2011 VJC2 JC2 H2 Economics Prelim P2 Mark Scheme

Essay 1
As the world experiences soaring international oil prices, countries like Malaysia and Indonesia have provided fuel subsidies while Singapore and Australia have not.

Discuss the impact of soaring international oil prices and fuel subsidies on society. [25]

Approach:
Candidates should recognise that soaring international oil prices can be explained using a Demand/Supply/elasticity (DSE) framework. Although not explicitly required by the question, the possible DSE reasons for soaring international oil prices should be briefly explained/described (as it may have some bearing on the impact on the various sectors of the society). Candidates must use the DSE framework and welfare concepts (consumer and producer surplus) to evaluate how society, broadly (1) crude oil producers (e.g. oil producing countries, oil producing firms etc), (2) crude oil consumers (e.g. oil refining firms, manufacturing industries, consumers of processed fuel – households and firms etc) will be impacted (negatively or positively) by soaring oil prices. Clear illustrations using clearly labelled diagrams and good examples are a requirement for strong marks. Strong candidates might even differentiate the analysis further by evaluating how the impact on specific groups within a broad group might be different (e.g. low-income vs high-income households, manufacturing sector vs service sector firms). As the question hints that some countries (governments) have implemented fuel subsidies, candidates must evaluate (using the DSE and welfare/efficient concepts) how the fuel subsidies (e.g. price ceiling, subsidies) might have affected the respective impact on the various sectors (include government) of the society. Therefore, diagrams and examples showing fuel subsidies measures must be included.

Possible concepts/discussion to be applied (do not need all to score full marks)
- Soaring international oil prices
    - DD, SS, Ep, Es factors
- Impact of soaring international oil prices on producers and consumers (and some governments and workers)
    - Net oil exporter countries (government) vs net oil importer countries
    - Oil producing firms vs oil consuming firms
    - High oil-dependent firms vs low oil-dependent firms
    - High oil-dependent households vs low oil-dependent households
    - High-income vs low-income households
    - P and Q, TR and TE analysis
    - Consumer and producer surplus
    - Efficiency vs equity trade-off
- Impact of fuel subsidies on producers, consumers, governments, workers
    - Price ceiling vs subsidies
    - Consumer, producer surplus and government expenditure
    - Efficiency vs equity trade-off
    - Equity in distribution of government subsidies

Intro
- Briefly identify that soaring oil prices is due to increase in demand and fall in supply/no change in supply.
- Soaring oil prices can have positive and/or negative effects on consumers (oil refining firms, oil/fuel consuming firms, households etc), producers (crude oil firms/countries).

- Identify that some countries like Malaysia and Indonesia provide fuel subsidies in response to dealing with the soaring international oil prices. Define fuel subsidies (price ceiling or subsidies) as payment made by the government to lower the price of fuel.
- Subsidies have positive and/or negative effects on consumers (firms which use oil and households) and the government. We also need to consider the impact on allocative efficiency and equity.

Body

Impact of soaring international oil prices

1. Explain reasons for soaring oil prices

Demand side:

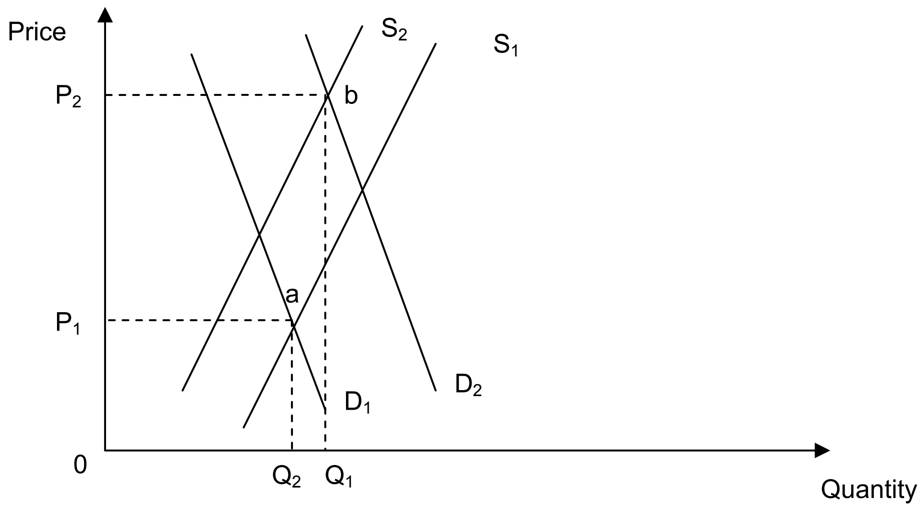
- Rising demand caused by increased demand from industrialized countries and rapidly expanding economies such as China and India which need oil for production. Rising affluence leading to a greater need for crude oil which is processed into fuel mainly used for transport, manufacturing for industrial products, electricity generation
- Hedge funds and other speculators betting on the possibility of higher prices have exacerbated price pressure in the market.

Supply side:

- Slow down in oil supply growth, crude oil is a limited resource, and the remaining accessible reserves are more technically difficult to extract.
- Events such as violence in the Middle East have led to disruptions in oil supply.
- Climate changes, freezing weather, storms, caused disruptions to the shipments of crude oil.
- Restriction of supply by OPEC.

(Accept explanation for no change in supply)

The increase in demand coupled with a fall in supply lead to the increase in oil prices. Large increase in price as the demand is price inelastic due to the lack of substitutes and supply for it is rather price inelastic as it is difficult to extract oil in the short run.



2. Negative impact of soaring international oil prices

- Consumer of crude oil will be negatively affected. The consumers of oil include oil refinery firms and households. As prices increase sharply, these consumers will face an increase in total expenditure (P x Q) of area $P_2bQ_1Q_20$. Show increase in total expenditure with reference to a diagram. EV: The impact could be more adverse for low-income consumers as a larger proportion of income is spent on fuel to generate power for basic needs e.g. lighting, electrical appliances. The impact could be less adverse on firms which are in the services industry where their dependence on fuel might be lower. Oil refinery industries (Venezuela, South Korea, Singapore) experience increase in cost of production and hence see falling profits. EV: The demand for processed fuel is also inelastic, therefore these firms can transfer the increase in cost of production to the buyers of processed fuel. Households experience higher cost of living which adversely affects their standard of living. EV: Those living in countries such as Australia and Singapore which do not provide fuel subsidies will experience a greater rise in cost of living compared to countries such as Malaysia and Indonesia which provide subsidies.

- (Answers which explain impact of soaring international on macro economic objectives are acceptable but must ultimately link answers to impact on households, workers, firms)

3. Positive impact of soaring international oil prices

- As oil faced a sharp increase in price, oil producers will benefit. As prices increase sharply, total revenue (P X Q) earned will be much higher. Increase in total revenue is area $P_2bQ_1Q_20$. Countries in the Middle East such as Saudi Arabia and Iran will see huge increases in revenue as they control a large proportion of the world's oil reserves. EV: Their governments do not need to tax to raise tax revenue, therefore consumers and producers in such countries benefit as they not need to pay taxes.

- (This market has –ve externalities. Production/consumption of oil results in pollution that is harmful to the health of 3rd parties. Briefly explain that the market mechanism results in over-production of petrol resulting in welfare loss. With less quantity produced/consumed soaring international oil prices reduces allocative inefficiency and hence causes less welfare loss.)

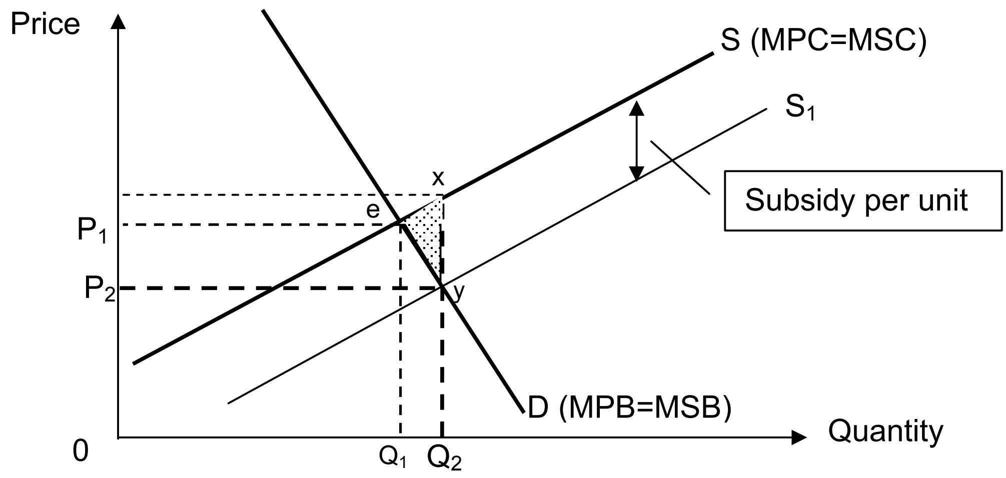
Impact of fuel subsidies

1. Explain fuel subsidies

The rationale for implementing fuel subsidies is to help firms which use fuel lower cost of productions so that their goods are cheaper and also as it is a basic necessity for households, so the subsidies help households especially the poor afford it.

Types of fuel subsidies

a) A subsidy given by the government has the effect of decreasing the marginal cost of production. Imposing a subsidy will shift the supply rightwards, i.e. supply increases. Producers will now need a lower price to offer the same quantity for sale. (Explain with reference to a diagram)



b) The government may impose a maximum price on fuel which means consumers of fuel pay the maximum price. The government then compensates petrol producers the difference between the market price and the maximum price.

2. Positive impact of fuel subsidies

- Consumers of petrol enjoy lower prices because of the subsidy. For households, they will enjoy greater consumer surplus (can refer to a diagram, increased consumer surplus of area P_1eyP_2) and lower cost of living.

EV: But these subsidies benefit both the poor and the rich households alike as everyone enjoys the same benefits of the subsidy. It seems that the subsidies mainly benefit the richer owners of cars and air-conditioners. Thus, equity in income distribution could be worsened.

- Firms which use petrol in their production (e.g. for transportation) will benefit as the subsidy allows them to reduce their cost of production. This allows them to enjoy greater profits.

EV: These subsidies will lead to firms and their shareholders gaining significantly which may worsen the income equality in the country.

- Firms in countries which has fuel subsidies will be able to continue their production at a lower cost and this provides them with an advantage in terms of competitiveness in exports. EV: this distortion in the opportunity cost distorts the comparative advantage of the country and as a result specialise in the production in a 'wrong' industry.

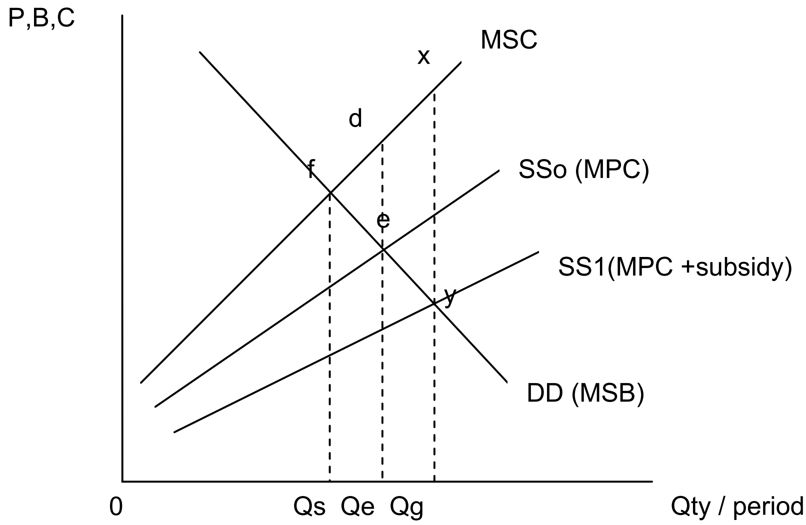
- (Answers which explain impact of subsidies on macro economic objectives are acceptable but must ultimately link answers to impact on households, workers, firms)

3. Negative impact of fuel subsidies

- If the initial equilibrium output was allocative efficient, then the provision of a subsidy in such a market will result in welfare loss. With reference to the subsidy diagram, - Assume that the initial equilibrium output, Q1 is allocative efficient (MSB = MSC). The rise in supply causes the equilibrium price to fall to P2 and output to rise to Q2. The resulting rise in output by Q2 – Q1 units causes a welfare loss equal to area exy. This is because for each of the

Q2 – Q1 units, MSB < MSC which means there would have been a net welfare loss in producing those units.

- Furthermore, this market has –ve externalities. Production of petrol results in pollution that is harmful to the health of 3rd parties. Briefly explain that the market mechanism results in over-production of petrol resulting in welfare loss.



By increasing production/consumption of petrol, production subsidy worsens allocative inefficiency and hence causes greater welfare loss (rises from area fde to fxy). This is an example of govt failure. With the current practice of heavily subsidizing petrol, industries have less incentive to continually lower costs as compared to rivals in other countries. Over time, this is indeed a serious issue as foreign producers become more competitive whilst the local producers become "addicted" to cheap fuel.

- In addition, these subsidies may distort opportunity cost of the country as the price of petrol is artificially low. Firms in the countries with these subsidies may benefit from lower cost of production and consume petrol beyond its true opportunity cost. This distorts the efficient allocation of resources further.

- These subsidies are a huge strain on the government budget. These means that there is money spent on other important sectors of the economy such as health, education and infrastructure which may affect standard of living. Countries such as Malaysia and Indonesia are spending huge amounts on subsidies causing them to face budget deficits which have adverse effects on society. Furthermore, the government may increase taxes to fund the subsidies. For example, increase in personal income tax which leads to fall in disposable income which means households will have less purchasing power, and this affects their standard of living.

Conclusion
Soaring oil prices though have benefited crude oil producers have led to relatively more significant negative impact on society. Some governments around the world have reacted with

the introduction of fuel subsidies to increase affordability of this necessity. The impact of the soaring oil prices and fuel subsidies vary from country to country.

With continued rising oil prices, the amount spent by governments on such subsidies will not be sustainable. The benefit of affordable prices for the poor will come at a very high opportunity cost - e.g. forgo expenditure on investments needed for economic growth. These subsidies are at best temporary measure as it distorts the efficient working of the price mechanism.

Alternative solutions to tackling high oil prices include governments encouraging firms to use more fuel-efficient technology. Although this may require funds and a significant period of time, it may be a better long term to address the adverse impact of high oil prices.

Mark Scheme

L1	Answer which identifies /defines terms that are relevant to the question.	1 – 5
	Answer which only explains why oil prices are soaring and rationale for provision of subsidies OR An answer which briefly describes impact of soaring oil prices and/or fuel subsidies but answer lacks economic analysis.	6 – 8
L2	An answer which explains the impact of soaring oil prices or fuel subsidies with some economic analysis.	9 – 11
	An answer which evaluates both positive and negative effects of soaring oil prices <u>and</u> fuel subsidies with economic analysis but some gaps in explanation OR A one-sided answer which evaluates both positive and negative effects of soaring oil prices <u>or</u> fuel subsidies OR A one-sided answer which considers both the impact of soaring oil prices and fuel subsidies but evaluates only positive effects <u>or</u> negative effects. With some reference to different countries.	12 – 14
L3	An answer which accounts for the rise in oil prices and the rationale for providing subsidies. An answer which thoroughly evaluates both positive and negative effects of soaring oil prices <u>and</u> fuel subsidies. Limited comparison using examples (e.g. oil-producing countries vs. Non oil producing countries or countries with subsidies vs. those without, low-income vs high-income households, manufacturing vs non-manufacturing firms etc)	*15 – 17*
	All in the above row + compares using examples (e.g. oil-producing countries vs. Non oil producing countries or countries with subsidies vs. those without, low-income vs high-income households, manufacturing vs non-manufacturing firms etc)	18 – 21
E1	Makes judgments based only on critical analysis. Conclusions are largely	1 – 2

	generic. E.g. “Whether this effect will happen will depend on ……”	
E2	Makes judgments based on critical analysis and consideration of the short run and long run; which parties will be most or least affected; type of country. Gives suggestions on other measures to deal with the root causes of soaring oil prices.	3 – 4

Essay 2

Barriers to entry confer more market power on firms in their pricing and output decisions and behaviour.
a. Using examples, explain how barriers to entry will confer more market power on firms. [10m]
b. Discuss whether greater competition should be introduced into markets in Singapore. [15m]

a. Explain how barriers to entry will confer more market power on firms. [10m]
Approach
Candidates should use at least 3 (different types/nature) examples of barriers to entry and explain clearly how each BTE will confer more market power on firms. Types of BTE include natural (EOS, control of raw materials, localized monopolist) or artificial ones (legal barriers, deterrence strategies). Concepts like market share, lesser substitutes, more inelastic demand etc are important concepts to be applied in the answer. An illustration with a diagram will be an excellent way to conclude the answer.

Introduction
Barriers to entry (BTEs) are obstacles or restrictions that make it difficult or impossible for new firms to enter an industry. BTEs can be artificial or natural. The degree or extent of BTEs will determine the level of market power and competition in an industry. Typically for industries will high barriers to entry, the firms will generally have higher market power.

Explain how more market power is conferred:
The extent to which a firm can exercise its influence on market power is an indication of its market power. The number and size of firms, nature of product and barriers to entry contributes to a firms' market power. The more market power a firm has determines the slope of the demand curve (more price inelastic demand and less substitutes - higher price a firm can charge)

Example 1
- Natuiral -- EOS
    - o Industries such as telecommunications and utilities usually have very high fixed cost and often requires a large output to spread out the large fixed costs (i.e. reach MES). As the MC or variable cost of supplying extra output is very low relative to the fixed cost, the AC is falling throughout the entire range of the market demand curve. For example, setting up the extensive network of power stations and cables to distribute electricity is very high but distribution of an additional kW of electricity is very much lower in comparison.
    - o Often the whole market is only able to support a single firm as the AC will be substantially higher if the market share was divided (illustrate with diagram).
    - o Therefore, only 1 single firm tend to serve the entire market and it therefore has substantial market power. (Illustrate with diagram the profit max P and Q.

Example 2
- Artificial barriers -- legal
    - o Artificial barriers through licencing or patents which are usually given only to very few firms or 1 firm in the case of patents confer high market power on firms. As the license is granted to only a few firms or 1 firm, the firm with the license or patent will be able to enjoy exclusive right to the market.

- For example, Singtel was the sole fixed line telephone services provider before the telecommunication sector was liberalized.
- This prevented new firms entering the industry and therefore created a very inelastic demand for Singtel due to a lack of substitutes available as Singtel has complete market share. → Conferring SingTel with high market power.

BTE like intellectual property rights and patents can help firm to confer more market power. Firms are unable to join a particular industry as they do not have the technology or patents and is thus unable to free ride on that of the others, e.g. Apple's distinctive touch screen capabilities enables it to gain a strong market share in the global electronics market with its IPhone, IPAD. Its competitors, like Creative Z110 and Blackberry, have seen a fall in market share as it is unable to compete due to its limited technology and thus leading to Apple acquiring more market power.

Strategic Entry Deterrence
Strategic entry deterrence are used by the incumbent firms to prevent entry of new firms and even drive out the other marginal existing firms in the industry. Strategic entry deterrence, like product recognition and product complexity, is used to confer more market power. The firm may engage in a lot of advertising which raises the fixed cost and it would be hard to compete with the incumbent as the very high cost discourages potential entrants. Product complexity in terms of after sales services is provided and developed e.g. BMW and Mercedes engage in a lot of advertising and extensive services. The costs of developing the brand name and dealer network may be substantive and this acts as an effective deterrent for new entrants to the market. Hence the market power they had is much more than their rivals like Kia and Toyota.

Conclusion
High barrier to entry makes it difficult for new firms to enter the industry and as a result of a lack of substitutes lead to an inelastic demand for firms. The inelastic demand allows firms the ability to restrict output in order to raise prices without losing significant market share.

Mark Scheme

Level		Marks
L1	Mere definition of relevant concepts or Description of the different kinds of BTEs without explaining how they confer firm with more market power.	1-3
L2	Explain how BTEs may confer firms with market power using relevant concepts however, there are gaps or mistakes or there is a lack of use of examples.	4-6
L3	Clear explanation (using relevant concepts) how BTEs (at least 3 different types) confer more market power on firms. There is also consistent and good use of examples to illustrate.	7-10

b. **Discuss whether greater competition should be introduced into markets in Singapore. [15m]**

Approach
The discussion on whether greater competition should be introduced into markets in Singapore should be done using a TAS framework. The thesis on why/how greater competition should be introduced should focus on the benefits of having greater competition. The anti-thesis will focus on the cost of having greater competition. The benefits and costs to be discussed will be the respective impact on consumers, producers, society, discussion can be in terms of prices/consumer surplus, profits/producer surplus, choices/variety, quality (in terms of innovation/R&D), efficiency/welfare loss and equity (issues such as employment, economic growth or SOL can be considered but will be difficult to be conclusive). It is important to note that it is difficult (almost impossible) to have a synthesis or an overall conclusion remark on whether greater competition is indeed good for Singapore on the whole as the costs and benefits in the various industries could be very different due to differences in the nature of the industry (e.g. nature of product, size of market, EOS, importance of technological advancement). What is more manageable and definitely expected from candidates is an assessment of whether greater competition is indeed good in the respective markets or sectors in Singapore (e.g. public transport, primary health care, broadband provision, banking, F&B, retail, manufacturing, construction etc). A clear analysis of the benefits and costs of greater competition and an application of the analysis, to at least 2 distinct examples, and a conclusion/synthesis is required.

Introduction
Having greater competition means allowing more firms to enter the industry. This increases the level of competition amongst firms and tends to result in a loss of market share/power in existing firms. Greater competition has impact on consumers, producers and society on a whole and these impact can be analysed based on the impact on prices/consumer surplus, profits/producer surplus, choices/variety, quality (in terms of innovation/R&D), efficiency/welfare loss and equity.

Examples of increasing competition in markets may include the outcome of pro-market government policy such as liberalization, deregulation etc. The impetus could be to encourage Singaporean firms to be more efficient, be able to compete more effectively with foreign competition or prevent the exploitation of consumers.

Thesis (Greater competition in Singapore markets is beneficial)

Effects on consumers:

<u>Lower prices</u>
The introduction of greater competition into the Singapore markets → reduces market power amongst firms → price elasticity of demand increases (potential weakening of market power) → ability to charge high prices come down→ lower prices → increasing consumer's surplus (assume the quantity consumed is the same).
E.g. liberalization of the Telco industry with the entry of M1 and Starhub has led to lower of prices of mobile plans)

The introduction of competition also reduces the occurrence for X-inefficiency as there are competitors to benchmark against each other to provide good quality products/services at low cost → more stringent cost-saving techniques are adopted by firms to remain competitive → consumers may gain in terms of lower prices.

E.g. issuing 2 licenses to MBS and RWS to ensure that there is little room for them to be complacent, allowing SingTel to operate MioTV to prevent Starhub Cable from enjoying complete dominance in the cable TV market

More variety/choices
The introduction of greater competition → firms to be more dynamic and responsive to consumers' needs → better, more innovative services, more promotional offers → consumers enjoying a wider variety and quality of products or services.
E.g. Telcos (number portability, wide network or costumer service centres, more VAS), liberalisation of the Singapore-KL route to allow more airlines to operate has increased the options available to passengers as they are not restricted to SIA or MAS flights.

Effects on Society:

Allocative efficiency
As explained earlier, greater competition → reduced market power → reduced ability to restrict output to increase price → society moving closing to the allocative efficient output.

Equity
The reduction in the supernormal profits earned by the firms → more equitable income distribution between the consumers and producers

Anti-thesis (Greater competition in Singapore markets is not beneficial)

Effects on consumers

Higher prices
With greater competition → firms may engage in promotional efforts (e.g. advertising, trying to secure the distribution rights) in order to increase the market share or improve their attractiveness to consumers → however competitors will also engage in similar efforts → increase in promotional cost without any significant increase in market share → firms will increase price as a result of rising cost of production → consumers will face higher prices
E.g. Starhub and SingTel trying to out-bid each other for the rights to telecast soccer matches and consumers suffer a higher price as a result, consumers pay higher prices as a result of firms paying big sums of money to celebrities to endorse their product.

The relatively small market in Singapore may only be able to accommodate a small number of firms. With the entry of more firms into the market → each firm will have a smaller market share → less scope for large scale production → inability to reap substantial internal EOS →higher cost of production → firms may transfer the higher cost of production to consumers

Less R&D/innovation
Firms require ability and incentive to do R&D. Therefore, greater competition → reduction in protection → reduction in incentive to do R&D. Also, if greater competition leads to lesser profits, there will also be a reduction in the ability to do R&D. → consumers may suffer due to a lack of efforts in R&D/innovation.

Effects on producers

Lower profits

With greater competition → firms lose some market power and ability to set higher prices → market share is reduced and the price they can charge is reduced → lower sales revenue.
Also, greater competition → increase in promotional activities → increase in cost of production.
Therefore, the reduced revenue coupled with an increase in cost of production results in reduced profits for the producers.

The relatively small market in Singapore may only be able to accommodate a small number of firms. With the entry of more firms into the market → each firm will have a smaller market share → less scope for large scale production → inability to reap substantial internal EOS →higher cost of production → reduce profits

Evaluation
We can see from our discussion that greater competition in the Telco industry is largely beneficial for the society as the competition amongst SingTel, Starhub and M1 ensured that prices are kept low and competitive. The 3 firms also compete amongst themselves to provide good quality customer care and value-added services. Consumers are able to benefit and society move closer towards more efficiency in the distribution of resources and equity in income distribution. Although it may seem the producers do not benefit from the reduction in profits. However, the greater competition has forced them to become more efficient and as a result they are now able to compete better in the face of foreign competition.

It was slightly different in the banking sector when reduced competition amongst the local banks was encouraged with the mergers of several banks into 3 larger ones (DBS, OCBC and UOB). The merger of the local banks allowed them to be able to exploit more EOS as the increase market share allowed the banks to increase production. These EOS includes R&D, firm EOS etc (e.g. ebanking, investment in sophisticated systems). Consumers were able to enjoy lower prices and better products as a result of the reduction in competition. This also resulted in the banks becoming more competitive to be able to cope with foreign competition when they were introduced into Singapore. Now, consumers enjoy even more due to the increased competition when the foreign banks were allowed to set up their operations in Singapore.

The media industry was one where greater competition was not beneficial due to the limited size of the domestic market. When Mediaworks was formed to inject competition into the market, the result was wasteful competition and duplication of resources. The cost of production was raised as artistes and production crew had more bargaining chips in asking for higher wages. Advertisers were also able to bargain the price they have to pay for advertisement airtime. As a result, profits fell and the two firms merged eventually. A similar result is expected in the public transport (e.g. MRT) where it will be wasteful if 2 different companies operated and served the same route.

Conclusion
Therefore, it is difficult to conclude that greater competition is indeed good for Singapore. There are industries whose characteristics favoured more competition, especially those which face competition from foreign firms. Those industries which generally are not conducive for reduction in competition are those such as public transport and media, utilities etc

Mark Scheme

Level		Marks
L1	Able to define relevant concepts or able to list and describe the various benefits and costs of greater competition. However, there is no economic	1 -4

	analysis.	
L2	An answer which addresses both the benefits and costs of having greater competition in Singapore, however there are gaps or mistakes in the analysis OR An answer which addresses both the benefits and costs of having greater competition, however there are no or very little reference to the Singapore context OR A one-sided answer which consider only the benefits OR costs of having greater competition in Singapore	5 – 8
L3	An answer which thoroughly evaluates both the benefits and costs of having greater competition with reference to the Singapore context and examples.	9 – 11
E1	Conclusion which is largely unexplained.	1 – 2
E2	Conclusion which is explained and take into account Singapore context.	3 - 4

Essay 3

Consider different forms of market failure in Singapore and evaluate their significance for the efficient working of the economy. [25]

Approach

Different *types* of market failure: market power, externalities, ignorance and asymmetric knowledge, principal-agent problems and moral hazard, should each receive attention. The first three of these can reasonably expect to gain the lion's share of the marks. (Answers that treat inequality of income as a further source market failure should also receive credit if the argument supporting inequality is well presented. Full marks can be attained without this approach.)

<u>*Assertion*</u> of the levels of significance of different failures will only reach modest marks. An <u>*argument*</u> is expected about why these phenomena are market failure at all, and then about the level of *significance* they have *in Singapore*.

Brief Outline

First a general *definition* and explanation of market failure as the inability of markets to clear where MSC = MSB, the socially optimum (*efficient*) level of output.

Then **either** an overview of the ***variety*** of forms that market failure can take, with some attempt at *categorising* its forms either by type – market power, externalities, etc, or by effect – under-provision of public goods, merit goods, goods provided monopolistically, or in markets with asymmetric information; overprovision of demerit goods and in some cases because of moral hazard. This should be followed by *detailed* examination of each illustration and an attempt to assess its ***significance***...

Or *straight into* a *case by case* examination of the particular ***instances*** of market failure in some detail but with observations about how the underlying reasons for the cases ***differ*** from each other and (as above) an attempt to assess the ***significance*** of each.

A concluding broader *evaluation* of the significance of each failure *in the* ***Singapore*** *context,* probably with some attempt at ranking (but this is not necessary if the differing significance has already been made clear).

Mark Scheme

L1	Demonstrates ability to *define* market failure and *recognise* a range of illustrations	1-8
L2	Shows an *understanding* of the underlying reasons for a variety of examples of market failure but with no clear attempt to address 'significance'	9-14
L3	Demonstrates ability to *analyse* the underlying reasons for individual cases of MF in order to clearly *distinguish* and *differentiate* them from one another and *assess* their individual significance	15-21
E1	Offers a justified overarching evaluation/ranking of the significance of the range of cases cited, but incompletely	1-2
E2	Offers a thorough and overarching evaluation of the differing significance of the range of chosen Singaporean examples used	3-4

Essay 4

Singapore's real GDP growth was 13.9% and current account surplus growth was 32.8% in 2010.

a) Explain why real GDP and current account balance are indicators of living standards in Singapore. (8)

b) Discuss the most appropriate policies that a government could adopt to achieve sustained economic growth. (17)

Approach

Define real GDP, current account balance and standard of living. Explain the use of real GDP per head as the key indicator of standard of living. Explain the great importance of trade to the Singapore economy. Since GDP = C+I+G+(X-M) the size of NX as a percentage of GDP is of significance for Singapore.

However, both are indicators only of the material welfare of the people. To have an indication of the quality of life, there must be other indicators.

Brief Outline

Define standard of living -- the material and non-material welfare of an individual or household.

Real GDP

Define Real GDP -- the value of final goods and services produced within the country during a period of time usually a year after discounting for inflation.

It is a measure of Singapore's economic activity or output performance. It can indicate material welfare of an individual.

Real GDP divided by the appropriate population gives real GDP per capita. **Real GDP per capita** is a key measure of the average living standards in Singapore. The strong growth in Real GDP means Singapore is producing more output domestically. It indicates higher income per head, the people can consume more final goods and services and thus improved (material) standard of living. When the economic pie gets bigger, it will facilitate redistribution of incomes.

Whereas a contraction of real GDP figure indicates that the Singapore economy has shrunk (e.g.2009-Singapore went into a recession) and the people are worse off, having lower per capita income.

Current account balance

The current account balance is divided into 2 main items: visible balance and invisible balance. Singapore is a small and open economy which is strategically located. The nature of the economy compels it to be trade driven. Total trade makes up more than 300 percent of GDP and net exports about 30% of GDP. GDP=C+I+G+(X-M). Thus, any changes in the current account balance have great bearing on the country's real GDP.

It is important for Singapore to continue having a current account surplus as export is the largest component of GDP. When Singapore records a strong current account, its GDP expands boosted by export revenue. (given that GDP=C+I+G+X-M).There will be more income for the people, more consumption and a higher living standards. This is also an indication that the country is not spending beyond its means.

However, there should be other indicators on nonmaterial welfare. Some examples are UN's Human Development Index and MEW to have a more accurate measure of living standards.

Mark Scheme

L1	A sketchy explanation of Real GDP and current account balance as indicators of living standards in Singapore	1-2
L2	An adequate explanation of **both** Real GDP and current account balance as indicators of living standards in Singapore A good explanation of either Real GDP **or** current account balance as indicators of living standards in Singapore	3-5
L3	A good explanation of both Real GDP and current account balance as indicators of living standards in Singapore	6-8

b) Discuss the most appropriate policies that a government could adopt to achieve sustained economic growth. (17)

Approach

The focus of the question is the choice of the most appropriate policies on achieving the macroeconomic goal of sustained economic growth. Discussion on appropriateness will include that of effectiveness and suitability. For actual growth to be sustained in the long-run, there must also be increase in potential output. Discuss the mechanism, suitability and the effectiveness of demand-side and supply-side policies in achieving actual and potential growth. Discuss how well each policy works and their limitations given the different nature and the current state of the economies. Use country examples to illustrate.

Brief Outline

Define actual and potential growth. To have sustained economic growth, there must be potential growth.

Explain how policies bring about actual growth work.

1) Expansionary fiscal policy to raise AD

Involves raising government expenditure and/or reducing taxes to increase AD and leading to a multiple rise in NY.

Consider the appropriateness of the policy.
Less effective for small and open economies like Singapore where G, domestic C and I are small relative to X. The extent of change in AD is therefore smaller. Also, there is a weak multiplier effect due to high leakages because of high MPS and/or MPM. Whereas for large economies like the United States fiscal policy is much more effective in stimulating economic growth as it has a large proportion of G and domestic C, I relative to X and a large multiplier. As such, Singapore uses fiscal policy to deliver supply-side initiatives to promote potential growth. For example during the 2009 Financial Crisis.

In a recession, fiscal policy is more effective than monetary policy in stimulating growth as government spending is a direct injection into the economy and it can be targeted. But then again there are other limitations like time-lag and crowding out effect. Also in a recession, large tax cuts may not bring about huge private investment if business expectations are poor.

2) Expansionary monetary policy to raise AD

Involves increasing money supply or lowering interest rate to encourage C and I thus increasing AD.
Consider the appropriateness of the policy
Such a policy is ineffective for a small and open economy like Singapore which is an interest rate taker. Whereas for large economies, monetary policy is more appropriate given a large domestic economy.

In a recession, due to low consumer and business confidence, C and I may not increase with fall in interest rate. Thus, fiscal policy is more effective. But a decreased interest rate will allow the government to borrow to finance a deficit budget. Thus, expansionary monetary and fiscal policies in a recession can well complement one another.

3. Exchange Rate policy
Depreciation will cause exports to be cheaper in foreign currency and imports more expensive in domestic currency. Assuming Marshall-Lerner Condition holds, (X-M) rise leading to actual growth.

Consider the appropriateness of the policy
During weak economic climate, the exchange rate can be weakened to stimulate exports. But it has its limitations especially for small, open and export-driven economies as it causes cost-push inflation and may encourage competitive depreciation, leading to negative feedback effects. Thus, the use of exchange rate policy to stimulate actual growth is limited in such economies. Preventing the currency from strengthening to promote exports has been successful in China. If there is a global recession, such a policy is ineffective as global demand is low.

4. Trade Policy
The support of freer trade will expand export markets allowing for production on a large scale and goods becoming more price competitive. E.g. signing of FTAs

This is of importance for economies with small domestic markets and which are resource scarce, for example Singapore. These economies are dependent on both imports and exports. The increase in the current account surplus will boost actual growth. However, some countries may also turn to protectionism during weak economic climate which makes it difficult to reap the benefits from free trade policy.

Supply-side policies to boost potential growth (rightward shift of LRAS)
Once the economy attains full employment, further increase in real output can only occur if there is a rise in productive capacity in the economy (potential growth). To have sustained economic growth, there must be potential growth which is promoted with supply-side policies. They can be market-oriented or direct interventionist. The range of supply-side policies are privatization, deregulation, liberalisation, weaken trade unions, reduction of tax rates, government providing or subsidising training programmes, government fund/subsidies R&D, reduction of personal tax rates, building of infrastructure etc. But such policies may have long gestation period and may be a financial burden on the government.

Consider the appropriateness of the policy.
Supply-side policies are paramount and ongoing for all economies aspiring for sustained growth. But supply-side policies may be more effective in bringing about sustained growth for small and open economies given the limitations of demand management policies.

Conclusion

To have sustained actual growth there must be potential growth. Once an economy reaches full employment, the productive capacity has to be increased to allow for further actual output to increase. Supply-side policies targeting the increase in potential output is ongoing for all economies. Demand side policies targets actual growth. Which policies work best will very much depend on the current state of the economy and the nature of the economy. For small and open economies, demand-side policies like the conventional monetary and fiscal policies may be inappropriate or less effective. Such economies use supply-side policies more actively to achieve economic growth. In a recession, fiscal policy can be more appropriate than expansionary monetary policy. The latter works well in an inflationary situation. To achieve sustained growth, countries will usually use a mix of policies.

L1	Definitions of actual and potential growth. Identify some AD-side and AS-side policies	1-5
L2	Explanation of how dd-management policies can boost AD and SS-side policies boost AS with economic analysis but some gaps in explanation E.g. of gaps - considered only actual growth but not potential growth (vice-versa) - considered only demand management policies but not supply side policies (vice-versa) - explained theories but with little or no examples to illustrate - largely 1–sided without consideration of demerits/limitations	6-9
L3	A good analysis of the effectiveness and suitability of these policies (at least 2 demand-side and supply-side policies) with good use of examples to illustrate.	10-13
E1	Mainly unexplained judgement	1-2
E2	Judgement based on analysis of the nature and state of the economy	3-4

Essay 5

In 2010, the total trade deficit in the US was US$497.9 billion, an increase from the US$375 billion trade deficit of 2009.

Source: *U.S. Census*

a) **Explain the possible causes of the trade deficit in the US. [10]**
b) **To what extent does the nature of the US economy influence policy recommendations to tackle the worsening trade deficit? [15]**

a) **Approach**

Explain what is meant by trade deficit and explain at least 3 possible causes for the US trade deficit. Answers need to consider the characteristics of the US economy and its economic situation in recent years e.g. **loss in comparative advantage, the global economic recession, deterioration in the quality of the goods**, etc.

The reasons should clearly show how exports revenue may fall/increase less than imports expenditure. Need to include the assumption of price elasticity of demand for X and M wherever applicable.

Mark Scheme for Part (a):

L1	Shows knowledge of trade deficit and/or identify the causes of trade deficit	1-3

L2	Able to explain the reasons that lead to US trade deficit with some gaps in explanation Or Able to explain reasons that leads to trade deficit with no reference to the US context	4-6
L3	Able to explain thoroughly and illustrate at least 3 possible reasons for the US trade deficit **Max 8: without any examples**	7-10

b) <u>Approach</u>

- Candidates need to explain **<u>briefly</u>** the various policy tools (i.e. expenditure reducing, expenditure switching, supply-side) that the US government has at its disposal to address its worsening trade deficit. (A detailed explanation of the workings of each policy is NOT required)
- The main focus of the essay should be on the **<u>policy recommendations</u>.** Justify that the **<u>suitability and effectiveness</u>** of these policies depend on the **<u>characteristics of the US economy</u>** (e.g. dependant on its large domestic market and capital for growth, size of its multiplier, the areas of its comparative advantage, households/govt's attitude towards consumption and savings, great influence in the global financial market, strong dependence on the confidence in US currency, huge and sustained fiscal deficit etc.)
- While the effectiveness of the policies is largely influenced by the above, US policy makers need to consider **<u>other situations/conditions</u>,** (other factors not confined to the nature of the US economy) that may limit/improve the workings of the policies (i.e. the inherent problems in the policies – time lags, inefficiencies, the impact of the global recession, trading partners' trade policies, etc).
- Policy recommendations should also be based on **<u>the underlying reasons of the worsening trade deficit in US.</u>** If policies implemented do not 'match' the actual cause of the worsening deficit, not only will it worsen the deficit, there could be other unintended consequences on the economy.
- Students then have to make a judgement as to whether the characteristics of the US economy **<u>play a significant role</u>** in determining the appropriate policies to recommend.

Suggested outline:

Intro:
Describe the nature of the US economy:

- Dependant on its relatively large domestic market and capital for growth
- Domestic firms contribute a large percentage of its GDP and employment
- US is a major trading partner for most countries
- Comparative advantage lies in capital intensive production and services.
- Besides its large trade deficit, US also has a very large budget deficit which forces the government to borrow for its public sector spending.

Body:
<u>Thesis: (Nature of the US economy influences policy recommendation)</u>

Explain briefly the policies that can be used to tackle US trade deficit.

(I) Expenditure reducing policies:

Explain that **contractionary FP or MP** may be suitable because of the **nature of the US economy**:

1) large proportion of its C and I relative to its GDP/external demand. A fall in C and I will have a great impact on AE and income which in turns decreases the consumption of M.
2) low savings and large domestic C which affects the size of its downward multiplier

Evaluation:

- However, US households' consumerism behaviour may limit the effectiveness of this policy. When income falls, the level of precautionary savings may not rise by much and households may continue to spend. This may be worsened by the current low i/r that US banks offer.
- Since US is a major trading partner for a lot of countries, reducing its imports expenditure may cause a large fall in the exports revenue of other countries. These other countries may in turn demand less of US exports, worsening the trade deficit.

(II) Expenditure switching policies

(1) Devaluation of the currency

This policy is not available to the US government. Due to the bigger reliance on its domestic market (as compared to its external sector) and the ability to control its i/r independently, the US Federal Reserve Bank has chosen to control its money supply to influence its interest rates instead of the external value of its currency. Therefore it has adopted a floating exchange rate system.

(2) Protectionism

Protectionism is the main policy tool that the US government has used to tackle its trade deficit. Protectionism is suitable because domestic firms' contribution to its GDP is very large and there may be a need to protect those industries that have lost comparative advantage esp. those involved in the lower end of the production chain or labour intensive industries.

Evaluation:

- Due to its large presence in the global market, protectionism may also invite retaliation from its trading partners in the form of similar protectionistic measures. This move may spiral into a trade war.

(III) Supply side policies:

Supply side policies can be implemented to improve exports competitiveness (both price and non-price) by improving quality and productivity.

1) In order to improve the quality of US exports →employ higher level of technology and increase automation.
2) Increase in exports competitiveness can also be achieved through higher level of productivity. Government spending on education facilities, retraining programmes may develop a better skilled workforce. Such spending will help to improve the productive capacity and put downward pressure on cost-push inflation.

Evaluation:

- The outcome of such government spending may not be certain as not all firms would be able adopt these new methods of production.

- Also, these new production methods would displace a certain degree of lower skilled workers and these workers would find it difficult to find new work as they may not have suitable skills required by these industries. This may increase structural unemployment for the country and worsens the overall unemployment rate in view of the recession.
- Spending on the R&D sector and retraining programmes can be very costly and it takes a very long time before the intended outcome is seen. As the US government has a large budget deficit, it may not be able to spend much on these areas. It may have to borrow even more and borrowing may result in crowding out effect (this may not be very significant in a recession as the other sectors in the economy may not borrow very much) and causes a burden on the future American generation. **Anti-thesis: (Other factors that influence policy recommendation)**

1) Inherent problem of each of the policies

- Fiscal Policy – Govt spending may be inflexible in the SR, difficult to reduce G.
- Monetary policy – C and I may be i/r insensitive
- Protectionism distorts comparative advantage and increases inefficiency. Results in misallocation of resources since the inefficient producers are protected from foreign competition.
- Supply side policy – costly, long gestation period

2) Need to consider that US is currently in a recession, expenditure reducing policies may be ineffective as it will deflate the economy further and worsens the problem of unemployment.
3) Trading partners' protectionism policies may negate the effect of US supply side policies that aim improve its exports competitiveness. In this case US may consider signing FTAs to eliminate some of these trade barriers.
4) The suitability of the policies is also dependent on whether the US government is able to diagnose the main cause of the worsening trade deficit correctly. If the worsening trade deficit is due to high level of M consumption, then expenditure reducing policies would be suitable but if it is due to lack in X competitiveness, then expenditure switching or supply side policies should be implemented instead. A misdiagnose of the problem may result in choosing the wrong policy and in turn may cause an adverse impact on the economy.

Conclusion:

In general, the policies that are available for the US government to tackle its worsening trade deficit have mostly depended on the nature of the US economy. For example expenditure reducing polices should have a great impact on consumption of imports due to the large size of the US multiplier but consumers' behaviour towards savings may weaken the impact of this policy. Supply side policies on the other hand helps to improve the quality of exports and considered as apt and timely considering that US has lost comparative advantage in certain production. However, the government's large budget deficit will limit some of its spending in improving areas in productivity. There are also other factors that may influence the policy choice of the US government. Expenditure reducing policies may not be suitable in view of the current US recession and unemployment problems. Protectionism has been the main policy used to reduce US trade deficit especially in reducing the trade deficit with developing countries such as China. This policy however goes against the true nature of the US economy as its implementation is not in line with the country's comparative advantage. In assessing the suitability of the policies, it is also important for the US government to know the main cause of its trade deficit problem. This could be the first criteria for policy consideration before examining the nature of the US economy.

<u>Mark Scheme for part b)</u>

L1	Shows some knowledge of the nature of the US economy and/or brief explanation of policies that will help to reduce the trade deficit	1 – 4
L2	Able to explain <u>clearly</u> how the policy choice will depend on the nature of the US economy but with limited evaluation **OR** Able to explain that the policy choice is not only dependent on the nature but considered other factors, with <u>gaps in explanation</u>.	5 – 8
L3	Provides a clear analysis *and critical approach* (provided evaluation) on the effectiveness of all 3 policies. Considered the multi-faceted nature of the US economy AND other factors/situations that may weaken these policies.	9 –11
E1	Makes judgments based on critical analysis, highlighted only the nature of the US economy	1 – 2
E2	Makes judgments based on critical analysis on the nature of the US economy <u>and</u> other factors.	3 – 4

Essay 6

Globalisation of trade and investment can raise global output. Unfortunately, the impact on prosperity both between and within different countries is very variable, with some groups suffering an absolute decline in incomes.

Examine the claim that globalisation whilst beneficial overall has adverse economic consequences for certain firms and households. [25]

<u>Approach:</u>

- This question focuses on material and non-material benefits / costs related to globalisation. Reference must be made to selected micro / macro objectives related to globalisation. Eg: economic growth, unemployment, efficiency and equity as these will have impacts on firms / households
- In discussing the benefits of globalisation, some issues that could be raised include global output, higher consumption possibilities, choices, EOS, rising income. In the case of adverse consequences of globalisation, issues include rising income inequity, structural unemployment and negative externalities
- The essay should discuss issues related to
    - the country / countries as a whole
    - different extent of gains made by different countries (eg: LDCs vs DCs)
    - different extent of gains made by different sectors within the country eg industries with CA vs those without, skilled vs unskilled workers
- As the question calls for impacts on firms and households, hence explicit links must be made to them. Concepts related to
    - Firms: revenue, costs, profits, efficiency, market share and producer surplus
    - Households include a) providers of factors of production; and b) consumers: price, choice, wages, consumer surplus
- Use of *contrasting* country examples is important in this essay to enhance the quality of discussion.

Outline

- Explain the meaning of globalisation and how it brings about reorganization of production, trade and the integration of financial markets. For example, with the lowering of transport costs and communication costs, barriers to movement of goods and services, labour, and capital are lowered.
- Explain the benefits to countries that are engaged in globalisation:
    - ➢ Explain that with freer movement of goods and services, countries could specialise and trade in goods in which they have comparative advantage, that is, those in which they could produce at lower opportunity costs according to differences in their *factor endowments*. [Give contrasting examples of countries with an abundance in unskilled labour [China?] and capital/technology/expertise [USA? Japan? Germany?], and the goods they would specialize in, Highlight the benefits:

Micro concepts:

- ▪ More consumption possibilities [beyond their PPC] given that resources are more efficiently utilized. Quantity increases, prices fall, increasing households' material welfare. Trade is not limited to countries with differing factor endowments. Countries with similar factor endowments such as Japan and Germany also trade with each other in goods such as cars, giving households more variety too. [intra-trade]
- ▪ Firms will see larger markets for their products, TR increases. EOS reaped due to larger global market ➔ higher revenue, increase productive and allocative efficiency, lowers unit cost ➔ more profits for firms
- ▪ Cost is further lowered outsourcing the more labour intensive production processes [such as simple assembly and call centres] by firms (from DCs) to LDCs ➔ lower unit costs and higher profits for firms as the wages in China and India are relatively lower.
- ▪ When these cost savings are passed onto consumers, households enjoy lower prices and higher material welfare.
- ▪ Faced with more global competition, firms would also have to be more efficient to maintain their price and non-price competitiveness. This again would benefit households in terms of production quality, variety as well as prices.
- ▪ Specialisation according to different factor endowments meant that DCs which are likely to be endowed with skilled workers in capital / knowledge based industries or capital owners will benefit from greater production. Similarly, LDCs' CA in labour intensive products and the lower-end manufacturing sector will gain due to higher employment for lower-skilled workers and hence income for them
- ▪ FDI are likely to rise in DCs / LDCs based on the countries' factor endowments ➔ the above group of workers will further reap the gains from these investments. In addition, rise in I ➔ rise in AD ➔ rise in actual EG

Macro Ideas

- Export revenue for both DCs and LDCs would increase. Countries can also expect an increase in FDI. This increase in AD, this would lead to more real economic growth and employment opportunities, increasing the material welfare of households, especially those who are in sectors in which the countries have comparative advantage.

- An increased flow of FDI and technology, and unrestricted access to markets in DCs will benefit LDCs to a greater extent and help them move up to higher value added sectors and catch up with the DCs. The higher productivity means LDCs enjoy increasing productive capacity and can potentially earn higher income and greater consumption (rise in AD & AS ➔ rise in EG)

- Explain the adverse consequences to countries that are engaged in globalisation:
  [Note: It would be good if candidates can highlight that DCs and LDCs face different problems]
  - Structural unemployment – this is likely to affect the DCs more than LDCs. This could be due to: a) Globalization exposing firms in DCs, esp those in more labour intensive sectors such as manufacturing [e.g. tyres and steel in the USA] to competition from low cost countries such as China and India. b) Outsourcing: This means that workers in certain industries eg production workers in manufacturing industry in the US and service-sector workers in industries where the business processes have been outsourced like IT software design or auditing may be unemployed. c) influx of cheap labour displacing local blue-collar workers. The demand for low-skilled workers would fall. Furthermore, theseworkers may have difficulty acquiring relevant skills to move up to higher value added sectors such as finance, biotechnology etc in which DCs enjoy CA.

  - Income inequality [this follows naturally from structural unemployment]
    This problem is likely to apply more to DCs. Given that DCs specialize in high-end goods, skilled workers will see a rise in demand for them. Given the inelastic supply, the income of workers in these industries will rise very fast. Eg “mind" workers like engineers, attorneys, scientists, professors, journalists, consultants are able to compete successfully in the world market with globalization. On the other hand, unskilled workers in DCs are likely to see a fall in demand for their services, and hence a fall in wages. Worse, supply of these workers from the LDCs is increasing, depressing wages further. Hence different sectors within the economy will see different extent of gain, leading to widening income gap.

    [Not required in this question, but good to know if you want to develop this point further: The inequality may be worsened by trade unions of these industries with weak negotiating power since they now hold less power over firms that are able to easily replace workers, often for lower wages, and have the option to not offer unionized jobs anymore. Hence workers in such industries may see a decline in their income or be unemployed. However, it can also be argued that these lower-skilled workers (those in the lower / middle income groups) may potentially enjoy more from free trade. This is because they are likely to spend a larger proportion of their income on low end manufactured good eg clothes, shoes, and the like whose prices are often directly affected by free trade. On the other hand, the higher income group tends to spend more on services eg education, leisure and these are less subject to competition from abroad.]

    In LDCs, the income gap could arise due to geographical immobility. Most industries are found along the coastal / urban areas due to better transport and infrastructure facilities [e.g eastern coastal states in China vs the western ones]. Globalisation implies that production is like to take place in these places leading to increasing income disparities between urban and rural areas.

- Negative externalities experience by LDCs due to weak policing of its resources. Households / firms who are not involved in the production / consumption of these products may incur external cost like healthcare or lower productivity of its workers due to pollution or depletion of its resources ➔ worsen non-material SOL. Examples: China has the most polluted cities in the world. Amazon forests in Brazil are cut down to make way for urbanization. Excessive dependence on primary sectors as seen fast depletion of natural resources in Russia and Brunei.
- Exploitation of child labour: In many LDCs, globalization will result in MNCs utilizing workers to take advantage of the lower wage rates. This could mean exploitation of child labour with low pay. An example is the use of sweat shops by sports shoe manufacturers like Nike. The factories are often set up in these countries where employees agree to work for lower wages than would be required in DCs. However, one could argue if this is really exploitation. Will these workers be better off without globalization? Or is the lower wage rate offered a reflection of the country's CA?
- Nature of products exported: the main export of LDCs is usually agricultural goods which are income inelastic. On the other hand, DCs exports mainly manufactured goods which are income elastic to the LDCs. Given rising income over time, this means that DCs are likely to see a faster rise in demand for their goods than LDCs. This translates into faster increase in revenue for firms in DCs than in LDCs
- Assumptions of CA principle: it assumes fair trade ie no dumping etc so that all will benefit from the higher trade volume. However, in reality, this is not true and LDCs are often accused of dumping their goods to markets in DCs. Like the issue on child exploitation, is it a question that LDCs possess CA in these areas or is it a manipulation of currencies (eg China). However, when DCs dumped its products to LDCs, it is usually not due to CA.
- Volatility: the close interconnectedness due to globalisation implies that any crisis in one country may have adverse impacts on others. Eg: collapse of the subprime mortgage market in the U.S. led to a global financial crisis and recession in other countries, especially those very reliant on external demand such as Singapore. Such unpredictability can reduce a country's long term growth

Conclusion

In the long run, globalization is an important determinant of long run growth and rising living standards and arguably benefits would outweigh the costs arguably for most nations For example, globalization has played an indispensable role in lifting many people in emerging developing countries such as China and India out of poverty. However, the ***gains and costs ,maybe unequally distributed*** between different countries and between different firms and households in a particular country. Furthermore, not all countries stand to gain from globalization. For example, while the African countries, have a lot of potential to gain from trade, they continue to be undeveloped and poor largely due to corruption and weak institutions. The role of governments is therefore critical. Through policies such as retraining, transfer payments, strengthening environmental and labour regulations, as well as R&D to identify and develop potential areas of CA, the government could help in minimizing the adverse consequences and maximize the full benefits of globalization. These policies would also go a long way in ensuring a more equitable distribution of the benefits between different parties.

L1	1- 8	For an answer which identifies some basic relevant concepts eg CA principle, opportunity cost ratios, structural unemployment Assertions are made rather than reasoning Lists of benefits / costs Descriptive in nature
L2	9 - 11	Some generic and superficial *explanation* of the benefits and costs of globalisation
	12 - 14	Generic *explanation* of the benefits and costs with some attempts to distinguish between the differing extent of gains between countries / firms / households A more detailed one-sided answer explaining the given quote or an attempt to provide 2-sided explanation Egs (if used) are stated, rather than explained
L3	15 - 17	Balanced and analytical answer with <u>SOME</u> use of relevant examples Clear explanation of the links between the benefits / costs to the peculiar nature of LDCs / DCs Good analysis of <u>SOME</u> of the key issues like income equity, economic growth and structural unemployment Clear explanation related to differing gains / costs across different levels <u>OR</u> at different levels ie households, firms, countries
	18 - 21	A balanced and analytical answer with <u>CONSISTENT</u> illustration using relevant examples Clear explanation of the links between the benefits / costs to the peculiar nature of LDCs / DCs Good analysis of <u>MOST of</u> the key issues like income equity, economic growth and structural unemployment Clear explanation related to differing gains / costs across <u>AND</u> at different levels ie households, firms, countries.
E1	1-2	Conclusion is largely generic and lacks substantiation
E2	3-4	Thoughtful evaluation and substantiation of countries that benefit / lose from globalisation. Makes an overall stand.