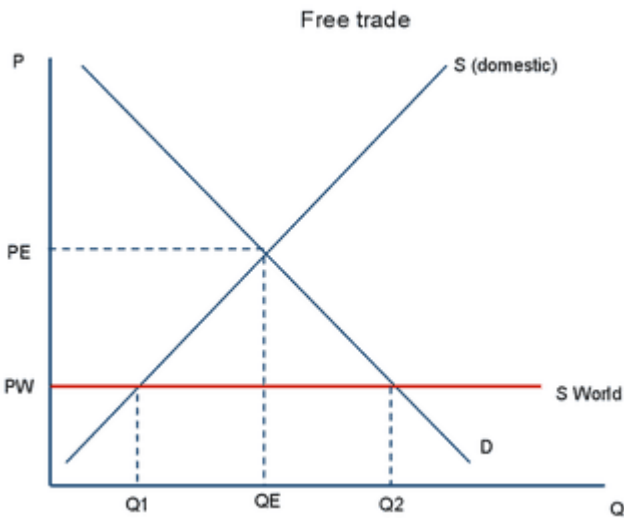
Organization of the answers:

Recommended organization: Either by the agents or by desirability and undesirability then infused the effects of globalization into the answer. Considerations of possibilities and likelihood of the effects occurring and application to the real world context would best answer the question. Given the open nature of the question and the limited time constraint, the priority of the answer should be on the differing agents. All answers should be directly addressing the effects of globalization and should not just briefly mention globalization.

Consequences of globalization	<p><b><u>Increase in Trade</u></b></p> <p>Globalization enhances connectivity between economies. With better communication technology, economies are able to import goods and services across different economies. E.g. Online shopping platforms like Amazon and Taobao facilitates the sales of goods and services between economies. Better transport technology also enable economies to trade at a lower cost. E.g. With better transport technology like more lightweight vehicle materials from cast iron and steel to magnesium aluminum alloys and carbon fibre constructions will allow for faster and more efficient transportation. Products could be transported at a faster rate and more products could be transported, therefore average cost of production is lower.</p>
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## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

<p>Government</p>	<p><b><u>Desirable only when economies have the comparative advantage in the production of goods and services.</u></b></p> <p>Increase demand for exports from better connectivity with different economies, higher demand for the goods and services. In addition, with lower transport costs, prices of exports can be lower, given that exports have many substitutes available from the international market, demand is price elastic. Quantity demanded will increase more than proportionately, where export revenue will increase.</p> <p>Links to the different Aims: Increase net export, increase AD, and increase actual economic growth. Improves trade balance in current account of BOP.</p> <p>***Countries without CA, would end up importing more goods and services. Fall in domestic consumption of goods and services if imported goods are close substitutes with high cross elasticities. They would experience a decrease in actual economic growth and a worsening of trade balance in current account of BOP.</p>
<p>Consumers</p>	<p><b><u>Desirable in the short run when consumers have access to the goods and services.</u></b></p>  <p>Prices of goods will be lower for the consumers from PE to PW while they enjoy a higher quantity of goods and services from Qe to Q2. The variety of goods and services enjoyed will also be higher since an economy opened to free trade from globalization can access the goods and services from different economies. E.g. Consumers in Korea do not just have access to automobiles like Kia and Hyundai but also automobile from Japan like Honda and Toyota. Consumer surplus also increased from with free trade.</p> <p>*** In the long run, the consumption of additional imports could mean a lower domestic consumption if they are substitutes, especially for larger economies that has their own domestically produced goods and services which are potential close substitutes to those in the world market. The fall in domestic consumption will reduce AD, resulting in a fall in RNY for</p>

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**Suggested Answers**

	the consumers who might have lesser purchasing power and therefore lowered ability to demand for more goods and services, decreasing SOL.
Producers	<p><b><u>Undesirable if the goods produced are substitutes to the trading partners.</u></b></p> <p>Close substitutes with <math>XED &gt; 1</math>, the demand for domestic goods will fall by more than proportionately resulting in a fall in total revenue for the producers.</p> <p>With globalization and more trade, price falls from PE to PW, quantity sold would fall from QE to Q1, producer surplus would also fall.</p> <p>*** If complements, the demand for the domestic goods might increase bringing about more revenue. E.g. if the company offers transport services, the imported goods and services would require delivery services provided by the domestic market enhancing the revenue. If the traded goods are factors of production that could be purchased at a lower price, this will bring about cost savings for producers, increasing their overall revenue.</p>
Consequences of globalization	<p><b><u>Increase in Capital</u></b></p> <p>Better information technology meant that investors would be better able to attain information about the different economies and therefore invest in the different countries based on the information. Furthermore, better information flow facilitates more accurate business plans and encourages FDI flow between economies. E.g. Facetime facilitates meetings across different economies.</p> <p>Better transport technology would allow the management team to travel between economies for more face to face administrative and management meetings.</p> <p>In addition, with more outsourcing and offshoring possible, there is greater segmentation of production processes, increasing capital flow between economies.</p> <p>*Outsourcing: Moving internal operations to a third party. Moving transactional activities to the experts to give an organization the capacity to focus on its expertise.</p> <p>*Offshoring: Primarily a geographic activity. Takes advantage of the cost differentials by relocating factories from costly countries to cheaper economies.</p>
Government	<p><b><u>Desirable only when economies complement with relevant regulations to ensure sustainability of the economy.</u></b></p> <p>Increase in long term capital inflow brings about an increase in AD leading to actual economic growth. Increase in quantity of capital leads to an increase in productive capacity of the economy, LRAS shifts to the right, economy enjoys potential economic growth.</p> <p>In addition, long term capital inflow leads to an improvement in the capital and financial account of BOP.</p> <p>However, with more foreign direct investments in the economy, especially in manufacturing sectors where there could be production of air pollutants or electronic wastes that could pollute the environment, it would lead to a lowering of the non-material standards of living in the economy. Despite enjoying the economic growth, the environmental degradation would stunt the growth rate in the long run due to the</p>

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

	<p>exponential depletion of the resources from excessive use and pollution, making growth unsustainable. E.g. In China where it is the world manufacturing factory, air pollution from carbon emission if energy production is an imminent problem where the government is recently implementing measures and regulation to reduce the pollution problem.</p> <p>***If the capital flows were able to enhance and develop more green technology transfer, it would be more desirable for the economy and growth would be more sustainable.</p>
Consumers	<p><b><u>Undesirable when the capital inflow brings about market dominance and not more competition in markets.</u></b></p> <p>For small economies where the capital inflows that are often huge MNCs, tend to dominate the economies. MNCs usually have larger production output and enjoys a higher economies of scale where the lowered AC enjoyed is able to be translated to lower prices when firms pass on their cost savings.</p> <p>Lower prices of the goods by MNCs, leads to a decrease in demand for domestic goods and services. In cases where they are close substitutes and <math>XED &gt; 1</math>, the decrease in demand would be at a greater extent and domestic firms might suffer a subnormal profit. When that persist in the long run and the domestic firms shut down, MNCs will dominate the domestic market. With market domination and lack of substitutes, MNCs will enjoy a more price inelastic demand where they would charge at a higher price in order to earn more revenue. The higher price charged and the lower output would be undesirable for consumers where they would have been exploited by the MNCs that are dominating the market.</p>
Producers	<p><b><u>Desirable only when producers are considering outsourcing or offshoring or when they are the ones expanding their market overseas.</u></b></p> <p>Capital mobility-&gt; better outsourcing-&gt; Enjoys a lower cost of production by expanding production processes in other economies. E.g. Assembly work that is more labour intensive was outsourced to countries like Taiwan, China for some electronics like smartphone. Especially for countries with higher labour cost, the outsourcing of this assembly process that is labour intensive would reduce the cost of production for the producers.</p> <p>Expansion of sales market overseas-&gt; e.g. Franchise-&gt; increase consumer market-&gt; Increase potential demand for the good-&gt; higher output-&gt; increase ability to enjoy economies of scale -&gt; e.g. technical economies of scale where production processes have been specialized and labours could increase productivity by focusing on one production process.</p>



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**Suggested Answers**

Consequences of globalization	<p><b><u>Increase in Labour</u></b></p> <p>Better information technology allows individuals to easily hunt for jobs in other economies. E.g. jobbatical and NPWorldwide works are job agencies that recruits globally and enables labour to be more mobile across different economies.</p> <p>Transport technology allows labors to be geographically mobile and able to travel easily across different regions. E.g. With more airlines that could fly further and faster enhances traveling experience and encourages more travelling and labour mobility. In fact, there are considerations for supersonic and hypersonic flight that could cut journey times by half.</p>
Government	<p><b><u>Undesirable if it brings about non- inclusive growth.</u></b></p> <p>Labour mobility</p> <p>Increase inflow of low skilled labour-&gt; increase supply of low skilled, low wage labour-&gt; decrease wages for low wage labour-&gt; widens income gap</p> <p>Increase inflow of high skilled labour-&gt; increase supply of high skilled, high wage labour-&gt; decrease income for high wage labour-&gt; reduce income gap</p> <p>*** Dependent on the economies preference for the labour and whether the foreign labour policy is targeting the higher or lower skilled labour</p> <p>Generally desirable when considering the inflation of the economy. Higher supply of labour-&gt; reduction in labour cost across all sectors of the economy-&gt; decrease unit COP-&gt; increase SRAS-&gt; reduce cost push inflation</p> <p>***Only if the economy is the one attracting labour, usually for developed economies, the labours from developing economies tend to flow towards developed economies in the hope to find jobs that offers a higher pay.</p>
Consumers	<p><b><u>Desirable if economy is labour intensive and prices of goods and services are lowered as a result of lowered cost.</u></b></p> <p>Increase in available labour supply-&gt; lowered wages-&gt; lowered cost of production for firms-&gt; pass on cost savings to consumers-&gt; lower prices and better accessibility to the goods and services.</p> <p>***If it's labour intensive and labour takes up a higher proportion of the total cost of the firms, the cost saving would be significant and the lowering of prices could happen.</p> <p>Or</p> <p>Increase in supply of labour-&gt; better able to engage the high skilled labours who can engage in product innovation and research-&gt; improvement in quality of the products or increase in the variety of goods and services available-&gt; higher satisfaction derived.</p>

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### Suggested Answers

Producers	<p><b><u>Desirable for producers in developed economies than developing economies.</u></b></p> <p>Increase in available labour supply-&gt; lowered wages-&gt; lowered cost of production for firms-&gt; Reduction in AC-&gt; Increase in total profit</p> <p>The reduction in cost would shift AC1 to AC2, together with MC, new market Qmax2 and new Pe2 brings about a higher supernormal profit.          ***If it's labour intensive and labour takes up a higher proportion of the total cost of the firms, the cost saving would be significant and the increase in profits would be significant</p>
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Level	Descriptors	Marks
3	<p>3: Expect a thorough knowledge of facts and theory with an excellent ability to describe and explain in a precise, logical and reasoned manner. Considerations of the different consequences of globalization and the different effects on government, consumers and producers should be explicitly explained. <u>New illustrations and examples</u> apposite to the materials discussed should be introduced as further evidence of the ability to recognize the <u>principles of the question</u> and their <u>application to relevant current situations</u>. Students should be able to criteria referenced the context where globalization could be desirable and when it might be undesirable.</p> <p>3: Expect a good knowledge of the facts and theory of the question, clear evidence of the ability to use the facts and theory with accurate reference to the question with a novel application. Answers could be a good mix of differing consequences on consumers, producers and government, anchoring on trade, labour and capital mobility with a balance discussion on the desirability.</p> <p>5: If students only mention 2 out of the 3 economic agents where analysis is well presented</p>	15- 20
2	<p>2: Evidence of an ability to identify the consequences of globalization on the different economic agent, some ability at graphs where relevant, fair ability to apply known laws to new situations where answers are more theoretical. The answer will be relevant to the question but the theory may be incompletely explained.</p>	9- 14

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	<p>2: Expect an accurate although undeveloped explanation of the facts relating to the question together with an explanation of the theory, and evidence of some ability to discriminate and form elementary judgements. BUT do not expect a clear logical presentation. There will not be much evidence of the ability to recognise unstated assumptions, nor to examine the implications of a hypothesis, nor the ability to organise ideas into a new unity.</p> <p>2: If students only mention 2 out of the 3 consequences where analysis is well presented.</p> <p>2: Well presented ONE SIDED argument.</p>	
1	<p>1: Answer shows some knowledge but does not indicate that the meaning of the question has been properly grasped, Basic errors of theory or an inadequate development of analysis may be evident.</p> <p>Low L1: Where answer is mostly irrelevant and only contains a few valid points made incidentally in an irrelevant context.</p> <p>Max 8: If only one agent has been explained but well balanced analysis with considerations of the different effects of globalization. / If only one consequence of globalization has been explained with considerations of the different economic agent.</p>	1- 8
E3	<p>answer that (so far as required by the question) builds on appropriate analysis to evaluate critically alternative theoretical explanations, contemporary issues, perspectives and policy choices, that recognises unstated assumptions and evaluates their relevance, and that synthesises economic arguments to arrive at well- reasoned judgements and decisions.</p>	4- 5
E2	<p>answer that makes some attempt at evaluation or a conclusion that answers the question but does not explain the judgement or base it on analysis.</p>	2- 3
E1	<p>answer that gives an unsupported evaluative statement(s).</p>	1

### **SECTION 3B: CHALLENGING QUESTIONS**

1. Singapore's pattern of trade with the world has changed significantly both in terms of the countries we trade with as well as the type and volume of goods and services we trade in.

Discuss the factors that have resulted in the changing pattern of trade of Singapore with the rest of the world.

[25]

[AJC 2016]

#### **Suggested Answer**

##### **Introduction**

Identify the changing pattern of trade of Singapore with the rest of the world

- Pattern of trade should be changing in terms of:
  - o The types of goods/services
    - Increasingly, services are taking up a larger percentage of total trade
    - Increase in exports of higher end manufactured goods
    - Top exports: Refined Oil, Electronic Equipment, Machines/Engines, Pharmaceuticals, Medical Equipment
    - Top imports: Electronic Equipment, Oil, Machinery, Gems and Precious metals, Vehicles
  - o The volume of goods and services
    - General increase in the volume of trade
  - o The import origins and export destinations
    - China experienced the greatest extent of increase in volume of services exported (rose by 10 times from 2000-2014)
      - From 4% (6<sup>th</sup>) of total exports to 12% (2<sup>nd</sup>)
    - USA was top export destination in 2000 (19%) but sixth in 2014 (4.8%)
    - Japan was top import origin in 2000 but sixth in 2014 (replaced by China who was 4<sup>th</sup> previously)
      - Top import from Japan was integrated circuits (22%) but in 2014, Japan's share of integrated circuits import was only 3.5%.
    - In 2000, Asian economies received 60% of exports from Singapore (North America- 20%, Europe- 16%) but in 2014, Asian economies received 74% of exports from Singapore (North America- 6.4%, Europe- 10%)

##### **Body**

<b>Factor 1 (Internal/Supply):</b> Government policies (signing of FTAs)	(there are more recent FTAs that have been agreed and signed but it is unlikely that these will account for the changing POT)  China-Singapore FTA signed in Jan 2009. Comprehensive Economic Cooperation Agreement (CECA) (FTA with India) signed in Jan 2005.  With more FTAs → removal of tariffs on Singapore exports (GCC: Tariff elimination on approximately 98% of Singapore's exports to the GCC → lowers the distortion of opportunity costs → allows firms to tap on Singapore's CA → this accounts for the increase in export volume with these regions (also accounts for the changing destination for our exports)
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**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

	<p>[More FTA → Trade creation between new trading partners  → Changing export destinations (USA was top export destination in 2000 but sixth in 2014)]</p> <p>Some countries have experienced major recessions in recent years (EU and US) that has affected Singapore (e.g. Singapore was the first Asian economy to suffer from the 2009 Global Financial Crisis) → there might be a deliberate action by the Singapore government to reduce its dependency or vulnerability to such external shocks by signing more FTAs with countries from other parts of the world → Changing export destinations (USA was top export destination in 2000 but sixth in 2014). However, it is impossible to decouple from the USA as her GDP is still the largest as percentage of World's GDP.</p> <p>Increase in the number of ASEAN members → increase in export destinations → increase in market size and hence demand for exports → account for the increase in trade volume with Asian economies (changes in export destination)</p>
<p><b>Factor 2</b>  <b>(External/Demand):</b> Different rates of growth experienced by different countries</p>	<p>China has experienced rapid economic growth. With rising income in China, Chinese citizens and firms will be demanding more imports as purchasing power increases, some of which are produced in Singapore. This contributes to an increase in export volume to China as well as an increase in total export volume.</p> <p>With rising income in China, this may also correspond with an increasingly consumerist culture (MPC increases) → higher income induced consumption.  Also, with China being more open, her MPM increases as well → contributes to an increase in X from Singapore</p> <p>Relative to China, other countries have grown at a slower rate and hence contributed to their decrease in share of total exports → total X has continued to increase but China is rising to become one of the top trading partners</p>
<p><b>Factor 3 (External/supply):</b>  Foreign governments changing the structure of their economy (e.g. rise of China as a manufacturing powerhouse)</p>	<p>Other neighbouring economies are increasingly producing higher quality goods and services and moving along the value chain → China is increasingly developing new areas of CA (low-end manufactured goods → high-end manufactured goods and capital machineries) → as Singapore economy does not have to import low-end capital goods from North America or Japan → decrease in % of M from Japan/NA and increase % of M from China</p>
<p><b>Factor 4 (Internal/Supply):</b>  Changing domestic CA (link to changing domestic factor endowments) → changing opp</p>	<p>Government policy to invest in education (encourage different specialisations at university, especially science and engineering courses) → labour becomes more skilled → increases the opportunity cost of dedicating labour to low skilled jobs → CA in Singapore changes from production of</p>

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<p>costs → changing areas of specialisation)</p>	<p>low-end manufactured goods to high end manufactured goods and capital goods → results in changing types of exports/imports</p> <p>[e.g. In 1980s, CA was in low end manufactured goods (textiles) due to the relatively higher opportunity cost in producing high end goods as compared to developed countries → Singapore largely exported textiles and imported high end manufactured goods (usually from the West). However, as Singapore upgraded the skills of the labour force → opportunity cost in producing high end goods became relatively lower → Singapore started importing textiles (from emerging/developing economies) instead and exported these high end manufactured goods]</p> <p>Government policy to develop more factor endowment (SS-side policy to develop infrastructure such as biopolis and Jurong Island) → shifting from providing engineering services to bio-pharmaceutical sector/ petrochemical industry → results in changing CA as Singapore now enjoys a lower opportunity cost of producing goods and services in these industries → pharmaceutical/petrochemical products as % of X increases</p>
<p><b>Factor 5 (Internal/Demand):</b> Changing tastes and preferences</p>	<p>Increasing intra-industry trade: More variety required</p> <p>Increase in ease of access to foreign markets online that caters to varied tastes and preferences: Chinese retailers on Taobao as opposed to retailers on established online e-commerce platforms i.e. ebay and amazon → increases in volume of imports as well as the variety of import</p>
<p>Students can also mention other factors such as:</p> <ul style="list-style-type: none"> <li>- changing transportation costs</li> <li>- changing exchange rates</li> </ul> <p>Any other factors are acceptable as long as it is linked to a stated change in the pattern of trade of Singapore with the rest of the world.</p>	

### Conclusion + Evaluation

Students can evaluate by explaining what is the most important factor attributing to the changing pattern of trade of Singapore with the rest of the world.

Time Period: In the SR, may be taste and preferences as government policies to change CA and negotiate FTAs have a long time lag.

Situation: Singapore's heavy reliance on trade means that the government has a major role to play in international trade and ensuring the relevance of Singapore exports to the global economy. Hence, government intervention may be the most significant factor.

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**Mark Scheme:**

<b>Knowledge, Application, Understanding and Analysis</b>		
<b>L3</b>	For a thorough and well-elaborated answer that shows a range of factors that may have accounted for the changes in the patterns of trade experienced by the Singapore economy. There is good application to the Singapore economy and precise identification of significant changes to the patterns of trade, in view of external and internal factors.	<b>15 – 20</b>
<b>L2</b>	For an undeveloped answer that shows some understanding of a few factors that may have accounted for the changes in the patterns of trade experienced by the Singapore economy.	<b>9 – 14</b>
<b>L1</b>	For an answer that does not address the question requirement and did not account for the changes in the patterns of trade of Singapore. The answer is largely descriptive and lacks a clear structure.	<b>1 – 8</b>

<b>Level</b>	<b>Evaluation</b>	<b>Marks</b>
E3	For an answer that builds on <b>appropriate</b> analysis to evaluate critically alternative theoretical explanations, contemporary issues, perspectives and policy choices, that <b>recognises unstated assumptions</b> and evaluates their relevance, and that <b>synthesises economic arguments</b> to arrive at <b>well – reasoned judgements</b> and decisions.	4 – 5
E2	For an answer that makes <b>some</b> attempt at evaluation or a <b>conclusion that answers the question</b> but does <b>not explain the judgement</b> or base it on analysis.	2 – 3
E1	For an answer that gives an <b>unsupported</b> evaluative statement(s)	1

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

2. Traditional trade theory explains that differences in relative opportunity cost result in countries specialising and trading according to their comparative advantages. In recent years countries are also increasingly trading in goods within the same industry, and at the same time experiencing the phenomenon of off-shoring, where firms have relocated parts of their production process overseas.

(a) Explain how Singapore has benefitted from opening its door to trade and capital flows.

[10]

(b) To what extent are recent changes in global trade and capital flows attributed to differences in opportunity cost?

[15]

[RI 2014]

### Suggested Answer for part (a)

#### Introduction:

- Clarify the meaning of “opening its doors to trade and capital flows”
  - Singapore adopting a pro-trade stance with no barriers to trade as reflected in its total trade value (X+M) being about 3xGDP
  - Singapore being open to capital flows with minimal restrictions to capital flows both in terms of FDI and hot \$ flows
  - Benefits can be assessed in terms of attainment of macroeconomic and microeconomic goals. Singapore has adopted an open approach to trade and capital flows in view of it being a small economy, lacking in natural resources, with a small domestic market and a price and interest taker in the global commodity and financial market.

#### Body:

- Explain the benefits for Singapore in terms of increase in trade flows

#### 1) Increase in X revenue via FTAs

- Define FTA: Legally binding agreement between two or more countries that seeks to reduce or eliminate trade barriers.
- Explain that Singapore has pursued an openness to trade with its signing of FTAs (both bilateral and multi-lateral) which has enabled Singapore it to expand its exports markets.
- With the lowering of trade barriers against Singapore's X, Singapore is able to leverage and trade according to its comparative advantage and increase both its export volume and value, overcoming its constraints of a small domestic market.
- Increase in X value → Increase AD → more than proportionate increase in NY (briefly explain the k effect) → increase real GDP → increase real national output → increase utilisation of existing resources → actual growth (Illustrate with rightward shift of AD curve)
- With firms increasing production → increase demand for labour, with labour being a derived demand → increase employment.
- Increase in X revenue improves current account of BOP (ceteris paribus)



## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

#### 2) Increase in M expenditure

- By being open to trade, Singapore has also benefited from its ability to M essential raw materials and food stuff more cheaply than resorting to produce such goods herself where the opportunity cost of doing so would be high given its lack of natural resources.
- Lower prices on imported inputs → lower COP → Increase SRAS → Increase actual growth, lower GPL, dampening cost-push inflation. (Illustrate with downward shift of SRAS curve)
- Lower COP also increases Singapore's X price competitiveness, assuming  $PED_x > 1$  → Increase in X revenue and similar effects on raising AD, actual growth and employment.
- By being open to trade, competition from foreign M lowers barriers to entry and forces firm to be cost-efficient and adopt product and process innovation → movement towards productive and dynamic efficiency,

Overall effect of increase in both export revenue and import expenditure has been an improvement of Singapore's BOT and current account of BOP. This is due to Singapore's high M content of exports. Cheaper imported inputs has largely been beneficial in promoting exports growth.

- Explain the benefits for Singapore in terms of increase in capital flows in the form of FDI (Students may also consider the effects of hot \$ inflow)

- Inward investment via FDI → increase in I component of AD → similar effects on raising AD, actual growth and employment.
- Increase in FDI → helps to build up capital stock and deepen Singapore's capital intensity. This has been particularly beneficial in accelerating Singapore's industrialisation process. Increases economy's productive capacity and increases potential growth. (Illustrate with rightward shift of LRAS curve)
- Increase in FDI → demonstration and competition effect → encourages innovation, R&D → increases potential growth.
- FDI inflows improves capital account in SR, ceteris paribus improves overall BOP.

Conclusion: Singapore has largely benefited from its openness to both trade and capital flows. This has been aided by the government's conducive economic policies to support and promote trade and FDI.

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

<b>Knowledge, Application, Understanding and Analysis</b>		<b>Marks</b>
<b>L3</b>	<ul style="list-style-type: none"> <li>✓ Excellent ability to apply to the given context of Singapore</li> <li>✓ Clear grasp of the important issues involved and the context (small open economy implications)</li> <li>✓ Good scope to answer (at least 3 points covering the benefits of both trade and capital flows)</li> <li>✓ Clear reasoned structure to whole analysis</li> <li>✓ Rigour in economic analysis               <ul style="list-style-type: none"> <li>○ Provides definition(s) to key terms in preamble/question</li> <li>○ Effective use of analytical economic framework (with diagrams)</li> <li>○ Examples used are explained</li> <li>○ Did not address issue of “opening doors to trade and capital flows” : Max 9</li> <li>○ Did not address M/ no CA theory: Max 7</li> </ul> </li> </ul>	<b>8 – 10</b>
<b>L2</b>	<ul style="list-style-type: none"> <li>✓ Answer shows an ability to identify facts, some ability at graphical illustration, fair ability to apply AD-AS analysis or relevant economic theory to explain the effects of trade or capital flows on the macroeconomic and/or microeconomic objectives.</li> <li>✓ Accurate though undeveloped explanation of the benefits of being open to trade/capital flows on the macroeconomic and/or microeconomic objectives.</li> <li>✓ No/Weak application to Singapore economy context</li> </ul>	<b>5 – 7</b>
<b>L1</b>	<ul style="list-style-type: none"> <li>✓ Weak and incomplete understanding of the question and context:</li> <li>- <b>Mainly</b> irrelevancies OR substantial glaring conceptual errors</li> <li>- Does not go beyond listing</li> </ul>	<b>1 – 4</b>

**Suggested Answer for part (b)**

Introduction:

Clarify the meaning of “recent changes in global trade and capital flows”.

- Increase in trade flows with reference to the rise of intra-industry trade.
- Increase in inward FDI with the trend towards off-shoring

State that differences in opportunity cost results in countries trading according to their comparative advantage.

- State the theory of comparative advantage.

Body

**Thesis: Recent changes in trade and capital flows can be attributed to the differences in opportunity cost as explained by the theory of comparative advantage.**

- ❖ Using the theory of comparative advantage, explain how opportunity costs differences between countries account for the rise in intra industry trade in a specific context.

- For trade in goods at different stages of production within the same industry.

Eg. China’s intra-industry trade in electronics.

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

China's has a relative factor abundance in low cost, low skilled labour and land, it is able to assemble and produce finished consumer electronics targeted at the mass market at a lower opportunity cost than a country like the South Korea, i.e China forgoes relatively lower amounts of other goods that would have been sacrificed to produce finished consumer electronic products. Eg. Household appliances, iPhone etc.

South Korea has a relative factor abundance in high cost but high skilled labour, higher degree of capital intensity, it is able to produce high-end electronic components at a lower opportunity cost than a country like China.

According to the theory of comparative advantage, China has CA in producing mass market finished consumer electronic products, it specializes in producing and exports such goods to countries like South Korea.

For the case of South Korea, it has a CA in producing high-end electronic components, it specializes in producing and exports such intermediate goods to countries like China.

Thus, the theory of comparative advantage and the differences in opportunity costs in production between countries explains the phenomenon of intra-industry trade.

- ❖ Explain how differences in opportunity cost also accounts for the phenomenon of off-shoring where firms relocate part of their production process overseas.
- Explain the rationale for off-shoring: firms seek to reduce COP and focus on core business. For a global MNC, it can seek to relocate part of its production process away from its home country to other countries where the cost of production is lower.

Eg. Global MNCs has taken advantage of the low cost labour and abundant land in countries like China to off-shore its manufacturing and assembly facilities. This has resulted in greater flows of FDI to China and also promoted the exports of goods such as finished consumer electronics which is in line with the theory of CA due to the differences in opportunity costs as explained earlier → more cost efficient to specialise and engage in such production activities.

Eg. Global MNCs has taken advantage of the low cost, abundant higher skilled labour in countries like India to off-shore its IT operations. Eg. global firms like HP IBM, Intel, AMD, Microsoft, Oracle Corporation and Cisco have off-shored their IT services. This is in line with the theory of CA. India with its relative abundant skilled labour would have a lower opportunity cost in providing IT related services → more cost efficient to specialise and engage in such activities

### **Anti-Thesis: Other factors can also account for the recent changes in trade and capital flows.**

- For trade in goods at same stage of production within the same industry.
- Demand side factors: Changes income, taste and preferences.

With the rapid growth and development of emerging economies like China, rising affluence has spurred greater intra-industry trade. Eg. Chinese consumers with their rising disposable income have a new found appetite and ability to afford better quality branded imported goods like apparel, bags and cars. Although China do manufacture and exports such categories of goods, it also imports them at the same time, resulting in a greater product variety for the domestic market.

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

In the agriculture industry, India, traditionally an exporter of corn is in the process of moving towards a net importer of feed grains due to the greater demand for poultry with India's changing taste and preference for meat.

➤ For FDI flows due to off-shoring

- Ability to respond to more quickly to changing local demand  
Global MNCs may value proximity to the local market. They want to be in, or close to markets where the consumer base is large, making customised products and responding quickly to changing local demand.  
Eg. Bombardier, a Canadian maker of airplanes and trains, used to focus on cost savings made by off-shoring jobs abroad; now Bombardier is in China for the large Chinese market. Lenovo, which has its own factories in China is moving some production to America so it will be able to customise its computers for U.S consumers and respond quickly to them.

➤ For trade and FDI flows due to off-shoring

- Diversification argument  
To reduce the vulnerability to economic shocks stemming from a too narrow a specialization, countries have increasingly sought to diversify their economy by pursuing industrial policies to also develop the sectors for exports which they traditionally have been a net importer.
- Role of FTAs: With the signing of FTAs, along with the lowering of trade barriers, the easing of investment rules has facilitated the shifting of production facilities overseas between the partner countries, eg. From U.S to Mexico with NAFTA → promotes off-shoring
- Economies of scale to produce a specific good within the broad product category. Intra-industry trade allows countries to specialise in a limited variety of production and thus reap the advantages of increasing returns (i.e., economies of scale), but without reducing the variety of goods available for consumption.
- (Optional: Seasonal variations impacting demand/supply conditions  
Eg. Broccoli imported to U.S from Mexico in the winter and exported from U.S to Mexico in the summer. )

Reasoned conclusion:

- For goods within the same industry but at different stages of production, intra-industry trade can be better explained due to the differences in opportunity cost and hence comparative advantage.
- For goods within the same industry but at the same stage of production, the effect of opportunity cost and comparative advantage differences become less important as a determinant of intra-industry trade and off-shoring.

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

<b>Level</b>	<b>Knowledge, Application, Understanding and Analysis</b>	<b>Marks</b>
L3	<p>Good use of appropriate framework/concepts in analysis</p> <ul style="list-style-type: none"> <li>▪ Sound application of theory of comparative advantage</li> </ul> <p>In-depth discussion of question</p> <ul style="list-style-type: none"> <li>▪ Appropriate scope, well-structured thesis and antithesis</li> </ul> <p>Good depth of analysis</p> <ul style="list-style-type: none"> <li>▪ Good application using appropriate contextual egs to illustrate intra-industry trade and off-shoring</li> </ul>	8-10
L2	<p>Use of appropriate framework/concepts in analysis</p> <ul style="list-style-type: none"> <li>- Some ability to apply the theory of comparative advantage and other relevant concepts with appropriate examples.</li> </ul> <p>Sufficient scope of coverage</p> <ul style="list-style-type: none"> <li>- Thesis and anti-thesis structure <ul style="list-style-type: none"> <li>- Max 7m if only discussed reasons for trade flows/capital flows</li> <li>- Max 6 if only covers inter-industry trade no/weak off-shoring explanation but good attempt at explaining CA theory.</li> </ul> </li> </ul> <p>Lacks consistent rigour in analysis</p> <p>Some errors in analysis</p>	5-7
L1	<ul style="list-style-type: none"> <li>• A demonstration of the inability to interpret or grasp the requirements of the question eg. Irrelevant answers that does not address the issue of intra-industry trade correctly</li> <li>• Lacks use of economic framework/concepts in analysis</li> <li>• Lacks scope of coverage - one sided answer (Max 5)</li> </ul> <p>Glaring conceptual errors</p>	1-4
<b>Evaluation</b>		
E3	Evaluative comments are well explained and is supported by economic analysis	4-5
E2	Some explanation of evaluative comments or inaccurate at times	2-3
E1	For an unexplained assessment, or one that is not supported by analysis.	1

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

3. In recent years, greater globalisation and rapid technological change have inevitably caused the unemployment rate to rise in Singapore.

Discuss the extent to which the Singapore government's approach to international trade may need to be adjusted in response to the rise in unemployment.

[25]  
[RVHS 2016]

### Suggested Answer

#### Introduction

- Define globalisation -- closer integration of economies and peoples of the world through the ease of movement of goods and services, capital and labour
- Government's approach to international trade is still largely appropriate and thus only needs to be adjusted to a small extent

#### Body

(A) Explain how greater globalisation and rapid technological change cause unemployment to rise in Spore

(I) Explain how globalisation leads to increase in cyclical unemployment

- In recent months, weak economic growth in Singapore's key export markets has directly affected the demand for our exports.
- Coupled with uncertain global outlook, this decline in external demand will likely translate to a fall in export revenue (X), causing aggregate demand (AD) to fall. This leads to a multiple fall in national income (NY) and in turn affects employment in export-related sectors.
- Make reference to AD-AS diagram

(II) Explain how globalisation leads to increase in structural unemployment

- Globalisation has also made it much easier for MNCs to outsource and relocate, as well as technologies in their work processes.
- As MNCs relocate out of Spore, this has resulted in a 'skills gap' i.e. workers who have lost their jobs due to economic restructuring or relocation of firms end up structurally unemployed because they lack the relevant skills to take on new jobs.
- No Diagram needed for this point

(III) Explain how rapid technological change leads to increase in structural unemployment

- Advancements in technology have also transformed the way in which goods are produced in recent years, consequently causing structural unemployment to rise too.
- While improvements in technology may generate new jobs, it has also led to a rise in structural unemployment because many retrenched workers lack the expertise and experience to fill such positions.
- Looking ahead, structural unemployment may rise further as the use of robots become more widespread, unless older workers acquire new skills to take on available jobs

(B) Explain how current approach to international trade is largely appropriate despite rise in unemployment

- Spore's approach to trade revolves around: staying open to global economy and maintaining global competitiveness. As such, policies are tailored around this approach.

(I) Trade policies

## **Chapters 10-12: Globalisation and the International Economy**

### **Suggested Answers**

- Focus on helping Singapore diversify her trade partners and forge new trade links → E.g. signing of free trade agreements and broadening export markets
- As a result, this helps Spore achieve EOS and diversify export markets during global shocks

#### **(II) SS side policies**

- Focus on keeping exports competitive → Govt embark on aggressive measures to raise the productivity of domestic firms and labour force e.g. Productivity and Innovation Credit (PIC) scheme
- Helps firms think of ways to raise productivity
- Other measures include Workfare Training Support Scheme (WTS) encourages Singaporean workers to attend training + Recent SkillsFuture Credit scheme

#### **(III) Exchange rate policy**

- Ensures export competitiveness and helps provide conducive environment for FDIs
- Keep Singdollar on gradually appreciating stance given high import content in Singapore's exports.
- Price stability ensures export competitiveness and attracts FDIs, which hopefully help generate jobs for domestic firms and workers.

#### **(C) Explain how current approach to international trade may need to be adjusted in response to a rise in unemployment**

- Globalisation and technological change is welcomed rather than avoided, despite its potential disruptive effects on industries and workers. Although this approach has yielded gains thus far, looking forward, minor adjustments can be made to better leverage on potential growth areas while minimizing the negative effects.
- Students can give any of the following or what is economically sound, some e.g. include:
  - Raise the capabilities of domestic small medium enterprises (SMEs)
  - Help domestic SMEs internationalize
  - Govt to identify new areas of comparative advantage to make us more resilient to global shocks
  - More comprehensive skills training programmes to increase workers employability
  - Provide more social safety nets
  - Establish more trade links with regional economies

#### **Conclusion: Synthesis**

- Spore's approach to trade will unlikely change drastically unless out nature changes drastically too
- Govt can have complementary measures to mitigate the harm, but they are nonetheless still taken in the right direction
- Cannot avoid globalization and tech change because these will ultimately yield more benefits than costs

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

**Suggested Mark Scheme**

<b>Knowledge, Understanding, Application &amp; Analysis</b>		
<b>L3</b>	<b>Upper 18-20</b>	Developed discussion of why current approach need/ need not be adjusted in view of rise in unemployment <b>‘Developed’</b> <ul style="list-style-type: none"> <li>- Appropriate links between greater globalisation &amp; tech change on structural &amp; cyclical unemployment</li> <li>- Good reference to Spore context/ nature</li> <li>- Relevant policies in line with approach to trade are chosen with explicit links to how they are suited for Spore</li> <li>- Adjustments are proposed after careful consideration of what is lacking currently</li> </ul>
	<b>Lower 15-17</b>	Developed discussion of why current approach need/ need not be adjusted in view of rise in unemployment; however, the adjustments are not explained in sufficient clarity/ depth
<b>L2</b>	<b>Upper 12-14</b>	Undeveloped discussion of why current approach need/ need not be adjusted in view of rise in unemployment OR Developed explanation of <u>2</u> of the following: <ul style="list-style-type: none"> <li>- how unemployment may rise due to globalisation and technological change</li> <li>- policies adopted in line with Spore’s approach to international trade</li> <li>- Suggestions for adjustments to approach</li> </ul>
	<b>Lower 9-11</b>	Undeveloped explanation of <u>2</u> of the following: <ul style="list-style-type: none"> <li>- how unemployment may rise due to globalisation and technological change</li> <li>- policies adopted in line with Spore’s approach to international trade</li> <li>- Suggestions for adjustments to approach</li> </ul>
<b>L1</b>	<b>Upper 5-8</b>	Undeveloped explanation of: <ul style="list-style-type: none"> <li>- how unemployment may rise due to globalisation and technological change</li> <li>- policies adopted in line with Spore’s approach to international trade</li> </ul> <b>‘Undeveloped’</b> <ul style="list-style-type: none"> <li>- Limited application to Spore context + explanation of policies lacks economic analysis and link</li> </ul>
	<b>Lower 1-4</b>	Smattering of valid points

<b>Evaluation</b>		
<b>E3</b>	Able to form a well-reasoned judgment that synthesises issue using economic analysis after looking at both sides. For e.g., students are able to project into the future; recognise that the degree of unemployment differs across industries; weigh the pros & cons of current policies before suggesting adjustments to be made	<b>4 - 5</b>
<b>E2</b>	Some attempt to sum up the points put forth, but does not go beyond this. Does not explain the judgement or base it on economic analysis.	<b>2-3</b>
<b>E1</b>	Comments are generic and superficially stated rather than substantiated with sound judgment	<b>1</b>



## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

4. Discuss how far the conflicts in government macroeconomic objectives depend on the openness of the economy. [25]  
[MI 2017]

Applying the 3Cs:

Command = 'Discuss' → Need 2-sided answer and an evaluative conclusion

Content = the extent to which the conflicts in government macroeconomic objectives depend on the openness of the economy (Thesis: conflict depends on openness. Anti-thesis: conflict does not depend on openness.)

Context = any economy

### **Suggested Answer**

- Government usually has the following macroeconomic policy objectives:
  - Low inflation (price stability)
  - Full employment or low unemployment
  - Sustainable economic growth
  - Favourable Balance of payments position
- Define open economy: free movement of exports, imports, and capital flows (e.g. Singapore)

### **Thesis: Tradeoff between inflation and economic growth/employment rates when government uses contractionary MP is affected by the extent to which economy is open**

Contractionary monetary policy (achieve low inflation).

Tradeoff: Economic growth may slow

- Decrease in money supply will increase interest rates → increased cost of borrowing → decreases C and I → AD decreases, price level decreases → low inflation
- however, as AD decreases, rate of economic growth falls

Effect of open economy:

- Contractionary monetary policy may cause larger tradeoffs in an open economy
- Increased interest rates in an open economy → increased capital inflow (hot money) → exchange rate appreciates
- As exchange rate appreciates, exports become less competitive and imports increase → more unemployment in export sector, BOP worsens, AD decreases even further → further fall in NY
- Greater extent of conflict in aims

Note: accept the converse where the trade-off is explained in terms of foregoing low inflation to pursue economic growth

### **Thesis: Tradeoff between inflation and economic growth/employment rates when government uses depreciation is affected by the extent to which economy is open**

Small and open economy may choose to adopt exchange rate policy to stimulate growth.

Tradeoff: between economic growth and cost-push inflation

- Depreciation → prices of exports in foreign currency will fall while prices of imports in domestic currency will rise.  $Q_x$  rises and  $Q_m$  falls. Assuming M-L condition, net exports rise.
- Rise to AD which leads to actual growth and falls in unemployment.
- However, the depreciation of the currency results in imported inflation, which is cost-push inflation

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

#### Effect of open economy

- Exchange rate policy will cause larger trade-off in an open economy which may import significant imported raw materials for the production → cost-push inflation → GPL rises → affect the export competitiveness.
- Greater extent of conflict in aims

#### **Thesis: Tradeoff between growth and unemployment when government uses ss-side policy is affected by the extent to which economy is open**

#### Supply side policies to increase economic growth by increasing AS

- Tradeoff: Structural Unemployment may increase
- May loosen labor migration/capital flow to increase productivity (i.e., market oriented ss-side policy) → increase AS → increase long run rate of economic growth
- However, may lead to higher structural unemployment if restructuring occurs too quickly (unskilled workers are laid off)

#### Effect of open economy

- The greater the openness of the economy, the structural unemployment might be more serious as the free-flow of labour and capital would replace domestic labour at a faster rate
- Greater extent of conflict in aims

#### **Anti-thesis: Explain at least two factors other than degree of openness that affect the trade-offs.**

The extent of the trade-off between economic growth and inflation also depends on other factors other than the openness → **state of the economy, type of government spending, government budget**

- Trade-off may be lower if the economy is in the midst of a severe recession and AD is currently low.
- Lots of spare capacity → can accommodate expansionary FP without adding to inflationary pressures.
- May also be temporarily if the government employs fiscal policies with supply-side effects such as infrastructure.
- Government budget – if there is budget deficit, the government may need to cut down on spending, leading to fall in AD and NY. However, the spending may have been on infrastructure, so potential growth is traded off. Conflict of low inflation and sustained economic growth.

#### **Conclusion:**

While the degree of openness definitely affects the extent of the trade-off in macroeconomic objectives, the extent to which it does so is dependent on the context of the country in question. For example, if the context is a developing that has abundant spare capacity such that it is not plausible for it to reach full employment, the state of the economy would be insignificant as an alternative factor since the economy would not reach full employment any time soon any way. In that case, the extent of conflicts in macroeconomic objectives would be largely dependent on the openness of the economy.

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

**Mark Scheme:**

Level	Knowledge, Application, Understanding and Analysis
L3 (15-20)	Complete and well-elaborated explanation of how policies work to achieve certain macroeconomic goals, the conflict that arises, and how the extent of the conflicts depends on the openness of the economy. This is done for at least 2 policies. Well-developed explanation of how other factors other than the openness will lead to conflicts of the macroeconomic goals.
L2 (9-14)	<p>Underdeveloped explanation of how policies work to achieve certain macroeconomic goals, the conflict that arises, and how the extent of the conflicts depends on the openness of the economy. Underdeveloped explanation of how other factors other than the openness will lead to conflicts of the macroeconomic goals.</p> <p>Complete and well-elaborated explanation of how policies work to achieve certain macroeconomic goals, the conflict that arises, and how the extent of the conflicts depends on the openness of the economy. This is done for at least 2 policies. No mention of other factors that affect extent of the conflict. Maximum – 14m</p> <p>Well elaborated answer that shows how conflicts in aims can happen and how the extent of the conflict depends on other factors (e.g., state of economy) – max 12m</p>
L1 (1-8)	<p>Descriptive answer that is poor or lack economic analysis.</p> <p>Answer is largely out of point or has serious conceptual errors.</p>
<b>Evaluation</b>	
E3 (4 – 5)	For an answer that builds on <b>appropriate</b> analysis to evaluate critically alternative theoretical explanations, contemporary issues, perspectives and policy choices, that <b>recognises unstated assumptions</b> and evaluates their relevance, and that <b>synthesises economic arguments</b> to arrive at <b>well – reasoned judgements</b> and decisions.
E2 (2 – 3)	For an answer that makes <b>some</b> attempt at evaluation or a <b>conclusion that answers the question</b> but does <b>not explain the judgement</b> or base it on analysis.
E1 (1)	For an answer that gives an <b>unsupported</b> evaluative statement(s)

## **Chapters 10-12: Globalisation and the International Economy**

### **Suggested Answers**

5. While some countries are increasingly engaging in establishing free trade agreements to promote trade and capital flows, others seem to view free trade agreements with scepticism.

**Discuss the factors that influence the different stands governments of different countries may have towards free trade agreements.**

[25]

[NJC 2017]

### **Suggested Answer**

#### **Introduction:**

- A free trade agreement seeks to lower both non-tariff and tariff barriers to trade.
- The different stands made by different governments will depend on the relative benefits and costs of signing FTA to the two countries due to changes in trade, capital and labour flow.
- The changing trade pattern and whether it is beneficial for a country to promote free trade will depend on the possible constraints faced by individual economies such as:
  - Nature of the economy (i.e. size of the economy)
  - Openness of the economy
  - Current stage of development of the country
  - Current state of the economy
  - The available measures to address the unintended consequences brought about by the FTA

#### **Impact of trade flow on:**

##### **Actual and potential economic growth**

- By signing FTA, there will be lower non-tariff trade barrier to allow a country to export their products to the member countries, increasing their export market size.
- The increase in the size of the export market will increase the demand for a country's exports. This will lead to an increase in price and quantity of exported goods resulting in an increase in export revenue.
- Assuming that import expenditure remained constant, the increase in export revenue will lead to an increase in net export revenue.
- The increase in net export revenue will lead to an increase in AD and hence an increase in real national income.

##### **Unemployment**

- With increasing competition from firms in member countries, firms in the economy may suffer a fall in market share. This will lead to a fall in AR and MR of the firms in the domestic economy.
- With a fall in the production by firms in the economy, there will be a decrease in the demand for labour in the economy, resulting in higher levels of unemployment.
- For workers who are not able to transit from one job to another due to the lack of skills, there will be an increase in structural unemployment.

##### **Price Stability**

- If the economy is near the full employment level, the firms will not be able increase the production due to the limited resources available in the economy. Therefore, firms will have to bid up the prices in order to clear the shortage in the economy. This may also lead to an increase in demand pull inflation.
- However, with greater access to cheaper imports, the economy may be able to enjoy a lower cost of production if the imported goods are raw material.
- This decrease in cost of production will lead to an increase in SRAS, leading to a fall in cost-push inflation.

## **Chapters 10-12: Globalisation and the International Economy**

### **Suggested Answers**

#### **Standard of living**

- If there is an increase in real national income, consumers will be able to purchase more goods and services and enjoy a greater variety of goods.
- Therefore, there will be an increase in the material standard of living.

#### **Equity**

- As firms in the expanding industries increase in size, there will be an increase in the demand for labour. The increase in the demand for labour in the expanding industries will lead to an upward pressure on the wage level of the worker in the industries.
- However, the industries that suffer a loss in comparative advantage will begin to decline and hence the demand for labour in these declining or sunset industries will fall. This will lead to a fall in the wage of the workers in these industries.

#### **Factors affecting the benefit and costs of increased trade flow:**

##### **1. Size of economy**

- The size of the economy may influence the country's dependency on trade for actual economic growth. A small country like Singapore will most likely benefit more from the signing of FTA due to size of the economy.
- The signing of FTA will also benefit a small country like Singapore more because the firms will be able to reap higher internal economies of scale as compared to a large country. Therefore, large countries such as USA may view FTA with scepticism.

##### **2. Openness of the economy**

- The openness of the economy will also determine whether there will be a net increase or decrease in net export due to the increase in trade flow.
- Countries such as United States are highly dependent on imported products. The increase in trade flow will allow more Americans to purchase more imports. The increase in demand for imports will cause the net export to fall, resulting in a decrease in AD and a worsening of the balance of trade.
- At the same time, economies that require the import of raw material from trading partners will stand to gain more. Countries such as Singapore will have to remain open due to the lack of natural resources. Singapore needs the import of raw material in order to produce the exported goods. Therefore, Singapore will find the free trade agreement beneficial.

##### **3. Current state of the economy**

- The current unemployment level and economic growth will determine the likelihood of demand-pull inflation.

##### **4. Current stage of development of the economy**

- If the economy has trade barriers to maintain an artificial comparative advantage, the signing of the FTA will cause the economy to lose its comparative advantage to other countries.
- The loss of the comparative advantage will mean that the economy will stop or reduce the specialisation and export of the product, leading to a fall in export demand of the economy. This will result in a fall in AD and hence a fall in the actual economic growth.
- At the same time, a developing country will also have a weaker bargaining power in their terms of trade. While the terms of trade will lie in between the opportunity costs between the two trading countries, there may only be an insignificant gain from trade when the terms of trade is agreed at a level where it is too close to the opportunity cost of producing the exported goods in the developing country. Therefore, developing countries may view trade agreements with scepticism.

## **Chapters 10-12: Globalisation and the International Economy**

### **Suggested Answers**

#### **5. Policies available to mitigate the negative impact**

- One of the factors affecting governments' stand towards FTA is the availability of policies to mitigate the negative impact

#### **6. Possible dumping by other countries**

- If there is possible dumping currently happening, the signing of the FTA will make it worse.

#### **Evaluation:**

- The size and openness of the economy are more important than the current state of the economy and possible dumping by other countries.
- The size and openness of the economy are key constraints that the economy will continue to face despite the current state of the economy. For example, Singapore must continue to promote free trade to have access to the much-needed raw material regardless of the current state of the economy. On the other hand, countries such as United States will not need to depend on trade for their survival due to their large domestic market base. Therefore, the size of the economy and openness of the economy is a significant factor in influencing their stands towards FTA.
- Lastly, external factors such as dumping can hardly be controlled by the economy. Furthermore, it is difficult for a country to prove that dumping is occurring. Therefore, to use argument to reject free trade agreement does not hold much ground.

#### **Impact of capital flow on:**

##### **Actual and potential Economic growth**

- The signing of the FTA can have significant impacts on capital flows.
- When there is an increase in the level of foreign direct investment, there will be higher level of investment.
- Since investment is part of AD, there will be an increase in AD. The firms will see an unplanned increase in inventories at the current general price level and caused firms to step up on the production.
- The increase in production will lead to a more than proportionate increase in real national income via the multiplier process. This may also lead to a possible increase in demand pull inflation as well.
- At the same time, the increase in FDI may also bring along transfer of technology and ideas.
- The transfer of technology may increase the quality of labour in the country. This will lead to an increase in the long run aggregate supply of the economy, leading to an increase in full employment level of the economy. This will result in possible potential economic growth.

##### **Unemployment**

- As more FDI enter the recipient countries, there will also creation of more jobs for the locals, generating a higher level of employment. However, there can be more outsourcing taking place as a country is open to capital flow. When there is greater outsourcing, firms will relocate a particular stage of production process overseas, causing an increase in unemployment in the home country.

##### **Price stability**

- The increase in production will lead to a more than proportionate increase in real national income via the multiplier process. If the economy is near the full employment level, the firms will not be able increase the production due to the limited resources available in the economy. Therefore, firms will have to bid up the prices in order to clear the shortage in the economy. This may also lead to an increase in demand pull inflation.

## **Chapters 10-12: Globalisation and the International Economy**

### **Suggested Answers**

- However, the increase in outsourcing will also lead to a fall in cost of production due to the cheaper labour costs in other countries. This will cause the SRAS to increase, resulting in a fall in cost-push inflation.

#### **BOP position**

- If there is a net capital inflow, the economy will enjoy an improvement in the capital and financial account.
- Assuming that there is no change to the current account, there will be an improvement in the balance of payment.
- Similarly, if there is net capital outflow, the economy will suffer a worsening of the balance of payment.

#### **Factors affecting the benefit and cost of increased capital flow:**

##### **1. Current stage of development and the current state of the economy**

- Two factors affecting governments' stand towards FTA are the current stage of development of the country and the current state of the economy.
- It is more commonly observed that FDI tends to move from developed countries to the developing countries as multinational firms outsource labour-intensive production to the developing countries, which has relatively higher labour endowment.

##### **2. Current state of the economy (Current BOP position)**

- This is especially worse for countries that are currently suffer from a negative economic growth, high unemployment and balance of trade deficit.
- The outflow of capital from the developed countries to the developing countries will mean that the developed countries will most likely suffer from a worsening of the balance of payment and an increase in the level of unemployment.

##### **3. Policies available to mitigate the negative impact**

- One of the factors affecting governments' stand towards FTA is the availability of policies to mitigate the negative impact
- For example, Singapore has various supply side policies to ensure that workers are unskilled, reskilled and upskilled in order to prevent structural unemployment. Therefore, in the event that there is outsourcing of production processes to other countries, the impact on structural unemployment will not be severe as these workers may be reallocated to other industries.

#### **Evaluation:**

- The current stage of development of the economy and the policies available to mitigate the negative impact are likely to be the more important factors.
- The current stage of development will determine the likely flow of the capital given the way how MNCs designed their supply chain management processes.
- In the case of United States, labour-intensive production will be outsourced to other countries such as Mexico. If there is a high degree of occupational immobility within the United States, then the probability of suffering from structural unemployment will be very high.

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

**Mark Scheme:**

Levels	Knowledge, Application, Understanding and Analysis
<p><b>High L3</b> <b>18 - 20</b></p>	<p>For an answer that demonstrates knowledge, understanding, application and analysis:</p> <ul style="list-style-type: none"> <li>• <b>EXCELLENT breadth</b> that considers the following economic concepts in explaining multiple and balanced perspectives, viewpoints, relationships and factors. ALL points chosen should be of <b>relevance</b> and <b>significance</b> in answering the question. <ul style="list-style-type: none"> <li>• Analysis of the FTA covers the increased ease of trade flow AND capital flow</li> <li>• Analysis include the impact on external and internal stability and at least 1 microeconomic goal</li> <li>• Analysis of at least 3 factors affecting the extent of the impact of trade flow and capital flow.</li> </ul> </li> <li>• <b>EXCELLENT depth</b> in economic analysis that reflects the following in ALL explanations. <ul style="list-style-type: none"> <li>✓ <b>Accurate</b> use of economic concepts, <b>clear</b> elaboration and <b>precise</b> use of economic terminologies, language and phrasing.</li> <li>• Use of AD/AS analysis to examine impact on macroeconomic goals</li> </ul> </li> </ul> <p>The answer should also be supported by:</p> <ul style="list-style-type: none"> <li>• Well-labelled and well-referred to diagram(s) / tool(s) of analysis drawn with <b>precision</b> (where appropriate).</li> <li>• <b>Relevant</b> examples and <b>accurate</b> use of facts.</li> <li>• <b>Logical</b> structure.</li> </ul>
<p><b>Low L3</b> <b>15 - 17</b></p>	<p>For an answer that demonstrates knowledge, understanding, application and analysis:</p> <ul style="list-style-type: none"> <li>• At least <b>VERY GOOD breadth</b> that considers the following economic concepts in explaining multiple and balanced perspectives, viewpoints, relationships and factors. MOST points chosen should be of <b>relevance</b> and <b>significance</b> in answering the question. <ul style="list-style-type: none"> <li>• Analysis of the FTA covers the increased ease of trade flow and capital flow</li> <li>• Analysis include the impact on internal stability and (external stability or a microeconomic goal)</li> <li>• Analysis of at least 2 factors affecting the extent of the impact of trade flow and capital flow</li> </ul> </li> <li>• At least <b>VERY GOOD depth</b> in economic analysis that reflects the following in MOST explanations.</li> <li>• <b>Accurate</b> use of economic concepts, <b>clear</b> elaboration, and <b>precise</b> use of economic terminologies, language and phrasing. <ul style="list-style-type: none"> <li>• Use of AD/AS analysis to examine impact on macroeconomic goals</li> </ul> </li> </ul> <p>The answer should also be supported by:</p> <ul style="list-style-type: none"> <li>• Well-labelled and well-referred to diagram(s) / tool(s) of analysis drawn with <b>precision</b> (where appropriate).</li> <li>• <b>Relevant</b> example(s) and <b>accurate</b> use of facts.</li> </ul>



**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

	<ul style="list-style-type: none"> <li>• <b>Logical</b> structure.</li> </ul>
<b>High L2 12 - 14</b>	<p>For an answer that demonstrates knowledge and understanding but lacks application and analysis:</p> <ul style="list-style-type: none"> <li>• At least <b>GOOD breadth</b> that considers the following economic concepts in explaining multiple and balanced perspectives, viewpoints, relationships and factors. <b>MOST</b> points chosen should be of <b>relevance</b> and <b>significance</b> in answering the question. <ul style="list-style-type: none"> <li>• Analysis of the FTA covers the increased ease of trade flow OR capital flow</li> <li>• Analysis include the impact on internal stability and (external stability or a microeconomic goal)</li> <li>• Analysis of at least 2 factors affecting the extent of the impact of trade flow and capital flow</li> </ul> </li> </ul> <p>OR</p> <ul style="list-style-type: none"> <li>• Analysis of the FTA covers the increased ease of trade flow AND capital flow</li> <li>• Analysis include the impact on any one of the following: <ul style="list-style-type: none"> <li>○ Internal stability</li> <li>○ External stability</li> <li>○ Microeconomic goal</li> </ul> </li> <li>• Good Analysis of at least 2 factors affecting the extent of the impact of trade flow and capital flow</li> </ul> <ul style="list-style-type: none"> <li>• At least <b>GOOD depth</b> in economic analysis that reflects the following in <b>MOST</b> explanations.</li> <li>• <b>Accurate</b> use of economic concepts, <b>clear</b> elaboration, and <b>precise</b> use of economic terminologies, language and phrasing. <ul style="list-style-type: none"> <li>• Use of AD/AS analysis to examine impact on economic goals</li> <li>• Clear linkage between factor to extent of impact on economic goals</li> </ul> </li> </ul> <p>The answer should also be supported by:</p> <ul style="list-style-type: none"> <li>• Diagram(s) / Tool(s) of analysis that may not be well-labelled, may not be well-referred to and may not be drawn with precision (where appropriate).</li> <li>• Some example(s).</li> <li>• <b>Logical</b> structure.</li> </ul>

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

<p><b>Low L2</b> <b>9 - 11</b></p>	<p>For an answer that demonstrates knowledge and understanding but lacks application and analysis:</p> <ul style="list-style-type: none"> <li>At least <b>SUFFICIENT breadth</b> that considers the following economic concepts in explaining multiple and balanced perspectives, viewpoints, relationships and factors. SOME points chosen should be of <b>relevance</b> and <b>significance</b> in answering the question. <ul style="list-style-type: none"> <li>Analysis of the FTA covers the increased ease of trade flow AND/OR capital flow</li> <li>Analysis include the impact on any ONE of the following: <ul style="list-style-type: none"> <li>Internal stability</li> <li>External stability</li> <li>Microeconomic goal</li> </ul> </li> <li>Analysis of at least 2 factors affecting the extent of the impact of trade flow OR capital flow</li> </ul> </li> <li>At least <b>SUFFICIENT depth</b> in economic analysis that reflects the following in SOME explanations. <ul style="list-style-type: none"> <li>✓ <b>Accurate</b> use of economic concepts, <b>clear</b> elaboration, and <b>precise</b> use of economic terminologies, language and phrasing.</li> <li>Recognition of the factors affecting the extent of the impact of trade flow OR capital flow</li> </ul> </li> </ul> <p>The answer should also be supported by:</p> <ul style="list-style-type: none"> <li>Diagram(s) / Tool(s) of analysis that may not be well-labelled, may not be well-referred to and may not be drawn with precision (where appropriate).</li> <li>Example(s).</li> <li><b>Logical</b> structure.</li> </ul>
<p><b>High L1</b> <b>5 - 8</b></p>	<p>For an answer that demonstrates knowledge but lacks understanding, application and analysis:</p> <ul style="list-style-type: none"> <li><b>INSUFFICIENT breadth</b> that considers the following economic concept(s). Point(s) chosen may be of relevance but may not be of significance in answering the question. <ul style="list-style-type: none"> <li>Analysis of the FTA covers the increased ease of trade flow OR capital flow</li> <li>Analysis include the impact on any ONE of the following: <ul style="list-style-type: none"> <li>Internal stability</li> <li>External stability</li> <li>Microeconomic goal</li> </ul> </li> <li>Analysis of at least 1 factor affecting the extent of the impact of trade flow OR capital flow</li> </ul> </li> <li><b>INSUFFICIENT depth</b> in economic analysis that may reflect the following:</li> <li>Lack of accuracy in the use of economic concepts, lack of clarity in elaboration, and lack of precision in the use of economic terminologies, language and phrasing.</li> </ul>
<p><b>Low L1</b> <b>1 - 4</b></p>	<p>For an answer that:</p> <ul style="list-style-type: none"> <li>Demonstrates <b>POOR</b> breadth and <b>POOR</b> economic analysis.</li> <li>Is irrelevant in analysis but may contain an introduction that addresses the question or contains no economic analysis but may contain a few</li> </ul>

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

	<p>statements that are relevant to the concepts required to answer the question.</p> <ul style="list-style-type: none"> <li>Contains fundamental conceptual errors in analysis.</li> </ul>
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Levels	Evaluation
<b>E3</b> <b>4 - 5</b>	<p>For an evaluation that contains</p> <ul style="list-style-type: none"> <li>➤ A synthesis of earlier economic arguments to arrive at <b>relevant</b> judgements/decisions (i.e. answer the question).</li> <li>➤ Well-explained criteria-based evaluative comments supported by <b>accurate</b> and <b>clear</b> analysis to provide <b>fairness</b> in views.</li> <li>➤ A good summative conclusion.</li> </ul>
<b>E2</b> <b>2 - 3</b>	<p>For an evaluation that contains</p> <ul style="list-style-type: none"> <li>➤ <b>Relevant</b> judgement(s)/decision(s) (i.e. answer the question) that may not follow from earlier economic arguments.</li> <li>➤ Criteria-based evaluative comment(s) supported by analysis to provide <b>fairness</b> in views but the comment(s) may not be well-explained, may be unclear and/or may be inaccurate at times.</li> </ul>
<b>E1</b> <b>1</b>	<p>For an evaluation that contains</p> <ul style="list-style-type: none"> <li>➤ <b>Relevant</b> but unexplained evaluative judgement(s)/statement(s) i.e. evaluative judgement(s)/statement(s) not supported by analysis OR</li> <li>➤ A <b>relevant</b> conclusion not properly explained</li> </ul>

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

6. Discuss the view that the extent to which countries benefit from globalization depends mainly on the type of Comparative Advantage that country has. [25]  
[NJC 2015]

#### Suggested Answer

##### **Question Analysis:**

Command word: Discuss the view

Concept(s): cause of effects of globalisation, type of comparative advantage (as a cause), discussion of different types of comparative advantage

Context: Open

##### **Introduction**

###### Key definitions

- Globalisation: refers to the increasing integration of national economies in terms of financial flows, trade, movement of factors of production, ideas, and changes in information and technology.
- Benefits: Link to the 4 macroeconomic objectives, consumer welfare, Standard of Living (SOL) – both material and non-material
- While the type of comparative advantage (CA) plays a significant role in the extent to which countries benefit from globalisation, there are however other factors which play equally significant roles in determining the benefits of globalisation.

##### **Body:**

**Thesis: Extent which countries benefit from globalisation depends on the type of comparative advantage that the country has**

###### Explain Comparative Advantage and effects on Trade

- **The Theory of Comparative Advantage** states that trade can benefit all countries if they specialise in (and export) the goods in which they have a comparative advantage.
- Looking at the example of Singapore and China, suppose each country has 10 units of resources which are divided equally to produce the 2 goods: Electronic Equipment and Cloth (i.e. 5 units of resources in wheat and 5 units of resources in cloth).
- The output is as follows:

**Table 1:** Production and consumption before specialisation  
(with 5 units of resources in Electronic Equipment and Cloth)

Good Country	Electronic Equipment (units)	Cloth (units)
Singapore	50	200
China	10	100
Total	<b>60</b>	<b>300</b>

- This means that 1 unit of resource in Singapore can produce 10 units of electronic equipment or 40 units of cloth; while 1 unit of resource in China can produce 2 units of electronic equipment or 20 units of cloth.

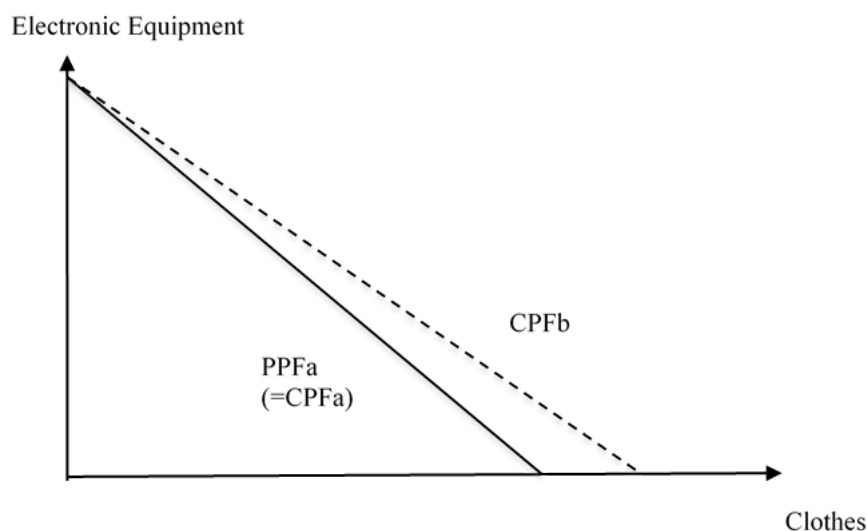
## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

**Table 2:** Opportunity Cost Ratios for Singapore and China

Good Country	1 unit of resource can produce	
	Electronic Equipment (units)	Cloth (units)
Singapore	10 or	40
China	2 or	20

- Singapore therefore has absolute advantage in both electronic equipment and cloth.
- A country is said to have absolute advantage in the production of a good if it can produce more of the good with the same amount of resources (or uses less resources to produce the same quantity of the good) compared to another country
- However, the countries can still gain from trade if they specialize according to their comparative advantage, which is determined by their opportunity cost in production, or relative efficiency in producing the good. As seen above in Table 2, the opportunity cost of producing 1 unit of Electronic Equipment for Singapore is 4 units of clothes while the opportunity of producing 1 unit of Electronic Equipment is 10 units of clothes. Thus Singapore has the comparative advantage in producing Electronic Equipment while China has the comparative advantage in producing clothes.
- As shown in Fig. 1, Singapore will choose to specialise completely in Electronic Equipment. Before Trade, the consumption possibility frontier (CPF<sub>a</sub>) is identical to that of its production possibility frontier (PPF<sub>a</sub>). Singapore can then trade with China based on the prevailing terms of trade which will see an outward shift of the consumption production frontier, from CPF<sub>a</sub> to CPF<sub>b</sub>, which reflects the gain from trade, with the countries specialising in the respective goods in which they have the comparative advantage.



**Figure. 1** Production Possibility Frontier and Consumption Possibility Frontier of Singapore

## **Chapters 10-12: Globalisation and the International Economy**

### **Suggested Answers**

#### Explanation of why different countries have different types of comparative advantage

Countries have different comparative advantages due to:

- i) Resource endowment of the country (Heckscher-Ohlin Model)
  - According to Heckscher Ohlin Model, a country with a huge population (relative to other factors of production) will have a comparative advantage in labour-intensive production e.g. China and India. They also tend to be developing countries. On the other hand, a country with a huge capital base and high-skilled labour will have a comparative advantage in capital-intensive production. E.g. USA and Singapore. They also tend to be developed countries.
  - The countries can each benefit from the gains of specialisation and trade based on terms of trade that lie between the opportunity cost ratios of the 2 countries.
  - The gains from trade may differ based on the different types of comparative advantages that the countries possess as this may affect the bargaining power of the countries.
  - Looking at the examples of Singapore and China, with China having comparative advantage in clothes, tends to have a lower income elasticity of demand due to it being a necessity while for electronic equipment, the good tends to have a high income elasticity of demand due to its status as a luxury good thus over time, given increases in global incomes, the terms of trade tends to worsen for clothes manufacturers like China while the terms of trade improves for electronic equipment manufacturer like Singapore.
  - Thus with increased trade due to globalisation, countries with comparative advantages in capital-intensive industries (Singapore) would have benefited more than countries with comparative advantage in labour-intensive industries.

#### **Effect on Investment and Outsourcing/Offshoring**

- With globalisation and the ease of communication and removal of barriers on movement of goods and services and factors of production, the principle of comparative advantage is extended to intermediate goods (rather than just final goods) – For example, many companies in developed countries (with CA in capital goods) have tended to outsource production to developing countries (with CA in labour-intensive goods) This is especially for the assembly of final consumer products which tend to be labour intensive and is usually located in countries with a huge population such as China.

Note: Students can choose to compare between any 2 different types of comparative advantage for analysis and illustration.

#### Analysis for countries with CA in labour-intensive production

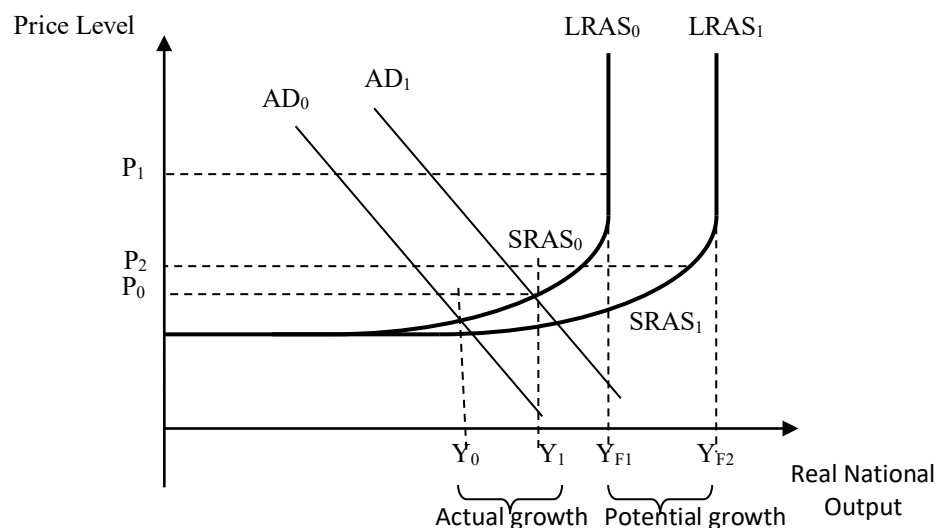
- Outsourcing leads to increased inflows of foreign direct investment (FDI) and increasing investment (I) leads to an increase in aggregate demand (AD). Assuming that the increase in FDI facilitates the growth of the export sector which increases overall export revenue, this will result in an overall increase in AD from  $AD_0$  to  $AD_1$  as shown in Figure 2.
- The investment, coupled with the transfer of ideas, information and technology will increase the long-run aggregate supply (LRAS) of the economy as shown in the increase from  $LRAS_0$  to  $LRAS_1$  (The investment may also introduce production techniques that lowers the cost of production, resulting in an increase in short-run aggregate supply – illustrate in diagram)
- With the increase in AD and increase in LRAS, there is an increase in real national income from  $Y_0$  to  $Y_1$ , resulting in actual economic growth.

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

#### Diagrammatic analysis

**Figure 2:** Actual vs. Potential Growth using AD/AS model



- At the same time, there is also an increase in employment as more labour is required with the increase in production. The influx of foreign direct investment will improve capital and financial account and the increase in net exports will improve the current account, leading to an overall improvement in the balance of payment.
- As there will be increased employment of low-skilled workers, this is likely to close the income gap between them and high-skilled workers/ capital owners and result in greater income inequality. However, this also depends on whether the low-skilled workers will be exploited, especially by the multi-national companies.

#### Analysis for countries with CA in capital-intensive production

- Likely that with outsourcing (with outflows of FDI), the countries will be better able to focus on capital-intensive industries which they have comparative advantage in. However, problem of structural unemployment for low-skilled workers due to transition of economy to focus on high-skilled, capital-intensive industries. Result in higher income inequality between the low-skilled workers and high-skilled workers/capital owners.

#### Effect on movement of labour

- With globalisation, there will be outflow of high-skilled labour from countries with CA in labour-intensive industries to countries with CA in capital-intensive industries to take up labour shortages. These countries tend to be developed countries. This will result in serious brain drain problems for developing countries, which has huge populations and CA in labour-intensive industries.

Evaluation: With globalisation, economic migrants of all types (high-skilled and low-skilled alike) have taken advantage of the increased communication and transport accessibility to move from developing countries to developed countries due to the perceived higher standard of living in developed countries. Thus, CA is not the only factor explaining migrant flows and the pursuit of a higher standard of living may be a better factor at explaining migrant flows.

## **Chapters 10-12: Globalisation and the International Economy**

### **Suggested Answers**

**Anti-Thesis: Extent which countries benefit from globalisation does not depend on the type of comparative advantage that the country has**  
(Discussion of 3 factors would suffice)

#### **Limitations of comparative advantage as a theory**

##### **1. Transport cost and location**

- Although globalisation has reduced communication and transport costs, transport costs still play a significant factor, especially if the country has a comparative advantage in goods that are bulky, low-valued and/or perishable products which limit the number of markets that the country can export to and thus the benefits of globalisation. For example, agricultural products of Malaysia.
- The extent to which countries benefit from globalisation also depends on the distance to the main markets (such as USA). Countries nearer major markets (e.g. USA) will have a natural advantage over countries located further away.
- Thus this will be a factor that will limit the gains of trade by countries wishing to specialise based on their comparative advantage

#### **Other factors that influenced benefits from globalisation**

##### **2. Trade not based on CA: Intra-industry Trade (Horizontal)**

- Inter-industry trade (based on comparative advantage) is just one type of trade whose volume will increase due to globalisation.
- With globalisation, there will also be an increase in intra-industry trade which is not based on comparative advantage.
- Theory of Comparative Advantage assumes that goods are homogenous in nature. However, in the real world, there are different varieties of the same product and thus taste and preference of consumers is important as a demand factor that affects trade flows and facilitates intra-industry trade rather than inter-industry trade based on CA.
- Intra-industry trade allows consumers to enjoy a variety of products without sacrificing the cost advantage of economies of scale arising from large scale production.
- Intra-industry trade, may also bring about increased competition for domestic industries, leading to their closure, thus reducing domestic employment and economic growth.
- Comparison with Type of CA as a factor: Intra-industry constitutes a large portion of overall trade, especially for manufactured products thus with globalisation, the presence of intra-industry may play a bigger factor in determining whether countries benefit from globalisation.

##### **3. Use of government policies**

Different countries may benefit differently from globalisation due to the adoption of differing policies by them.

- Trade Liberalisation vs. Protectionism: Some countries may pursue trade liberalisation policies (through the signing of Free Trade Agreements) which allows them to gain from increased exports (using exports as an engine of growth) and to attract Foreign Direct Investment.
- E.g. Singapore has signed a myraid of FTAs with different countries in order to develop Singapore as an integrated manufacturing centre and attract firms to invest in Singapore (FDI) and use Singapore as an export hub (with low tariffs and trade restrictions), which in turn increases exports.
- Laws on immigration may also differ between countries, limiting the gains from globalisation. E.g. Singapore's tightening of foreign labour flows
- Protectionistic policies adopted by some countries can limit the gains from trade of other countries or even cause the other countries to be adversely affected due to unfair trading practices. Eg. restrictions on import of agricultural products by developed



## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

countries to protect domestic farmers reduce the agricultural exports of developing countries, thus reducing their benefit from trade.

- Governments may also play a role in determining the type of comparative advantage the country will have. Type of comparative advantage is not static and may change over time. Governments may encourage the development of new comparative advantages, especially in moving up the production chain, as part of their development strategy. For example, the Chinese government plays an instrumental role in providing subsidies and other forms of help in developing the solar panel industry, a capital-intensive industry, even though it is not a comparative advantage that China traditionally has.

#### 4. Nature of economies

- Size of countries as a factor: Smaller countries may better benefit more from bigger countries.
- For small countries such as Singapore, gains from specialisation may only appear when coupled with gains from economies of scale. Small markets like Singapore will not be able to support large-scale industries and rely on market access to large markets in order to reap the cost advantages from these large-scale industries. This is however also dependent on whether the goods that the country specialises in allows internal economies to be reaped. For example, if the country specialises in cottage industries that suffer from internal diseconomies of scale at a relatively small output, then globalisation will not bring about the benefits that it should.

Small countries also depend on trade for their imports of necessities thus a key determinant of whether countries benefit also depends on the size of the country.

#### Conclusion/Synthesis

- Significance of transport costs/locations as a limitation of comparative advantage
- CA is ultimately a theory that explains the supply side of why countries trade and demand factors such as intra-industry trade are equally important in determining the extent of benefits from globalisation.
- Finally, governments themselves also play a significant role in determining the extent of benefits of globalisation with the policies adopted as well as the different nature of economies often playing a more significant role
- Thus, type of comparative advantage plays a significant role but is not the main reason that determines the extent of benefits from globalisation.

Level	Knowledge, Application, Understanding and Analysis
Level 3  High L3 18-20	<ul style="list-style-type: none"><li>• For an answer that shows:<ul style="list-style-type: none"><li>- Excellent depth in analysis:<ul style="list-style-type: none"><li>○ Accurate use of the concepts of comparative advantage &amp; globalisation and thorough examination of the different types of comparative advantage between countries</li><li>○ Detailed examination of benefits based on a criteria encompassing the 4 macroeconomic objectives and standard of living/consumer welfare</li></ul></li><li>- Excellent breadth in analysis:<ul style="list-style-type: none"><li>○ Answer demonstrates a thorough examination of increased trade flows and other different aspects of globalisation (at least 2 including trade) and how benefits from globalisation are affected by different types of comparative advantage as well as at least 3 other factors</li></ul></li><li>- Supported by<ul style="list-style-type: none"><li>○ Well labelled and well referred AD-AS diagram and opportunity cost tables or PPF diagram</li><li>○ Contextualised examples based on the different types of comparative advantage and other factors</li></ul></li></ul></li></ul>

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

<p>Low L3 15-17</p>	<ul style="list-style-type: none"> <li>○ Logical structure</li> <li>• For an answer that shows: <ul style="list-style-type: none"> <li>- Very good depth in analysis <ul style="list-style-type: none"> <li>○ Accurate use of the concepts of comparative advantage &amp; globalisation and thorough examination of the difference in types of comparative advantage between countries.</li> <li>○ Some examination of benefits based on a criteria encompassing at least 3 macroeconomic objectives and/or standard of living/consumer welfare</li> </ul> </li> <li>- Very good breadth in analysis: <ul style="list-style-type: none"> <li>○ Answer demonstrates a very good examination of increased trade flows and other aspects of globalisation (at least 2, including trade) and how benefits from globalisation are affected by both different types of comparative advantage as well as at least 2 other factors</li> </ul> </li> <li>- Supported by <ul style="list-style-type: none"> <li>○ Well labelled and well referred AD-AS diagram and/or opportunity cost tables or PPF diagram.</li> <li>○ Contextualised examples based on the different types of comparative advantage or other factors</li> <li>○ Logical structure</li> </ul> </li> </ul> </li> </ul>
<p>High L2 12-14</p>	<ul style="list-style-type: none"> <li>• For an answer that shows: <ul style="list-style-type: none"> <li>- Good depth in analysis <ul style="list-style-type: none"> <li>○ Accurate use of the concepts of comparative advantage &amp; globalisation and some examination of the difference in types of comparative advantage between countries.</li> <li>○ Some examination of benefits based on at least 3 macroeconomic objectives and/or standard of living/consumer welfare</li> </ul> </li> <li>- Good breadth in analysis: <ul style="list-style-type: none"> <li>○ Answer demonstrates a good analysis of increased trade flows and other aspects of globalisation (at least 2, including trade) and some examination of how benefits from globalisation are affected by both different types of comparative advantage as well as at least 2 other factors</li> </ul> </li> <li>- Supported by <ul style="list-style-type: none"> <li>○ Use of AD-AS diagram or opportunity cost tables.</li> <li>○ Contextualised examples based on the different types of comparative advantage or other factors</li> <li>○ Logical structure</li> </ul> </li> </ul> </li> </ul>
<p>Low L2 9-11</p>	<ul style="list-style-type: none"> <li>• For an answer that shows: <ul style="list-style-type: none"> <li>- Sufficient depth in analysis <ul style="list-style-type: none"> <li>○ Some use of the concepts of comparative advantage &amp; globalisation with possible inaccuracies and some examination of the difference in types of comparative advantage between countries.</li> <li>○ Some examination of benefits based on at least 2 macroeconomic objectives and/or standard of living/consumer welfare</li> </ul> </li> <li>- Sufficient breadth in analysis: <ul style="list-style-type: none"> <li>○ Answer demonstrates a sufficient analysis of increased trade flows but superficial examination of other aspects of globalisation</li> <li>○ Some examination of how benefits from globalisation are affected by different types of comparative advantage but other factors are insufficiently examined (One-sided analysis)</li> </ul> </li> <li>- Supported by <ul style="list-style-type: none"> <li>○ Contextualised examples</li> <li>○ Some logical structure</li> </ul> </li> </ul> </li> </ul>

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

High L1 5-8	<ul style="list-style-type: none"> <li>• For an answer that shows:               <ul style="list-style-type: none"> <li>- Insufficient depth in analysis                   <ul style="list-style-type: none"> <li>○ Inaccurate use of the concepts of comparative advantage &amp; globalisation and why differences in types of comparative advantage between countries exist.</li> <li>○ Little reference to a criteria of what constitutes benefits</li> </ul> </li> <li>- Insufficient breadth in analysis:                   <ul style="list-style-type: none"> <li>○ Answer demonstrates some understanding of the effects of globalisation at a superficial level.</li> <li>○ Attempt at examining how benefits from globalisation are affected by different types of comparative advantage and other factors</li> </ul> </li> </ul> </li> </ul>
Low L1 1-4	<ul style="list-style-type: none"> <li>• For an answer that               <ul style="list-style-type: none"> <li>- Is largely irrelevant</li> <li>- Contains fundamental conceptual errors in analysis.</li> <li>- May have only addressed one part of the answer and little else. For example, why different countries have different types of comparative advantages.</li> </ul> </li> </ul>
<b>Evaluation</b>	
E3 4-5	<ul style="list-style-type: none"> <li>- Illustration of the judgement made on analysis given</li> </ul>
E2 2-3	<ul style="list-style-type: none"> <li>- Judgment of significance of types of comparative advantage based on analysis</li> </ul>
E1 1	<ul style="list-style-type: none"> <li>- Unexplained judgment</li> </ul>

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

7. To what extent can policies undertaken by the Singapore government mitigate the negative impact of globalization and reap its benefits to the fullest? [25]  
[RI 2015]

### Suggested Answer

#### Introduction

- Define globalisation
  - o Facilitated by improvement in technology and breaking down of artificial barriers, there is an
    - increase in international trade of goods and services
    - increase in international flow of foreign direct investment/technology
    - increase in international movement of labour
- Policies implemented by Singapore include:
  - o Fiscal policy
  - o Exchange rate policy
  - o Supply-side policies

#### Body

- Globalisation can bring about the following benefits:
  - o Increase in X arising from Singapore's increased access to international markets
    - Increase in AD, resulting in more than proportionate increase in real NY due to multiplier effect
    - Increase in derived demand for labour, resulting in lower cyclical unemployment rate
    - Improvement in BOT, BOP, ceteris paribus, resulting in modest appreciation of currency &/or accumulation of foreign reserves
  - o Increase in FDI
    - Increase in AD in SR as factories are built and capital goods are purchased
    - Increase in AS in the long term as stock of capital goods in Singapore is increased, and better production technology might be introduced with the inflow of FDI
    - Increases in AD and AS result in sustained and low-inflationary economic growth in the LR
    - FDI creates jobs, helps to lower unemployment rate. In addition, wages also increase due to high value adding nature of jobs created. For example, financial industry.
    - FDI creates new production capabilities for Singapore economy. This helps to improve X. For example, pharmaceutical, aerospace industries.
  - o Increase in foreign talent pool
    - Increase in AS as quantity and quality of labour force is augmented
    - Foreign talent helps to develop high value adding and strategic industries in Singapore. For example, R&D scientists and finance/banking professionals.
- Globalisation can cause the following problems:
  - o Increase in volatility of economic performance
    - Increase reliance on X and FDI results in increased volatility of economic performance of Singapore economy. For example, Singapore's economic performance is highly correlated to global economic performance, particularly US and China.

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

- Structural unemployment
  - Loss of CA due to the emergence of competing economies in areas of capital-intensive manufacturing industries results in structural unemployment.
  - Due to lower cost of production in countries such as China and regional countries like Thailand, Malaysia, firms may choose to offshore and outsource certain business activities such as capital-intensive manufacturing which used to be conducted in Singapore. Retrenched workers from these industries may not have appropriate skills to be employed in emerging industries in Singapore. This mis-match in skills results in structural unemployment. For example, the off-shoring of hard disk and wafer fabrication industries.
- Increased income inequality
  - CA export-oriented industries will experience increase in DD for their goods and services. This translates to an increase in DD for labour in these industries causing wages to increase.
  - Non-CA sunset industries will lag behind or experience a fall in DD for their goods and services. This results in lower wage or slower wage growth in these industries.
  - Hence, income inequality worsens. This creates inequitable outcomes which create social tension. For example, wages in financial, pharmaceutical sectors have been rising at faster rates relative to non-CA industries.
- Strain on infrastructure
  - The inflow of foreign workers adds to the labour force and resident population in Singapore. They require space to live, and the use of public infrastructure such as public transport to commute and public spaces to relax. This poses a strain on our public infrastructure and limited land space.
- To reap the full benefits of globalisation, Singapore government should try to achieve the following:
  - Improve the competitiveness of Singapore's X industry through
    - Improving its price competitiveness
    - Improving the quality of its X
  - Improve the attractiveness of Singapore as a FDI destination for overseas MNCs.
  - Attract top talent to augment the quantity and quality of its labour force.
- To mitigate the negative effects of globalisation, Singapore government should try to achieve the following:
  - Reduce the volatility of Singapore economic performance
  - Address structural unemployment that might arise
  - Manage income inequality in Singapore
  - Enhance and expand its public infrastructure to cope with increasing labour force and resident population
- **[Many policies are presented below for your learning purpose. Candidates are not expected to cover all the policies. Instead, you are expected to clearly analyse how policies (4 is sufficient) can help to mitigate specific negative impact or reap specific benefit of globalisation, with a discussion of the effectiveness of these policies. Emphasis is on 1) linking specific policy to specific benefit/negative effect, 2) detailed analysis of how policy works to**

**maximise benefits or reduce the negative effect of globalisation, 3) discussion of the limitations of each policy.]**

- Policies that can improve competitiveness of Singapore's X industry include:
  - o Exchange rate policy to ensure low stable inflation in the LR
    - In times of economic boom, policy of modest, gradual appreciation of SGD moderates imported inflation and DD-pull inflation in Singapore. This helps Singapore manage its inflation rate at low, stable levels. It also helps to avoid vicious cycle of wage-price spiral. Over the long term, effective management of Singapore's inflation rate through the use of modest, gradual appreciation of SGD policy helps to improve price-competitiveness of Singapore's exports, vis-à-vis economies that experience relatively higher inflation rates.
    - However, a modest, gradual appreciation of SGD policy compromises actual growth in the SR as (X-M) decreases (assuming MLC holds).
  - o Wage policies that allow wages to grow in line with productivity gains
    - Through National Wage Council guidelines, Singapore government has been able to influence the rate of wage growth in Singapore. It has consistently recommended that wage growth should be in line with productivity gains. This helps to prevent an increase in the per unit cost of production in Singapore, maintaining price competitiveness of Singapore's exports.
    - However, NWC guidelines are guidelines which are not mandatory for employers to follow. There is unevenness in the adoption of NWC guidelines among employers. Moreover, NWC guidelines only cover labour cost of production. There are other types of cost of production, such as rental cost, raw material cost and equipment cost incurred by businesses.
  - o Supply side policies which help to improve productivity or improve quality of goods/services such as:
    - Subsidies for upgrading technology level to improve productivity. The Productivity and Innovation Credit Scheme (PIC) scheme was introduced by the government to encourage productivity and innovation activities in Singapore. It provides support to businesses that make investments to improve their productivity. Under the PIC Scheme, businesses can enjoy [400% tax deductions/allowances](#) and/or 60% cash subsidies for investments.
    - However, the PIC is an expensive scheme for the government to fund. The incremental gain in productivity of businesses is uneven. Some businesses have been able to tap on the scheme to purchase equipment which significantly improved business processes such as automating production processes. However, there were businesses which used the PIC to purchase photocopying machines and other equipment which did not improve productivity.
- Policies that can improve attractiveness of Singapore as a FDI destination for overseas MNCs:
  - o Competitive corporate tax rates. Singapore has lowered corporate tax rates over the decade from 20% to 17%. Lower corporate tax rates increases after-tax profits of firms. This stimulates both investments by local firms and FDI. Corporate tax rate is an important factor in attracting FDI as it directly affects profits.
  - o However, lowering corporate tax rates reduces tax revenue of the government. It may require the government to increase other types of taxation, such as GST.

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

Otherwise, the government's ability to spend will be curtailed. Corporate tax cuts can also trigger similar tax cuts from other countries competing to attract FDI. Competitive tax cuts result in a lose-lose situation among the competing countries.

- Enhancement of infrastructure to increase productivity of businesses in Singapore. For example, air, road infrastructure and industry infrastructure such as Jurong Island. Jurong Island boasts a set of seamlessly integrated infrastructure solutions which includes service corridors, logistics and warehousing, as well as a comprehensive host of shared third-party utilities and services. With its dedicated "plug and play" infrastructure, companies are able to enjoy cost savings.
- However, the development of large industry infrastructure requires a long planning and construction period. The industry-specific nature of Jurong Island also requires the government to correctly identify potential CA industries.
- Policies that can attract top talent:
  - Competitive income tax rates. Singapore's personal income tax rate is progressive in nature. It is competitive with a highest marginal tax rate of 20%. A relatively low personal income tax regime helps to attract top talent as they retain a greater proportion of their earnings.
  - [The limitations of a low personal income tax are similar to those of corporate tax. See previous discussion about corporate tax.]
- Policies that can reduce volatility of Singapore's economic performance:
  - Sign FTAs with diverse trading partners. This will help cushion the negative effect of economic slowdown of any one of Singapore's trading partners.
  - However, given the inter-connected nature of the global economies, Singapore will inevitably be significantly affected by economic slowdown of the biggest economies in the world, such as the US and Chinese economies.
  - Flexible wages that allow wages to fall during times of economic recessions. This will help save jobs. The NWC has recommended businesses to adopt a flexible wage model which comprises salary components which vary with the profitability of firms. This allows businesses to reduce wage costs and cope better during economic recessions. Consequently, there will be less retrenchment arising from business closures.
  - However, workers must be willing to accept such flexible wage structures. Trust between employers and workers have to be built and there has to be platforms for employers and workers to meet to negotiate the details of such flexible wage arrangements.
  - Use of foreign exchange and fiscal policy to stabilise the economy in times of global economic recessions. In times of economic recession in Singapore caused by fall in  $X$ , the Singapore government can adopt a once-off depreciation of SGD and/or expansionary fiscal policy. Depreciation of SGD increases  $(X-M)$  component of AD (assuming MLC holds). Expansionary fiscal policy of reducing taxes and/or increasing  $G$  results in increases in  $C/I$  and  $G$  respectively. Both policies result in more than proportionate increase in real  $NY$ , reduces cyclical unemployment and improves BOT.
  - However, depreciation of SGD results in imported inflation. Hence, the extent of depreciation is limited. Expansionary fiscal policy is limited in effectiveness due to the relative size of  $C$  and  $I$ , relative to  $X$ . Hence, it is at best able to reduce the negative effects of a fall in  $X$  but not offset it.

## **Chapters 10-12: Globalisation and the International Economy**

### **Suggested Answers**

- Policies that can reduce structural unemployment
  - o Subsidies for retraining of displaced workers. SkillsFuture credit is a cash subsidy given to mid-career individuals to support their learning needs, including learning skills to re-enter the workforce.
  - o Government is also involved in sourcing relevant skills based modular courses that help to equip Singapore workers with relevant skills to support CA industries.
  - o Through these subsidy and sourcing initiatives, it facilitates the process of individuals learning relevant skills to be employed in the Singapore economy.
  - o However, these initiatives are only receptive if workers are receptive to the idea of life-long skills retraining and upgrading. Hence, the government's efforts in using educational campaigns to bring across this idea. In addition, these initiatives are expensive and need to be funded using tax revenue. In order to be effective, the skills taught at these courses must be relevant and the quality of these courses must be good.
- Policies that can reduce income inequality
  - o More aggressive redistribution policies including more progressive taxation and generous transfer payments.
  - o Workfare Income Supplementation programme is a subsidy which seeks to supplement wages of low wage workers. More generous transfer payments in the form of subsidies of essential merit goods such as healthcare and housing also helps to reduce the effects of increasing income inequality.
  - o However, increasing corporate taxes reduces the incentive for businesses to invest. It also reduces Singapore's attractiveness as a FDI destination. It goes against the earlier mentioned policy of reducing corporate taxes to attract FDI. Increasing personal income taxes can reduce an individual's motivation to work and goes against the earlier mentioned policy of maintaining a competitive personal income tax regime to attract foreign talent.



**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

**Mark Scheme:**

<b>Knowledge, Application, Understanding, Analysis</b>		
<b>L3</b>	<ul style="list-style-type: none"> <li>- Explanations and analysis are well developed</li> <li>- Good explanation of the benefits and negative impact of globalisation and policies.</li> <li>- Balanced answer with limitation of policies discussed.</li> <li>- Answer is appropriate to the Singapore context with relevant examples cited.</li> <li>- Clarity of thought and coherent arguments.</li> <li>- Policies are linked to addressing specific negative impact or reaping specific benefits.</li> <li>- Answer has sufficient breadth and depth. At least 3 impact are discussed.</li> </ul>	<b>15-20</b>
<b>L2</b>	<ul style="list-style-type: none"> <li>- Appropriate theoretical framework</li> <li>- Used the 4 macro objectives and relevant economic objectives in analysing the benefits and negative impact of globalisation and policies.</li> <li>- Explanations and analysis are incomplete/underdeveloped.</li> <li>- Some explanation of the benefits and negative impact of globalisation and/or the policies.</li> </ul>	<b>9-14</b>
<b>L1</b>	<ul style="list-style-type: none"> <li>- No/inappropriate framework.</li> <li>- Did not use the 4 macro objectives and other relevant economic objectives in analysing the benefits and negative impact of globalisation and policies.</li> <li>- Glaring conceptual errors.</li> <li>- Did not address the question</li> <li>- Did not analyse any policies.</li> <li>- Superficial analysis</li> <li>- Listing of policies with no analysis using appropriate economics framework</li> </ul>	<b>1-8</b>
<b>Evaluation</b>		
<b>E3</b>	Evaluative comments are substantiated, well explained using economic analysis	<b>4-5</b>
<b>E2</b>	Evaluative comments are insightful and unsubstantiated using economic analysis	<b>2-3</b>
<b>E1</b>	An unexplained judgement → An unexplained evaluative conclusion/comment	<b>1</b>

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

8. Evaluate the policies the Singapore government should adopt to improve global competitiveness in light of the potential conflicts with the achievement of macroeconomic goals. [25]  
[NJC 2018]

### Suggested Answer Outline:

#### Introduction

- Singapore is a small and open economy that is heavily dependent on trade, due to our small domestic market and lack of resources for production.
- Therefore, the Singapore government needs to focus on appropriate policies to continuously improve our global competitiveness to boost our economy through our export demand. This includes reducing the price and improving the quality of our exports.

#### Body

##### **Policy 1a: Exchange Rate policy (Depreciation of Singapore dollar)**

- In a severe recession, to improve our global competitiveness by keeping the prices of our exports low, Singapore should directly reduce the price of our exports in terms of foreign currency through a depreciation of the Singapore dollar.
- Hence a depreciation of the Singapore dollar during times of recession, will help boost our global competitiveness and increase our export demand which will boost our aggregate demand and actual economic growth.

##### **Limitations of policy 1a: Conflict with macro goal of Price stability**

- A depreciation of the Singapore dollar would lead to higher import prices in terms of Singapore dollars. This would hence increase the cost of production of many of our industries. This would lead to a fall in Short Run Aggregate Supply (SRAS) and a rise in General Price level and cost push inflation in the economy.

##### **Choice of Policy 1b due to Conflict: Gradual and modest appreciation of Singapore dollar**

- Therefore during times of economic growth, where price stability is likely to be one of the main priorities of the government, Singapore generally maintains a policy of a gradual and modest appreciation of the Singapore dollar.
- Hence this helps mitigate any imported price push inflation due to inflation in our trading partners and has kept the inflation rate in Singapore generally low.

##### **Limitations of Policy 1b**

- However, an appreciation of our currency leads to an increase in the price of our exports in terms of foreign currency. If Marshall-Lerner condition holds in the long run, IE. The sum of the absolute value of the price elasticity of demand of our exports and imports is greater than 1, (X-M) and aggregate demand will fall in the long run, reducing actual growth.

##### **Policy 2a: Supply side policies to overcome potential conflict of inflation in LR and problems with overdependence on external demand and FDI through improving our domestic industries**

- The only way to maintain our global competitiveness in the long run is through our supply side policies. This is largely done by the Singapore government through efforts to increase R and D as well as retraining of workers.
- Focusing on developing the capabilities and competitiveness of its own local producers in face of foreign competition helps local enterprises grow and develop their capabilities to compete in the world market.

## **Chapters 10-12: Globalisation and the International Economy**

### **Suggested Answers**

#### **Limitations of Policy 2a: - Conflict with Structural unemployment**

- Efforts to develop our domestic industries and help them move up the value-added production chain, often leads to an increase in structural unemployment.

#### **Policy 2b: Supply side-Retraining/ Skills development our workforce**

- In order to prevent the conflict with structural unemployment and improve our labour productivity, the government also rolled out skills future, which enables all eligible Singaporeans to upgrade their skills by giving them a \$500 grant to attend accredited skills related courses. This is especially important for Singapore, given that labour is practically our only natural resource available.

#### **Policy 2a and 2b: Effectiveness**

- These schemes help increase the productivity of the firms and help lower their per unit cost of production. This will then increase the production capacity of Singapore in the long run, as well as lower general price level of the economy as LRAS increases.
- These will then help us improve our global, as well as making our economy more attractive to FDIs.
- Therefore, supply side policies are key to Singapore's global competitiveness and attainment of its macroeconomic goals. In particular, in the long run, to ensure we can continue to sustain our competitiveness through the encouragement of investments.

#### **Limitations of Policy 2a and 2b: Supply side policies**

- The impact of most Supply side policies are only seen the long run. Hence, they will not be able to improve Singapore's global competitiveness in the short run.
- Also opportunity cost is incurred.

#### **Due to limitations of Policy 1 and 2, also need FTAs to help boost export competitiveness**

- The Singapore government has in recent times embarked on a policy of forging FTAs with many countries.
- The lack of trade barriers has hence helped boost our export competitiveness due to less taxes on our exports leading to relatively lower prices.
- Adopting a free trade policy without any import restrictions also enables us to avoid retaliation from other countries which will hurt Singapore's exports.

#### **Use of FTAs to boost FDIs**

- In addition, FTAs go beyond trade. They also help boost FDIs as there is more interconnected investments between countries. They are designed to support SG's business community in moving up the value-added ladder and knowledge chain and to achieve global competitiveness.

#### **Anti-Thesis 2- Limitations of FTAs**

- With Free Trade policy, Singapore firms will face increased competition; Singapore's FTA partners will also enter Singapore more easily than before. Service suppliers are more likely to feel the impact of foreign competition.

#### **Evaluative Conclusion**

- Being a small and open economy with a small domestic market and a lack of resources, Singapore is highly dependent on both exports and imports to drive its economic growth. With a small domestic market and our dependence on external demand and FDIs, it is crucial for the government to have sound policies to maintain our global competitiveness.

## Chapters 10-12: Globalisation and the International Economy

### Suggested Answers

- In face of limitations from the policies adopted, it is thus crucial for Singapore government to use a mixture of long and short term policies, that target both increasing AD and AS to complement one another and help us overcome the potential conflicts and sustain the growth of our economy into the long term.

### Marks Scheme

Levels	Descriptors
<b>High L3 18 - 20</b>	<p>For an answer that demonstrates knowledge, understanding, application and analysis:</p> <ul style="list-style-type: none"> <li>➤ EXCELLENT breadth that considers the following economic concepts in explaining multiple and balanced perspectives, viewpoints, relationships and factors. ALL points chosen should be of relevance and significance in answering the question.</li> <li>➤ EXCELLENT depth in economic analysis that reflects the following in ALL explanations. <ul style="list-style-type: none"> <li>✓ Accurate use of economic concepts, clear elaboration and precise use of economic terminologies, language and phrasing.</li> </ul> </li> </ul> <p>The answer should also be supported by:</p> <ul style="list-style-type: none"> <li>✓ Well-labelled and well-referred to diagram(s) / tool(s) of analysis drawn with precision (where appropriate).</li> <li>✓ Relevant examples and accurate use of facts.</li> <li>✓ Logical structure</li> </ul>
<b>Low L3 15 - 17</b>	<p>For an answer that demonstrates knowledge, understanding, application and analysis:</p> <ul style="list-style-type: none"> <li>• At least VERY GOOD <b>breadth</b> that considers the following economic concepts in explaining multiple and balanced perspectives, viewpoints, relationships and factors. MOST points chosen should be of <b>relevance</b> and <b>significance</b> in answering the question.</li> <li>• At least VERY GOOD <b>depth</b> in economic analysis that reflects the following in MOST explanations. <ul style="list-style-type: none"> <li>✓ Accurate use of economic concepts, clear elaboration, and precise use of economic terminologies, language and phrasing.</li> </ul> </li> </ul> <p>The answer should also be supported by:</p> <ul style="list-style-type: none"> <li>• Well-labelled and well-referred to diagram(s) / tool(s) of analysis drawn with <b>precision</b> (where appropriate).</li> <li>• <b>Relevant</b> example(s) and <b>accurate</b> use of facts.</li> <li>• <b>Logical</b> structure.</li> </ul>
<b>High L2 12 - 14</b>	<p>For an answer that demonstrates knowledge and understanding but lacks application and analysis:</p> <ul style="list-style-type: none"> <li>➤ At least GOOD <b>breadth</b> that considers the following economic concepts in explaining multiple and balanced perspectives, viewpoints, relationships and factors. MOST points chosen should be of <b>relevance</b> and <b>significance</b> in answering the question.</li> <li>➤ At least GOOD <b>depth</b> in economic analysis that reflects the following in MOST explanations. <ul style="list-style-type: none"> <li>✓ Accurate use of economic concepts, clear elaboration, and precise use of economic terminologies, language and phrasing.</li> </ul> </li> </ul> <p>The answer should also be supported by:</p>

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

	<ul style="list-style-type: none"> <li>➤ Diagram(s) / Tool(s) of analysis that may not be well-labelled, may not be well-referred to and may not be drawn with precision (where appropriate).</li> <li>➤ Example(s).</li> <li>➤ <b>Logical</b> structure</li> </ul>
<b>Low L2</b> <b>9 - 11</b>	<p>For an answer that demonstrates knowledge and understanding but lacks application and analysis:</p> <ul style="list-style-type: none"> <li>• At least <b>SUFFICIENT breadth</b> that considers the following economic concepts in explaining multiple and balanced perspectives, viewpoints, relationships and factors. <b>SOME</b> points chosen should be of <b>relevance</b> and <b>significance</b> in answering the question.</li> <li>• At least <b>SUFFICIENT depth</b> in economic analysis that reflects the following in <b>SOME</b> explanations. <ul style="list-style-type: none"> <li>✓ Accurate use of economic concepts, clear elaboration, and precise use of economic terminologies, language and phrasing.</li> </ul> </li> </ul> <p>The answer should also be supported by:</p> <ul style="list-style-type: none"> <li>✓ Diagram(s) / Tool(s) of analysis that may not be well-labelled, may not be well-referred to and may not be drawn with precision (where appropriate).</li> <li>✓ Example(s).</li> <li>✓ <b>Logical</b> structure.</li> </ul>
<b>Low L2</b> <b>5 - 8</b>	<p>For an answer that demonstrates knowledge but lacks understanding, application and analysis:</p> <ul style="list-style-type: none"> <li>• <b>INSUFFICIENT breadth</b> that considers the following economic concept(s). Point(s) chosen may be of relevance but may not be of significance in answering the question.</li> <li>• <b>INSUFFICIENT depth</b> in economic analysis that may reflect the following: <ul style="list-style-type: none"> <li>✓ Lack of accuracy in the use of economic concepts, lack of clarity in elaboration, and lack of precision in the use of economic terminologies, language and phrasing.</li> </ul> </li> </ul>
<b>Low L1</b> <b>1 - 4</b>	<ul style="list-style-type: none"> <li>• Demonstrates <b>POOR</b> breadth and <b>POOR</b> economic analysis.</li> <li>• Is irrelevant in analysis but may contain an introduction that addresses the question or contains no economic analysis but may contain a few statements that are relevant to the concepts required to answer the question.</li> <li>• Contains fundamental conceptual errors in analysis.</li> </ul>
<b>Levels</b>	<b>Descriptors</b>
<b>E3</b> <b>4 - 5</b>	<p>For an evaluation that contains</p> <ul style="list-style-type: none"> <li>➤ A synthesis of earlier economic arguments to arrive at <b>relevant</b> judgements/decisions (i.e. answer the question).</li> <li>➤ Well-explained criteria-based evaluative comments supported by <b>accurate</b> and <b>clear</b> analysis to provide <b>fairness</b> in views.</li> <li>➤ A good summative conclusion.</li> </ul>

**Chapters 10-12: Globalisation and the International Economy**  
**Suggested Answers**

<b>E2</b> <b>2 - 3</b>	For an evaluation that contains <ul style="list-style-type: none"><li>➤ <b>Relevant</b> judgement(s)/decision(s) (i.e. answer the question) that may not follow from earlier economic arguments.</li><li>➤ Criteria-based evaluative comment(s) supported by analysis to provide <b>fairness</b> in views but the comment(s) may not be well-explained, may be unclear and/or may be inaccurate at times.</li></ul>
<b>E1</b> <b>1</b>	For an evaluation that contains <ul style="list-style-type: none"><li>➤ <b>Relevant</b> but unexplained evaluative judgement(s)/statement(s) i.e. evaluative judgement(s)/statement(s) not supported by analysis or</li><li>➤ A <b>relevant</b> conclusion.</li></ul>