

- a) Analyze the impact of globalization on the balance of payments. [10]
 b) Assess whether exchange rate policy is the most effective policy in managing the balance of payments in the light of a rise in globalization. [15]

a) Analyze the impact of globalization on the balance of payments. [10]

Command	Content	Context
Analyze	Impact on BOP	Globalization

<u>Increases in Trade Activity-> Greater reliance on trade</u> Recession in trading countries (E.g. 2008 Worldwide recession)	<ul style="list-style-type: none"> -> <u>In trading countries</u> -> Decrease in economic growth and employment -> Decrease in income level -> Decrease in purchasing power -> Decrease in consumption of goods and services -> Decrease in demand for imports -> <u>In domestic country</u> -> Decrease in demand for exports -> Fall in export revenue -> Fall in net export -> Persistent decrease will lead to a deficit and trade and service balance -> Deficit in the current account of BOP *Greater effects for economies producing income elastic exports
<u>Increases in Trade Activity-> Greater reliance on trade</u> Inflation in domestic country (E.g. India, China)	<ul style="list-style-type: none"> -> Increase in general price level -> Increase in price of domestically produced goods and services -> <u>Exports</u> -> Price of exports will be relatively more expensive -> PED > 1, due to availability of substitutes from trade -> Qdd of exports will fall by more than proportionately -> Decrease in export revenue -> <u>Imports</u> -> Fall in quantity demanded of domestically produced goods -> Increase in demand for imports -> Increase in import expenditure -> <u>Net export</u> -> Overall fall in net export -> Worsening of trade and service balance -> Persistent worsening will lead to a current account deficit in the BOP *Dependent on the cross elasticity of demand

<u>Increases in Capital Flow</u> <u>-> Greater reliance on trade</u> Relatively lower interest rates (E.g. USA vs China or Australia)	-> Foreign countries having a relatively higher interest rates -> Higher rates of return for portfolio investments -> Profit maximizing investors invest attracted to short term capital investments overseas -> short term capital outflow for domestic economy -> Persistent outflow will lead to a deficit in the capital and financial account -> Leads to a BOP deficit
<u>Increases Labour Mobility-> Greater reliance on foreign Talents</u> (E.g. Singapore)	-> Small economy with a lack of natural resources -> Labour as only resource -> To increase productivity and capacity -> Increase foreign labour/ talent -> Income earned is remitted to their own country -> Wages remitted is considered as an outflow via the unilateral transfer -> Persistent outflow will lead to a current account deficit in the BOP

L3	For an answer that uses analysis to underpin discussion on the causes of BOP deficit in different economies via different accounts of the BOP (Must include globalization) Max 7: 2 sided analysis but only one component Max 8: 2 well developed points	7-10
L2	An answer that undeveloped discussion on the causes of BOP deficit. Max 6: One sided analysis / without globalization	4-6
L1	Descriptive knowledge and/or without link to Balance of payments deficit.	1-3

a) Assess whether exchange rate policy is the most effective policy in managing the balance of payments in the light of a rise in globalization. [15]

Command	Content	Context
Assess	Manage BOP Assess exchange rate policy Explain other policies	Best Policy Relating to different economies and make comparison between the policies relating to globalization.

Exchange Rate Policy (E.g. Depreciation)	<p>-> Depreciation</p> <p>-> Value of currency is worth higher in terms of foreign currency</p> <p>-> Price of exports is relatively cheaper in terms of foreign currency</p> <p>-> Price of imports is relatively more expensive in terms of domestic currency</p> <p>-> Assuming Marshall Lerner's Condition holds, where sum of price elasticity of demand for imports and exports is more than one</p> <p>-> Increase in net export</p> <p>-> Improve trade and service of current account hence BOP</p> <p>-> Globalization brings about increase in trade activity (More effective)</p> <p>OR</p> <p>-> Depreciation</p> <p>-> Value of currency is worth higher in terms of foreign currency</p> <p>-> Cost of production in terms of foreign currency will be relatively lower</p> <p>-> Higher expected rate of returns (ESP if currency is expected to appreciate again)</p> <p>-> Attract more foreign direct investments</p> <p>-> Capital inflow</p> <p>-> Improve capital and financial account of BOP</p> <p>-> Globalization brings about increase in capital flow (More effective)</p>
Supply Side Policy (E.g. SGD\$2 Billion National Productivity Fund or SGD\$16.1	<p>-> <u>Enhance productivity among business and workers</u></p> <p>-> Lowers unit COP</p> <p>-> Pass on cost savings</p> <p>-> Lowering of prices for consumers</p> <p>-> $PED > 1$, availability of substitutes from trade</p> <p>-> More than proportionate increase in Q_{dd}</p> <p>-> Increase export revenue</p> <p>-> Improve trade and service balance</p>

<p>Billion for The Research, Innovation and Enterprise Council (RIEC)</p>	<ul style="list-style-type: none"> -> Improve current account of BOP -> <u>Research and development of new products</u> -> Improve on the quality of the products -> Meet the taste and preference of consumers -> Increases the demand for exports -> Increase export revenue -> Improve trade and service balance -> Improve current account of BOP -> Globalization brings about increase in trade activity (More effective) <p>OR</p> <ul style="list-style-type: none"> -> <u>Enhance productivity among business and workers</u> -> Lowers unit COP -> Higher profits -> Higher rate of return -> Attracts more foreign direct investments -> Capital inflow -> Improve capital and financial account of BOP -> <u>Research and development of new products</u> -> Improve on the quality of the products -> Meet the taste and preference of consumers -> Increases the demand for goods and services -> Increase expected revenue -> Attract more foreign direct investments -> Capital inflow -> Improve capital and financial account of BOP -> Globalization brings about increase in capital flow (More effective)
<p>Trade Policy</p>	<ul style="list-style-type: none"> -> Signing more Free Trade Agreement -> Increasing export countries -> Higher export revenue possible -> Increase export revenue -> Improve trade and service balance -> Improve current account of BOP -> Globalization brings about increase in trade activity (More effective) <p>OR</p> <ul style="list-style-type: none"> -> Signing more Free Trade Agreement -> Increasing export countries -> Higher expected rate of returns -> Attract more foreign direct investments -> Capital inflow -> Improve capital and financial account of BOP -> Globalization brings about increase in capital flow (More effective)

L3	For an answer that uses analysis to underpin discussion on whether exchange rate policies is the <u>most effective policy</u> to manage BOP given the rise in globalization . There should be at least 3 policies discussed. Max of 9 marks if candidate did not address the question requirement on the most effective .	9-11
L2	An answer that undeveloped discussion on the most effective policy in managing BOP. Limited link to context Max of 8 marks on analysis without relating to globalization/ without addressing managing	6-8
L1	Descriptive knowledge of policies, which does not fully address the question.	1-5
E2	For an evaluative assessment based on economic analysis (Appropriateness)	3-4
E1	Unexplained evaluative comments	1-2