

PRELIM SUGGESTED ANSWERS

2018 H2 Prelim Essay Q1

Question: Discuss the likely combined effects of economic growth and a rise in Goods and Services Tax (GST) on consumers and producers in different product markets in Singapore. [25]

Suggested Answer

Explain effects of economic growth on consumers and producers in different product markets

- Economic growth – rise in real national income and hence rise in household incomes
- Impact on product markets depends on the income elasticity of demand of products:
 - For normal goods with positive YED, demand would increase. Necessities such as rice ($0 < YED < 1$), demand would increase less than proportionate to the increase in income whereas for luxury goods such as cars ($YED > 1$), the demand would increase more than proportionate to the increase in income.
 - For normal goods, consumers' expenditure and hence producers' revenue would increase as both price and quantity increases, ceteris paribus.
 - For inferior goods with negative YED such as instant cup noodles, demand would decrease.
 - Consumers' expenditure and hence producers' revenue would decrease as both price and quantity decreases, ceteris paribus.

Explain effects of a rise in GST on consumers and producers in different product markets

- GST is an indirect tax on producer which raise unit COP (since GST is imposed on intermediate goods and raw materials) and thus decrease SS since producers will reduce production at any given price. The supply curve will shift upwards in a pivotal manner since it is an ad valorem tax (% tax). This means that the higher the initial market price, the larger will be the tax amount and hence both original and new supply curves diverge.
- The market price rises and market quantity falls. Impact on consumers' expenditure and producers' revenue depends on price elasticity of demand for products.
 - Assuming ceteris paribus and similar initial market prices of the goods in the 2 markets, when SS falls due to GST, the good with price inelastic demand will result in a more than proportionate increase in price and less than proportionate fall in Qdd.

PRELIM SUGGESTED ANSWERS

- Consumers' expenditure increases (hurt consumers as they pay higher price and enjoy lesser units of good)
- Rise in GST would result in less revenue earned by the producers since they need to pay the government the GST from whatever they received from the consumers. Some firms in the market may end up with subnormal profit which may cause them to shut down.
- There is a greater negative impact on consumers as compared to producers, if demand is more price inelastic than supply.

- On the other hand, if the demand of good is price elastic, then there will be a less than proportionate rise in price and more than proportionate fall in quantity. ⑨ Consumers' expenditure falls.
 - Hence in this case, the adverse impact on producers will be greater since spending by consumers fall and yet producers have to pay the GST when supply is more price inelastic than demand.

Explain combined effects of economic growth and a rise in GST on consumers and producers in different product markets

- Market for necessities e.g. Rice (normal good with price inelastic demand) ⑦ expenditure/ revenue rise
 - Given that $0 < YED < 1$, the rise in income leads to a less than proportionate increase in demand for rice ⑦ increase in consumer expenditure, ceteris paribus
 - As rice has a high degree of necessity as a staple food, its demand is price inelastic ⑦ the rise in price (due to rise in GST) will lead to a less than proportionate fall in Q_{dd} ⑦ consumer expenditure increases, ceteris paribus
 - ⑨ Combined reinforcing effect: Rise in consumer expenditure/ producer's revenue in the market for rice

- Market for luxury goods e.g. Cars (normal good with price elastic demand) ⑦ impact on expenditure/ revenue is uncertain
 - Given positive $YED > 1$ as car is a luxury good, the demand for cars will increase more than proportionate to an increase in income ⑦ large increase in consumer expenditure, ceteris paribus
 - As expenditure on cars generally take up a large proportion of an average household income, its demand is likely to be price elastic ⑦ the rise in price of cars (due to rise in GST) will lead to a more than proportionate fall in Q_{dd} ⑦ consumer expenditure falls, ceteris paribus
 - ⑨ Combined effect on consumer expenditure is uncertain – depends on the relative shift of demand and supply. The large increase in demand for cars (due to $YED > 1$) is likely to outweigh the fall in supply of cars, resulting in a rise in consumer expenditure/ producer's revenue.

PRELIM SUGGESTED ANSWERS

EV: However, for such luxury goods, the initial prices are high and so the amount of GST to be paid is likely to be high ➔ large rise in COP and hence large fall in SS which may be greater than the rise in demand ➔ so, overall consumer expenditure/ producer's revenue may fall instead.

- Market for inferior goods e.g. instant cup noodles (with price elastic demand)
 - ➔ expenditure/ revenue fall
 - Given negative YED as instant cup noodles are deemed as inferior good, the demand will fall when income increases as people would prefer to consume better quality food in restaurants ➔ fall in consumer expenditure, ceteris paribus
 - As there's availability of many other food substitutes, the demand for instant cup noodles is price elastic ➔ rise in price (due to rise in GST) will lead to a more than proportionate fall in Qdd ➔ consumer expenditure falls, ceteris paribus
 - ➔ Combined reinforcing effect: Fall in consumer expenditure/ producer's revenue in the market for instant cup noodles

Conclusion

As analysed above, the combined effect of economic growth and rise in GST on markets of normal goods with price inelastic demand is an unambiguous rise in consumer expenditure while markets of inferior goods with price elastic demand would see an unambiguous fall in consumer expenditure.

EV: Outcome is uncertain for other combinations (e.g. inferior good with price inelastic demand; normal good with price elastic demand) ➔ depends on the relative magnitude of change in demand and supply

EV: All the above analysis assumes ceteris paribus condition holds – not valid in the real world as there are many other factors which may also affect demand and supply of products. For e.g. if population size in SG increases, overall demand for all types of goods may rise, increasing consumers' expenditure and producers' revenue in different product markets.

EV: GST is a regressive tax ➔ greater burden on lower-income groups who pay a larger proportion of their income as taxes. Assuming same rise in income for all consumer groups, the lower-income consumers will be more negatively affected by the rise in GST especially on normal goods (necessities) with more price inelastic demand than supply

PRELIM SUGGESTED ANSWERS

Suggested Mark Scheme

	Knowledge, Application/Understanding and Analysis	
L3	For an answer that uses appropriate demand, supply and elasticity concepts as analysis to explain the combined impact of economic growth and rise in GST on consumers and producers in different product markets. Good use of diagrams to provide an analytic explanation.	15-20
L2	For an answer that uses demand and supply framework with limited analysis to explain the combined impact of economic growth and rise in GST on consumers and producers in different product markets. Diagrams are not used effectively as analytical tool. Max 12 if answer only analyze combined impact on 1 product market. Max 9 if answer only analyze impact of economic growth or rise in GST.	9-14
L1	For an answer that shows some knowledge of economic growth and GST with little/ no economic analysis. For an answer that consists of huge conceptual errors.	1-8

	Evaluation	
E3	For an answer that uses analysis to support an evaluative conclusion on the combined impact of economic growth and rise in GST on consumers and producers in different product markets in Singapore.	4-5
E2	For answer that make some attempt at evaluation.	2-3
E1	For an answer that give unsupported evaluative statement	1

PRELIM SUGGESTED ANSWERS

Another firm, Tada has entered Singapore's ride-hailing industry, joining a slew of others which made similar moves following Uber's exit. These firms are going up against the incumbent Grab and the market is set to get even more crowded with Indonesian ride-hailing giant Go-Jek's impending entry.

Explain the strategies a firm can adopt to compete in the ride-hailing industry. [10]

Approach

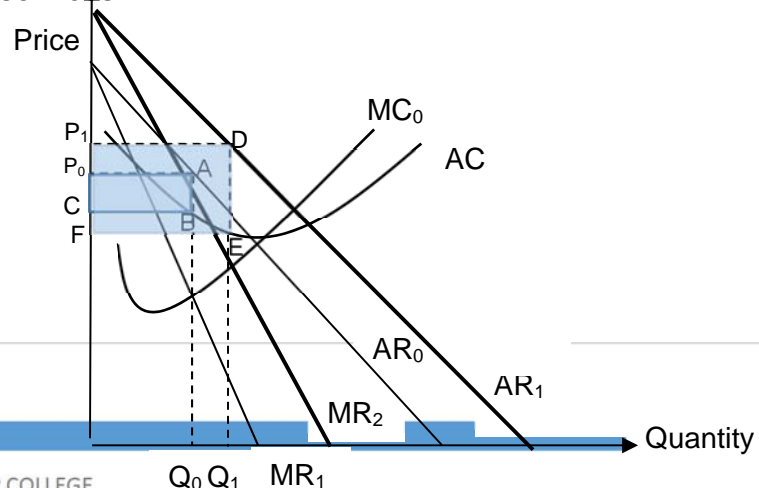
Students should recognize that the question is on the conduct of firms. Specifically strategies to compete can include both price and non-price competition strategies. The question is also open to the type/nature of firm in the ride-hailing industry. i.e Students may explain strategies of existing or incoming firms. Size of firms may vary too.

1) Price strategy (Increase revenue)

- Incumbent firm may adopt predatory pricing of which the service is set at a very low **price** with the intention to drive competitors out of the market or to create barriers to entry for potential new competitors.
- When price falls, given that demand for the services are price elastic given the number of substitutes platform, there will be a more than proportionate increase in Qd of the firm's service and TR increases. Hence, profits increases ceteris paribus

2) Non-Price strategy (increase revenue or lower cost)

- Expand services provided to open new markets and expand revenue sources. Eg Grab Shuttle Plus or Grab's food delivery service or Ryde's on-demand courier services



PRELIM SUGGESTED ANSWERS

Figure 1

- These services increase market demand for the company's services ➔ increasing AR ➔ AR shifts right from AR₀ to AR₁ ➔ Increase in TR and hence profits (CP₀AB to FP₁DE)

- Mergers and Acquisitions
 - Existing firms can merge or acquire other firms Eg Grab acquired Uber's Southeast Asia's Operations to achieve a combined business as the leader in platform and cost efficiency in the region.
 - Grab can then integrate Uber's ridesharing and food delivery business in the region into Grab's existing multi-modal transportation and fintech platform. Expansion of output results in technical EOS ➔ cost savings ➔ profits increases when unit COP falls, ceteris paribus
 - Also, AR for Grab increases and become more price inelastic as competition reduces. TR revenue increases.

- Innovation in product and service
 - Grab develop GrabPay- Mobile Wallet Payment Solution and tie up with business to utilise this as a cashless payment solution beyond rides. Grab Rewards points earned can also be used to redeem deals, discounts etc
 - All these encourage the use Grab ride hailing services and transform consumers' habits in cashless payment ➔ more demand ➔ increase in AR ➔ increase in TR

- Improve branding and reputation
 - Tada competes by attracting safe and quality drivers so quality services can be provided. Company charges zero commission and offer reward incentive for safe driving. It also emphasizes careful review of drivers rewards riders for accurate feedback
 - With emphasis on safety, some consumers may demand for Tada's services instead increasing TR.

Level	Descriptor	Marks
L3	Well-developed explanation of price and non-price strategies for firms to compete in ride-hailing industry. Strategies should	8 – 10

PRELIM SUGGESTED ANSWERS

	address increase in TR or lower TC for firms.	
L2	Underdeveloped explanation of price and non-price strategies for firms to compete in ride-hailing industry. Max 5m: For explanation of strategies that address increase in TR or reduction of TC only. Strategies may not be applied to the ride-hailing industry.	5 – 7
L1	Pure listing/description of strategies. Concept errors present.	1 – 4

Discuss whether the entry of new firms in various industries necessarily results in higher society's welfare.
[15]

Approach

The question tests on performance of firms. Students should interpret society's welfare as impact on consumers, producers and government. Analysis should be anchored on efficiencies concepts, profits, price, quantity, choice etc. Answers should also present two-sided arguments and on the extent of impact.

Introduction

Entry of new firms affects market share and power of existing firms. This results in various impact on economic agents of the society. There are many factors affecting the impact. This depends on type of industries and goods as well as different governments.

Thesis: Entry of new firms in various industries results in higher society's welfare

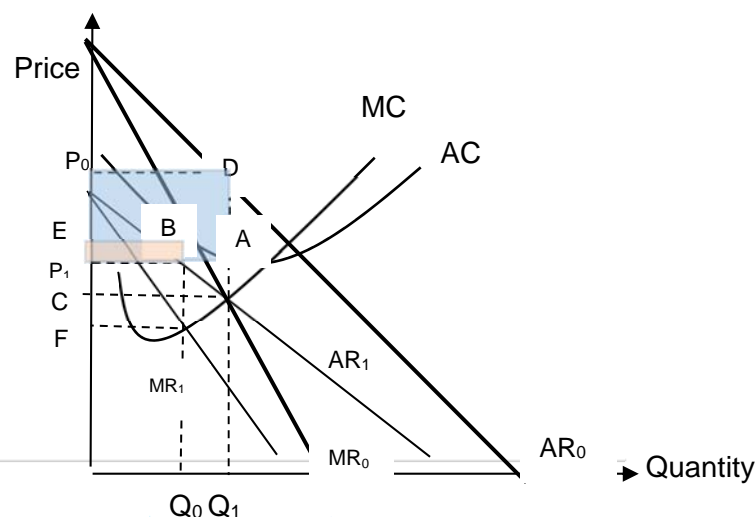


Figure 2

Entry of new firms ⑦ increase competition in the industry ⑦ existing firms faces a fall in AR and become more price elastic ⑦ AR shifts left from AR_1 to AR_2 ⑦ Price and Quantity of firm falls from P_0 to P_1 and Q_0 to Q_1 ⑦ Firms are less allocative inefficient as mark-up between price and MC reduces (P_0C to P_1F). With fall in prices, consumers can enjoy cheaper goods and services of higher variety and quality. Consumer surplus increases.

- Eg: Renowned national carriers have been hammered by budget carriers such as AirAsia at the low end of the market, while Persian Gulf airlines like Emirates Airline and Qatar Airways have eaten into their business for premium long-haul flights ⑦ This led to the airlines to engage in serious restructuring efforts, searching for new ways to make money and frantically cutting costs ⑦ Examples include **investment in latest aircraft and technology and investment** in cabin crew to deliver high quality services (**higher dynamic efficiency** as incentive to innovate increases) ⑦ consumers hence benefit more cheaper tickets and higher quality services.
- *EV: However firms may also lose the supernormal profits and hence its ability to innovate. In extreme cases, subnormal profits maybe earned (Fig 2) and firms may shut down. Incentive to compete must be balanced with ability to innovate for dynamic efficiency to be achieved. Innovation in the airline industry maybe restricted only to the bigger national carriers rather than the budget airlines which are making only low supernormal profits*
- *EV: In case of ride-hailing market in Singapore, Grab has obtained a high level of market share and loyalty among ride-hailing customers. It will be difficult for Tada, an incoming firm with little market presence to compete efficiently. Hence, Grab might not change its behaviour and no impact will effect.*

Firms may become **more productive efficient** as they are more concerned with being more cost efficient when more firms enter the market. When firms review the optimal combination of labour and capital to produce the goods, cost can be reduced ⑦ Productive efficiency improves and firms may still maintain their profits.

- *EV: For ride-hailing industry, threat of competition is high (high contestability) and current level of competition is high as start-up cost is relatively low, with dependence on contract labour with no inherent loyalty or specialized skills, and have free apps that can be downloaded in seconds. Firms are more likely to be productive efficient so as to maximise profits and ensure survival. On the other hand, industries of high levels of barriers to entry may not see the same result.*

PRELIM SUGGESTED ANSWERS

Overall, with reduced market dominance, market efficiencies can be achieved while efficient market conduct can be maintained. Overall productivity, innovation, and competitiveness of markets of the country can be promoted. This may also promote export competitiveness of goods and services and improve AD and BOP of the country, achieving better macroeconomic performance of the country.

Anti-thesis: Entry of new firms in various industries may not result in higher society's welfare

- With rising competition existing firms may lack the scale to reap sufficient IEOS especially in country of small market size like Singapore. Costs of firms increases unable to remain profitable firms close down and retrenchment occurs. When market consolidates, industry may still be dominated by a few large firms.
- Eg: In case of **natural monopoly**, which is a type of monopoly that exists due to high fixed or start-up costs such as Public Rail Transport and Energy Providers. With natural monopolies, economies of scale are very significant so that minimum efficient scale is not reached until the firm has become very large in relation to the total size of the market
- *Minimum efficient scale* (MES) can only be achieved when one firm has exploited the majority of economies of scale available and is the lowest level of output at which all scale economies are exploited.
- With entry of new firms and rising competition, natural monopoly cannot remain profitable shut down and goods cannot be supplied.

EV: However, without regulation, natural monopoly will produce at $MC=MR$ and charge at P_e while producing at Q_e , earning high level of profits. Protecting them against competition could worsen such behaviour. Regulation on pricing and output must be in place i.e AC/ MC pricing so as to ensure the benefits of protecting the natural monopoly outweighs the costs.

Other factors affecting extent of impact on society's welfare

- Impact more significant on markets dominated by one or few firms. For MC industry such as online blogshops, the impact on change in firms's behaviour could be less significant as the market was highly competitive to begin with.
- Similarly, if market has been highly contestable, firms; behaviour are already in check- productive and dynamic efficient. Entrance of more firms could erode profits and reduce existing firm's ability to innovate less dynamic efficient and worsening society's welfare

Conclusion

Adequate competition results in better market efficiencies and outcome, benefitting consumers and governments. Producers, however, are more likely to suffer from loss of

PRELIM SUGGESTED ANSWERS

profits when their demand is competed away. However, this depends on the strategies the firm undertake and the type of industries and countries the firms exist in. Some industries such as natural monopoly ones would require domination of one firm in the market. In small economies such as Singapore, too many firms in the market may result in loss of IEOS on existing firms when small size of market cannot sufficiently provide a large enough output for firms. In such cases, a good balance must be struck between competition and protection of these firms to allow them to be profitable.

Level	Descriptor	Marks
L3	A <u>balanced and well-developed answer</u> on the impact of entry of new firms on society's welfare. Answer should address various aspects of welfare and different agents and various industries.	8 – 10
L2	An <u>under-developed answer</u> on the impact of entry of new firms on society's welfare. Max 5: one-sided answer addressing only the thesis or anti-thesis.	5 – 7
L1	A one-sided answer which merely <u>lists and describes</u> the impact of entry of new firms on society's welfare. Many/Serious conceptual errors; mainly irrelevant points that does not address the question requirements.	1 – 4
Evaluation		
E3	For an answer that arrives at an analytically well-reasoned judgement on the impact of entry of new firms on society's welfare in various industries. Might also question any unstated assumptions to arrive at this well-reasoned judgement.	4 – 5
E2	For an answer that makes some attempt at evaluation, but does not explain adequately their judgement or base it in analysis, about their judgement on the impact of entry of new firms on society's welfare	2 – 3

PRELIM SUGGESTED ANSWERS

E1	For an answer that gives an <u>unexplained, unsupported</u> evaluative statement on the impact of entry of new firms on society's welfare	1
----	---	---

3	Markets may not function well when market participants do not have complete and accurate information, or when one market participant has more information than another.	
	(a) Using examples, explain how information failure might cause markets to not function well.	[10]

Suggested Answer (a)

Introduction: Briefly interpret key terms

Information failure exists when some, or all of the market participants do not have perfect information/knowledge (often relating to costs and benefits) needed to make an informed decision (i.e. as highlighted in the preamble). As a result of information

PRELIM SUGGESTED ANSWERS

failure, decisions made by rational economic agents may lead to inefficient outcomes in markets causing markets to not function well (i.e. Market to fail).

Body 1: Using an example, explain how imperfect information leads to market failure.

Definition: When market participants do not have complete and accurate information (i.e. imperfect information), they lack the necessary information to make informed decisions, which lead to less than optimal allocation outcomes in the market.

In the market for cigarettes for example, consumers fail to recognise the full costs resulting from the consumption of cigarettes (i.e. Smoking). This could be healthcare cost stemming from long term health problems and loss of income.

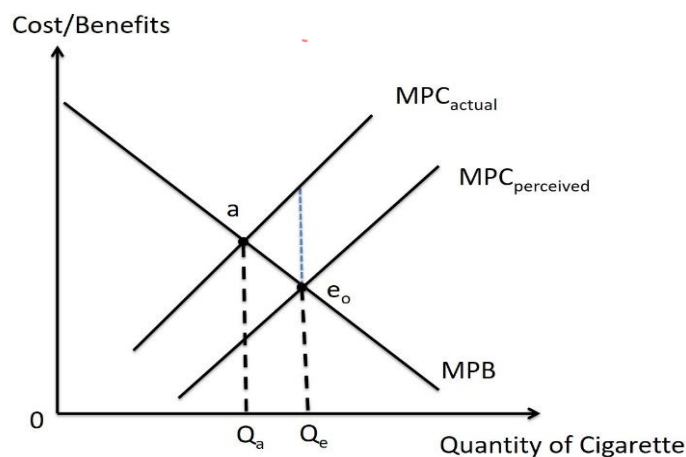


Figure 1: Imperfect Info - Cigarette

- With reference to figure 1, the marginal private benefit (MPB) of smoking is the pleasure experienced by smokers for fulfilling their nicotine addiction, while the marginal private cost (MPC) could be the cost of the cigarettes and other associated cost of purchasing cigarettes.
- Consumers maximise their satisfaction by consuming until Q_e where their $MPB = MPC$. However, due to imperfect information, the perceived MPC of smoking a cigarette is lower than the actual MPC of doing so.
- Under perfect information condition, the optimal equilibrium quantity is at Q_a where the actual MPC curve intersects with the MPB curve as shown in figure 1. Hence, imperfect information leads to the overconsumption of cigarettes.

PRELIM SUGGESTED ANSWERS

There is welfare loss incurred as actual $MPC > MPB$ at Q_e . Consumers will be better off consuming less units of cigarettes until Q_a .

- As a result, market is inefficient as too much resources is diverted to the market for cigarettes and hence, the market is said to be not functioning well.

Body 2: Using a different example, explain how asymmetric information leads to market failure.

Definition: In the situation where economic agents involved in economic transactions do not have the same amount of knowledge (i.e. asymmetric information), information gaps between economic agents can result in distortion of incentives and markets to not function well (inefficient)

Adverse Selection

- Consider the case of buying health insurance where **buyers have more information about their general health than the insurance company can hope to know**, even if it insists on medical examinations.
- To purchase health insurance at a cheaper premium, all buyers would claim to be in good health. The insurance company of course, cannot tell which buyer is in good health, which buyer is in bad health. **As a result, the market premium depends on the average health condition of all buyers.**
- However, if health insurance policy premium is set at the same amount for all market participants, then the insurance policy at the prevailing market price is a better deal for those who are unhealthy than for those who are healthy.
- (Healthy people are less likely to claim on the insurance and hence should pay a corresponding lower premium, while the unhealthy people are more likely to make claims and should pay a corresponding higher premium. Hence, at the single market price, some unhealthy people will find buying the insurance policy a better deal).
- **Because unhealthy people are more likely to want insurance, the proportion of unhealthy people in the pool of insured people increases.**
- This forces the price of insurance to rise, and more healthy people, aware of their low risks choose to not be insured.
- This further **increases the proportion of people in bad health among the insured**, which forces the price of insurance to go up more.
- This process continues until nearly all the people who want to buy insurance are unhealthy to a certain extent. **At that point, selling insurance becomes unprofitable so the insurance market collapses, resulting in what economists call a 'missing market'.** Even though health insurance can

PRELIM SUGGESTED ANSWERS

generate much welfare for society, the absence of such a good means that total market failure has occurred and market did not function well.

- As a result, the market adversely selects only the people in bad health to take up insurance resulting in market failure.

Body 3: Using another example, explain another consequence of asymmetric information leading to market failure.

Another consequence of asymmetric information is moral hazard.

Definition: This occurs when a person does not bear the full costs of his actions because the cost is being borne by someone else. In this case, it is due to the fact that the buyer knows more about his intended actions than the seller. The buyer therefore has a tendency to engage in riskier behaviour which he otherwise would not have engaged in, thus resulting in an adverse outcome which is detrimental to society.

Moral Hazard

- In the healthcare market, if an individual is not insured, the he is more likely to take care of his own health, through exercising, taking health supplements or going for regular health checks and hence reduce need to visit the hospital frequently.
- However, if the individual was to insure himself with health insurance at full value, he would be fully covered, and will not have to bear any addition cost in the event of hospitalisation.
- As a result, **the individual upon being insured, will have less incentive to take care of his health and may be prone to visiting the hospital over minor ailments.** They may even have an incentive to seek medical treatments more frequently and opt for more expensive and perhaps riskier services that they would otherwise not required.
- Such **change in behaviour** results in the **increase in consumption of healthcare services and hence overconsumption of healthcare services.** Market hence **over-allocates resources to the market for healthcare** and not function efficiently.
- (The payment from an insurance company lessens the burden on the individual in the case of an admission to the hospital but the additional health care spending generated by insurance represents a welfare loss to society.)

PRELIM SUGGESTED ANSWERS

Level of Response Marking Scheme (LORMS)

Level	Knowledge, Comprehension, Analysis and Application	Marks
L3	<p>For a well-developed answers that exhibit rigorous and clear explanation about how information failure can lead to markets to not function well.</p> <p>Answers are well-applied to a specific markets.</p>	<p>8 – 10</p> <p>(9)</p>
L2	<p>For an undeveloped answers that have insufficient economic rigour in explaining how information failure leads to market to not function well.</p> <p><i>Max 5m - Theoretical explanation of information failure with minimal application to specific markets.</i></p>	<p>5 – 7</p> <p>(6)</p>
L1	For a largely irrelevant answer which may contain conceptual errors.	<p>1 – 4</p> <p>(3)</p>

PRELIM SUGGESTED ANSWERS

Part (b) focuses on measures that both government and relevant economic agents (e.g. Firms) can implement to tackle information failure and hence market failure. While there may be many measures to tackle market failure, students are reminded to apply appropriate measures more targeted to reducing information gap economic agents have, than other less relevant measures. As part of the question requirement, it is also important to consider different markets once again. Lastly, evaluative comments about the appropriateness of measures are needed to access the 5 evaluative marks set aside.

	(b)	Discuss the appropriate measures to tackle information failure in the markets for different type of goods.	[15]
--	------------	--	-------------

Question Approach:

Suggested Answer (b)

Introduction:

As mentioned in (a), information failure can lead to market failure and measures relating to reducing information gaps are often implemented to tackle the problem of information failure.

Body 1: (For Imperfect Information)

Public Education and Campaign

To deal with imperfect information in the market, government often does public education especially in the form of campaigns. In the case of demerit good such as cigarette smoking, health programmes in schools and workplace and 'I Quit' smoking campaign by the Health Promotion Board (HPB) in Singapore aims raise awareness of the harmful effects of smoking.

- Allows consumers to gain more information about the associated costs and benefits of smoking. It also allow consumers to pickup more tips and strategies related to quitting smoking.
- **Consumers can get a better estimate of potential health risks and hence healthcare cost associated to consuming cigarettes.** As their perceived MPC moves closer to the actual MPC, this will lead them to reduce their consumption of cigarettes from Q_e to Q_a (ref fig. 1) **which leads to a more efficient outcome.**

Limitations: However, even with more information and knowledge of the associated cost, it is difficult to change behaviours such as habitual smoking, especially adult smoking. In addition, consumers may not act rationally even with greater awareness of the cost and benefits, especially in the case of teenage smoking (i.e. Teenagers are more likely to pick up the habit of smoking because of peer influence, *not that they are unaware of the harmful effects of smoking.*)

PRELIM SUGGESTED ANSWERS

EV: Hence, what is perhaps more appropriate is to **consider early intervention** such as the anti-tobacco education programme in mainstream schools to raise awareness of the harmful effects of smoking from young.

EV: More importantly, a **one-time off measure** (One-off, one message) **will not be as effective as a measures at multiple stages**. Early intervention not only prevents smoking initiation from young, it also adds additional touchpoints to encourage smokers to quit. Such an approach is hence more appropriate to deal with imperfect information related to smoking.

Next, to deal with asymmetric information, economic agents can consider different measures depending on the type of market and effects.

Body 2: (For asymmetric Information)

1. Screening (Adverse Selection)

In the case of adverse selection in the market for insurance in (a) for example, insurance providers expect all potential policy buyers to undergo medical assessment to **‘screen’ and differentiate the low risk from the high risk consumers**. Otherwise, they also require potential buyers to declare their medical history before purchasing insurance. ‘Exclusions’ listed may lead to non-claims (i.e. claims cannot be made for illnesses resulting from past medical conditions); policy premiums may be adjusted to reflect risk level of potential policy buyers.

- This essentially implies that the insurance providers are able to **gain more information about policy buyers and hence price policies according to their risk level**. With a reduction in the information gap between buyers and sellers, the extent of information failure can be reduced hence producing a more efficient market outcome.

Limitations: However, one of the key issue with screening is while more information can be acquired, **it will not eliminate the problem completely** as the extent to which potential policy buyers will disclose information such as medical history varies, and they may still exploit the information gap. **Hence, ‘screening’ is a necessary but insufficient measure.**

2. Regulation and Legislation (‘Lemon’ Law) (Adverse Selection)

In the case of second-hand car market for example, adverse selection due to second-hand car sellers having more information than car buyers leads to lower prices and lower average quality of cars ➡ eventually leading to a “missing market”.

- ‘Lemon’ laws are enacted to protect the interest of consumers. In Singapore for example, a consumer would be able to make a claim for a defective product (also known as ‘lemons’) within 6 months of purchase according to the Consumer Protection Act. It is compulsory for a seller of a defective product to repair,

PRELIM SUGGESTED ANSWERS

replace, refund or reduce the price of the defective product (subject to certain conditions).

- This effectively allows the **risks** of getting a poor quality good at a higher price **to be transfer to or shared** by the second-hand car seller for example. Second-hand car seller **aware of the law has less tendency to withhold information** from the buyer, hence reducing information gap.
- Should the seller refuse to make good on a defective product sold, consumers can bring the issue up with the Consumers Association of Singapore (CASE) to have them look into the matter on their behalf. CASE is a non-profit, non-governmental organisation dedicated to protecting the consumer interest.

Limitations: There are limitations to the “Lemon” Law however. It may be difficult determine the **source of the defect of the product**. For e.g, if the consumer had misused the item and caused the fault, he or she will not be able to make claims. But a consumer under the protection of ‘lemon’ law may argue otherwise. Also, while second-hand goods and vehicles are included, “satisfactory quality” as stipulated would take into account their age at the time of delivery and the price paid. This is however subjective. The “Lemon” Law also does not apply to services or consumer-to-consumer transactions.

EV: Perhaps what is more appropriate is to consider **changing the incentive of producers**. For example, the use of platforms where buyers can review about their experience with sellers and rate their product and service will reduce sellers’ incentive to exploit consumers with their superior knowledge. Instead, they will have a tendency to ensure that the accurate information is conveyed to consumers so as to get a positive review from them. (Bad reviews may affect their future profits)

3. Direct provision of Compulsory all-inclusive Insurance Coverage (MediShield Life) (Adverse Selection)

- Another measure to tackle the problem of adverse selection where the healthy may choose not to get insured is a compulsory all-inclusive insurance coverage directly provided by the government. The Singapore government for example implemented MediShield Life where basic insurance is provided for all Singapore Citizens and Permanent Residents. Enrolment is compulsory and risk is pooled.
- This helps to **eliminate the problem of adverse selection. Lower-risk individuals are mandated to remain in the scheme and hence get coverage.**
- Such a measure corrects for the situation where there are non-participants in the market (where market adversely selects only the high risk individuals, and the low risk individual exits the market), which can prevent the situation of market collapsing (refer to (a)).

Limitations: However, to provide insurance for everyone at an affordable premium, government has to set aside huge amount of budget.

PRELIM SUGGESTED ANSWERS

- With rising healthcare needs, claims may exceed the premiums collected, and government may risk higher healthcare expenditure in the future which is not sustainable.
- In addition, Medishield life also covers people with medical history (claims can still be made on illness which exist prior to buying the insurance) which further increases the risk government has to bear.

Note: Medishield life is NOT FREE. Citizens still have to pay for the basic insurance.

EV: MediShield Life however incorporated features of maximum claim limit, deductible and co-payment to make it more appropriate. A maximum claim limit for example, prevents exploitation of the scheme through incurring exceptionally large medical bills. A deductible which is the amount an individual has to pay out-of-pocket before the insurance kicks in also help to reduce the extent of moral hazard for less costly small illness episodes. However, once the insured is aware that his or her medical bill has exceeded the stipulated deductible amount, it is totally ineffective in addressing the issue of moral hazard.

But while mechanisms of maximum claim limit, deductible and co-payment reduce the extent of moral hazard, it does not totally eliminate the issue.

4. Co-payments (For Moral Hazard)

- As mentioned briefly above, to tackle the problem of moral hazard, government uses the system of **co-payments**. Public hospitals in Singapore, which are government-owned, **subsidises a proportion of the patients' bills and require the patient to pay the remainder**, a system that is known as "co-payment".
- Individuals then have an incentive to make healthy lifestyle choices, despite the government's subsidy of healthcare costs.
- In the case of insurance markets involving moral hazard, the insured patient will be required to pay an excess before claiming the insurance pay-out so that individuals will still prefer to take care of his/her health to avoid hospitalisation and not seek more expensive and even riskier services that they would otherwise not need or be hospitalised unnecessarily.
- But the insurance will still offsets some of the medical bills. **The effect of co-payment is to increase the price of health care services from zero to some positive value so that quantity demanded of healthcare services is reduced.** This can to made policy premiums more affordable.

Limitations: It can be difficult to determine the appropriate level of co-payment.

Healthcare costs in Singapore are high compared to neighbouring countries. As such, the market for healthcare in Singapore relies on both public and private insurance coverage to meet the high healthcare costs of individuals. If the co-payment amount is too high, it is possible that some low income individuals have difficulty paying the remainder of the hospital bills. If the co-payment is too low, the policy fails to solve the moral hazard problem.

PRELIM SUGGESTED ANSWERS

EV: Co-payment is an effective policy because it encourages consumers to be partly responsible for their own health, instead of relying on the state to provide healthcare treatment. However, it can lead to a less equitable outcome if lower income individuals cannot afford to pay the remainder of the medical fees leading to possible unintended consequence of lower-income individuals not partaking in the market (for insurance for example).

Conclusion:

The effects and the extent to which information failure occurs in different markets differ. In the real world, information is often imperfect. Hence, for policy measures to be appropriate, there is a need to better study the markets in detail. More importantly, consumers and producers need to make rational decisions based on the available information. But information comes at a cost traditionally. In fact, firms in the real world can profit from data-mining and selling information. Perhaps the more important issue is not about making information available, but how market participants make use of information.

Level of Response Marking Scheme (LORMS)

Level	Descriptor	Marks
L3	For a well-developed and balanced answer that clearly explains appropriate measures to tackle information failure and their limitations. Answers are well-supported with appropriate examples in various goods/service markets.	8 - 10
L2	For an undeveloped answer which attempts to explain the appropriate measures to tackle information failure in various goods markets. Max 7m – For an answer that is one-sided Or Max 7m – For an answer which does not have a variety of appropriate examples to explain the measures.	5 - 7
L1	For an answer that is largely irrelevant or only contain superficial knowledge and understanding. Answer may have conceptual errors.	1 - 4

PRELIM SUGGESTED ANSWERS

	Evaluation	
E3	For valued-judgements made on the appropriateness of measures well-supported with economic reasonings.	4 - 5
E2	For judgement(s) on the appropriateness of the measures that is largely unsubstantiated or unsupported.	2 - 3
E1	For an incidental evaluative comment.	1

Question 4

- a) Explain the limitations of using Real GDP per capita to compare standard of living between countries [10]

Introduction:

Define Standard of living : the social and economic well-being of life. There is 2 aspects material and non-material SOL. The material aspect of SOL refers to the amount of quantity, variety and quality of goods and service that can be enjoyed while the non-material aspect of SOL refers to the intangible aspect of life such as the literacy rate/ education level, mortality rate, happiness level etc.

Define Real GDP per capita: refers to the value of final goods and services that an economy has produced within the geographical boundary in a given period of time, with inflation and population size taken into consideration.

Limitation 1: The accuracy of the Real GDP per capita data collected

- a) Hidden economy
- The accuracy of the real GDP per capita collected may not be equally accurate for all countries and this can be affected by size of the hidden economy .
 - Hidden economy refers to economic activities that are not recorded but has economic values such as private tuition services or private home-based hair cutting service, mother cooking for the family or cleaning of the house or making a DIY cupboard from recycled materials.
 - Hence these activities are not recorded in the value of real GDP per capita ⑦ understating the value of Real GDP
 - For countries like Singapore where her Real GDP per capita is \$90531 and Qatar with \$124927 => Qatar will have a higher material SOL than Singapore as the people in Qatar has a higher income and can afford more good and services that gain more satisfaction. However, due to the overemphasis on academic success

PRELIM SUGGESTED ANSWERS

and small family size, Singapore has a larger hidden market such as private tuition and home-based childcare service by the neighbours or grandparents

b) Income Inequality

- The real GDP per capita may not accurately reflect the material SOL due to difference in level of income inequality of each country
- Income inequality is measured by Gini Coefficient, the value closer to 1 will imply high degree of income inequality while the value closer to 0 will imply a low degree of income inequality
- For a country that has high Real GDP per capita => an ave individual in the country has high level of income and is able to enjoy more and better quality goods and services => high level of material SOL. However, if the country also has high Gini Coefficient value => most of the income is generated in the country is distributed to only a small group of people in the country while the majority of the people in the country only received a small amount of the income that is generated in the country, hence the majority of people in the country is actually experience a low M. SOL. => the Real GDP per capita do not accurately reflect the M. SOL

Limitation 2: Non-material SOL is not taken into consideration

- The real GDP per capita reflect the non-material SOL
- When a country has high Real GDP per capita => the amount of goods/services produced by an ave individual is high => high production. With high production ➡ high level of pollution ➡ poor quality of air and possible increase in health problem ➡ low non-material SOL.

Limitation 3: Difference in Cost of living is not taken into consideration

- Real GDP per capita do not into consideration the difference in cost of living between countries
- One slice of pizze may cost \$5 in Singapore but the same slice of pizza may cost 1 yuan in China, although the Real GDP per capita in SG is higher than China, but no. of goods/service a person can buy in Singapore might be lesser than one who is staying in China

Level	Knowledge, Comprehension, Analysis and Application	Marks
L3	For a well-developed answers that exhibit rigorous and clear explanation about at least 3 limitations on the use of Real GDP per capita in comparison of SOL between countries, with use good and appropriate use of examples to illustrate the limitations.	8 – 10 (9)

PRELIM SUGGESTED ANSWERS

	<i>Max 8m – if only 2 limitations</i>	
L2	<p>For an undeveloped answers that have insufficient economic rigour in explaining the limitations on the use of Real GDP per capita in comparison of SOL between countries, with use good and appropriate use of examples to illustrate the limitations, with little or no use of examples to illustrate the limitations</p> <p><i>Max 5m – 1 well – developed limitation with some use of example</i></p>	<p>5 – 7 (6)</p>
L1	For a largely irrelevant answer which may contain conceptual errors.	<p>1 – 4 (3)</p>

PRELIM SUGGESTED ANSWERS

- b) Discuss whether a depreciation in exchange rate of a country will improve the standard of living of her population. [15]

Intro:

Depreciation of exchange rate refers to the lowering of the external value of a country's currency and this will affect the export revenue and import expenditure of the country. In turn, the change in the level of export revenue and import expenditure will affect the standard of living. The standard of living of a population refers to the quality of life, which can be measured by the change in both the material and non-material aspect of life.

Thesis 1: Depreciation of exchange rate will improve Material SOL

Depreciation of exchange rate for a country like Singapore ⑦ price of SG export to be cheaper in foreign currency ⑦ increase demand for SG export by foreigners ⑦ increase in the AD of SG ⑦ multiplied increase in RNY. In addition, the increase in SG export demand ⑦ higher production level in the industries of the export sector such as tourism, medical equipment etc ⑦ increase more need for factor of production like labour ⑦ increase employment. With higher employment level and an increase in RNY ⑦ actual E.G, SG households will have higher income ⑦ higher purchasing power ⑦ afford to enjoy more and better quality goods like luxury bags or restaurant meals etc ⑦ improve in material SOL.

EV: The extent of increase in export demand depends on

- a) Non-price competitiveness of the export
- b) PED of export

Anti-thesis 1: Depreciation of exchange rate will worsen the material

Depreciation of exchange rate ⑦ higher price of import in domestic currency ⑦ lower ability for Singaporeans to afford imported goods and service ⑦ enjoy less quantity of M ⑦ fall in material SOL

In addition, the price of imported FOP will also increase ⑦ increase in COP for domestic producers ⑦ SRAS falling ⑦ higher cost-push inflation ⑦ domestic goods are more expensive than before ⑦ fall in affordability ⑦ less domestic goods and service can be enjoyed ⑦ fall in non-material SOL.

Ev: The extent of M dependency of a country

For country like SG, material SOL might fall because SG lacks domestic final essential goods and services, eg food items and clothes etc ⑦ $PED_m < 1$ ⑦ depreciation will result in high imported inflation as well as significant increase in

PRELIM SUGGESTED ANSWERS

import expenditure for household ⑦ affordability will fall more than a country like Australia or Malaysia where they have many domestic subst, so $PED > 1$
Household's import expenditure will fall as they switch to domestic goods and lower imported inflation. The material SOL for a country that is small and dependent on import likely to fall more than that of a country that is large and less dependent on import.

Thesis 2: Government will have more tax revenue due to the export demand increasing

As mentioned, the depreciation will stimulate the economic growth of a country ⑦ households and exporting firms will have more income and profit ⑦ more income and corporate tax revenue can be collected ⑦ more funds for the government ⑦ increase ability to spend on the provision of public and merit good such as defense and healthcare/education ⑦ making these goods more affordable ⑦ more qty enjoy ⑦ material SOL improve. In addition, with greater access to healthcare and education ⑦ healthier and more educated citizens ⑦ increase in non-material SOL

EV: Depends on the budget objective of a government

For a developing country like Myanmar/Vietnam, the government may be more focus on economic development of the country ⑦ the amount of additional fund put into economic developmental projects like industrial parks/land clearance for commerce use/building of roads ⑦ increase in non-material SOL will not be significant. While developed countries like US/Norway, government may be more focus on achieving sustainable growth ⑦ more funds will be put into encouraging of green tech/healthcare/education ⑦ improve non-material SOL more significantly.

Anti-thesis: Increase export demand ⑦ higher pollution

As mentioned earlier, depreciation of exchange rate ⑦ increase in export demand and higher economic growth ⑦ higher production of goods and service ⑦ more goods and service produced ⑦ higher level of industrial pollution ⑦ worsen non-material SOL

Ev: Depends on country's government policy on regulating industrial pollution

Conclusion:

Small and open economy might not have improvement in the material SOL in SR, but a persistent depreciation will worsen that material SOL due to the rising imported inflation. while large and less open economy may be able to experience improvement in material SOL. The improvement in the non-material SOL due to

PRELIM SUGGESTED ANSWERS

depreciation will be dependent mainly on the government's action rather than the depreciation of the exchange rate.

Level	Descriptor	Marks
L3	<p>For a well-developed and balanced answer that clearly explains how a depreciation in exchange rate of a country will affect the standard of living of her population positively and negatively.</p> <p>Answers are well-supported with appropriate examples in various countries.</p>	8 - 10
L2	<p>For an undeveloped answer which attempts to explain how a depreciation in exchange rate of a country will affect the standard of living of her population positively and negatively.</p> <p>Answers contains no/some appropriate examples.</p> <p>Max 5m – one-sided answers that only explains for either a) material or non-material SOL, or b) positively affect or negatively affect SOL.</p>	5 - 7
L1	<p>For an answer that is largely irrelevant or only contain superficial knowledge and understanding.</p> <p>Answer may have conceptual errors.</p>	1 - 4
	Evaluation	
E3	For valued-judgements made on the appropriateness of measures well-supported with economic reasonings.	4 - 5
E2	For judgement(s) on the appropriateness of the measures that is largely unsubstantiated or unsupported.	2 - 3
E1	For an incidental evaluative comment.	1

IJC Prelim 2018 Paper 2 Question 5

Explain why strong economic growth is important but insufficient for most developed economies and discuss appropriate policies governments can adopt to achieve inclusive growth in their societies. [25]

Two main parts to the question:

(a) Explain why: provide reasons for

(1) Why strong economic growth is important for developed economies

(2) Why strong economic growth is insufficient (focus more on this)

(b) Discuss appropriate policies govt... achieve inclusive growth in (various) societies.

Suggested Key Points for Answer	Remarks
<p>Strong economic growth can be interpreted as significant increases in output produced.</p> <p>Strong economic growth is important because it can bring about many benefits to the economy:</p> <ul style="list-style-type: none"> - Improve material SOL <p>Strong EG -> significant increase in real national income -> increased disposable household income -> increase level of consumption -> increase material SOL</p> <ul style="list-style-type: none"> - Improve and maintain non-material SOL <p>For developed countries, strong EG can allow for sufficient taxes to be raised and to maintain government spending on key institutions like healthcare and education -> maintain literacy rates, healthcare standards -> important for non-material SOL</p> <ul style="list-style-type: none"> - EG can reduce cyclical unemployment. <p>With strong economic growth, firms increase derived</p>	<p>Students can also interpret as sustained growth i.e. actual + potential growth.</p> <p>Many students also wrote about economic growth influencing investors' expectations and enhancing business confidence in the</p>

PRELIM SUGGESTED ANSWERS

<p>demand for workers -> more workers are employed -> reduce cyclical unemployment.</p> <p>However achieving strong economic growth is not sufficient for most developed economies because it can create more problems and compromise other goals:</p> <ul style="list-style-type: none"> - Achieve strong EG does not necessarily solve structural unemployment problems that accompanies growth and occurs due to globalization and technological changes. - Strong EG is insufficient if Gini coefficient is high because it may create greater socio-economic divisions in society in terms of income as gains from growth increasingly accrue to the high income earners. - Strong EG can lead to greater ecological damage and lead to irreversible effects on the living environment -> not sustainable growth. 	<p>economy, thus attracting FDI. This is accepted as well if well-elaborated.</p> <p>These ideas can be developed into arguments.</p> <p>Since the command word is Explain, no evaluation is needed at this stage.</p>
<p>Inclusive growth refers to economic growth that is broad-based and benefits all segments of society, especially providing special consideration to the lower income groups or those adversely affected by structural changes in the economy.</p> <p>To achieve inclusive growth:</p> <ul style="list-style-type: none"> - Fiscal approach (adjusting tax and subsidies for redistribution purposes) a. Making taxes more progressive in the economy i.e. progressive income tax. Raising the tax rates for higher income groups. With economic growth -> higher income levels -> those falling into higher tax brackets -> pay 	<p>Students may use the example of</p>

PRELIM SUGGESTED ANSWERS

higher taxes -> increase government revenue -> allow for spending on various subsidies to the lower income groups. Redistribution of income from the high-earners to low-income.

- (i) Is it effective? It is effective to the extent that raising taxes on the higher income does in fact increase the tax base/tax revenue. Income taxes may incentivize residents to spend more time on leisure and work less because the opportunity cost of leisure has fallen (since the net benefits of work is decreasing for an individual). If the higher income earners work less, economic growth will be reduced and income tax revenue would fall, defeating the objective of achieving inclusive growth at both ends.
- (ii) Moreover, this is especially the case for countries with relatively open borders to capital and labour flows. Workers and firms can easily relocate to other countries with better tax rates if these countries were to make increase their tax rates. In the age of globalization, this is increasingly a concern for developed economies. Thus the option of making taxes more progressive may not be a very sound option. (Elaborate using AD-AS framework if necessarily)
- (iii) Are there other trade-offs? Depends on the society's value system and political preferences. Depends on government's efficiency, corruptibility, and whether NGOs and non-profits are already playing an active role in the economy.

b. Direct subsidies for lower-income such as GST vouchers, income supplements.

- (i) May indirectly create inflation via increased consumption and rise in AD that blunts the effects of the monetary benefits. Inflation is particularly bad for the lower-income workers as their wages tend to stagnate and rise slower than inflation due to slow productivity growth in these jobs. This erodes purchasing power of households and may be counter-productive to achieving inclusive growth.

negative income taxes used in some developed economies such as Singapore. Workfare is a type of negative income tax where low-wage earners are given income supplements by the government. This not only serves to reduce the income inequality and promote **inclusivity**, but also creates further growth via **actual** (income transfer increases C and AD) and **potential** growth (incentivizes more older workers to enter the labour

PRELIM SUGGESTED ANSWERS

	<p>c. Means-tested policies in areas such as healthcare, housing and education.</p> <p>(i) Allows benefits of economic growth to be more widespread to all segments of the population especially to those who cannot afford it.</p> <p>d. Supply-side policies to target slow growing industries and their workers.</p> <p>(i) Subsidies for sunset industries</p> <p>(ii) Retraining for workers who are structurally unemployed e.g. SkillsFuture</p> <p>e. Trade policies</p> <p>(i) Protectionist policies to target certain disadvantaged or declining industries.</p> <p>Evaluation ideas:</p> <p>(i) What's appropriate in the short-term may not be appropriate in the long-term</p> <p>Use of protectionist policies and other subsidies may be feasible in the short-run to cushion the negative impact of globalisation and slow productivity growth on some sectors, but could lead to worsening market inefficiencies and incur high opportunity costs for the economy. Instead the government needs to find ways to improve factor mobility across sectors and allow more people to participate in high-growth sectors and enjoy the benefits of strong economic growth.</p> <p>(ii) Growth is important and should not be sacrificed in return for inclusivity. -> incentives should not be heavily distorted to favour less work and reduce growth.</p> <p>(iii) Depends on specific country's economic context and current challenges confronting the economy -> different set of policies may be more appropriate.</p>	force and take on low wage jobs).	
Level	Descriptors	marks	
3	L3: 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 economic growth to	- 20	

PRELIM SUGGESTED ANSWERS

	<p>developed economies and the appropriateness of policies to achieve inclusive growth should be clearly justified. <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 policies could be appropriate overall and when it is not appropriate.</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 address the reasons for pursuing strong economic growth in developed countries and highlights why it may not be sufficient. Clear discussion of appropriateness of various policies to achieve inclusive growth introduced with a range of policies introduced.</p>	
2	<p>2: Explanation of relevant reasons for why economic growth is important but insufficient for developed economies. A two-sided answer with mention of various policies to achieve inclusive growth and an attempt to explain them and consider their limitations. The answer will be relevant to the question but the theory may be incompletely explained.</p> <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>1: Answer only addresses the consequences of economic growth.</p> <p>10: Well-presented ONE SIDED argument of various policies to achieve inclusive growth.</p>	14
1	<p>L1: 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>	1- 8
3	<p>3: An 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</p>	5

PRELIM SUGGESTED ANSWERS

	and decisions.	
2	n 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.	2- 3
1	n answer that gives an unsupported evaluative statement(s).	1

- 6** 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]

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:

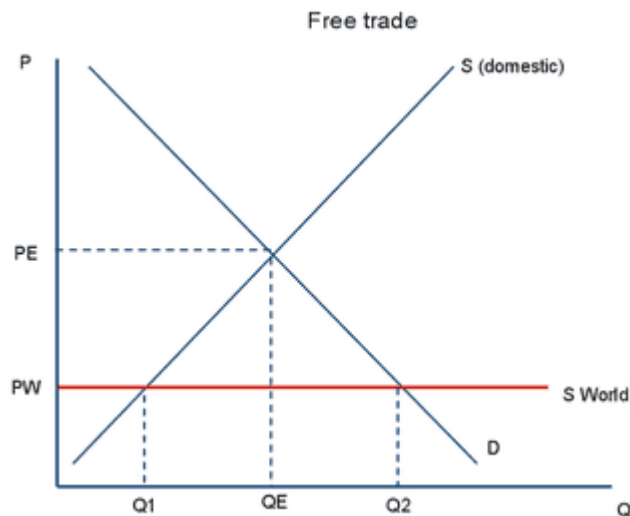
Recommended organization: Either by the agents or by desirability and undesirability then infused the effects of globalization into the answer. Considerations of possibilities and likelihood of the effects occurring and application to the real world context would best answer the question. Given the open nature of the question and the limited time constraint, the priority of the answer should be on the differing

PRELIM SUGGESTED ANSWERS

agents. All answers should be directly addressing the effects of globalization and should not just briefly mention globalization.

Consequences of globalization	<p><u>Increase in Trade</u></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>
Government	<p><u>Desirable only when economies have the comparative advantage in the production of goods and services.</u></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>
Consumers	<p><u>Desirable in the short run when consumers have access to the goods and services.</u></p>

PRELIM SUGGESTED ANSWERS



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.

*** 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 the consumers who might have lesser purchasing power and therefore lowered ability to demand for more goods and services, decreasing SOL.

Producers

Undesirable if the goods produced are substitutes to the trading partners.

Close substitutes with $XED > 1$, the demand for domestic goods will fall by more than proportionately resulting in a fall in total revenue for the producers.

With globalization and more trade, price falls from PE to PW, quantity sold would fall from QE to Q1, producer surplus would also fall.

*** 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

PRELIM SUGGESTED ANSWERS

	<p>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><u>Increase in Capital</u></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><u>Desirable only when economies complement with relevant regulations to ensure sustainability of the economy.</u></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 exponential depletion of the resources from excessive use and pollution, making growth unsustainable.</p> <p>E.g. In China where it is the world manufacturing factory, air</p>

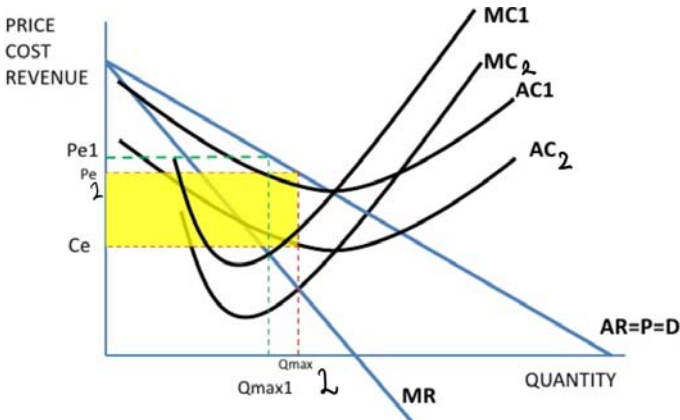
PRELIM SUGGESTED ANSWERS

	<p>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><u>Undesirable when the capital inflow brings about market dominance and not more competition in markets.</u></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 $XED > 1$, 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><u>Desirable only when producers are considering outsourcing or offshoring or when they are the ones expanding their market overseas.</u></p> <p>Capital mobility-> better outsourcing-> 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-> e.g. Franchise-> increase</p>

PRELIM SUGGESTED ANSWERS

	<p>consumer market-> Increase potential demand for the good-> higher output-> increase ability to enjoy economies of scale -> e.g. technical economies of scale where production processes have been specialized and labours could increase productivity by focusing on one production process.</p>
Consequences of globalization	<p><u>Increase in Labour</u></p> <p>Better information technology allows individuals to easily hunt for jobs in other economies. E.g. jobbatical and NPAnworldwide 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><u>Undesirable if it brings about non- inclusive growth.</u></p> <p>Labour mobility</p> <p>Increase inflow of low skilled labour-> increase supply of low skilled, low wage labour-> decrease wages for low wage labour-> widens income gap</p> <p>Increase inflow of high skilled labour-> increase supply of high skilled, high wage labour-> decrease income for high wage labour-> 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.</p> <p>Higher supply of labour-> reduction in labour cost across all sectors of the economy-> decrease unit COP-> increase SRAS-> 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><u>Desirable if economy is labour intensive and prices of goods and services are lowered as a result of lowered cost.</u></p> <p>Increase in available labour supply-> lowered wages-> lowered cost of production for firms-> pass on cost savings to consumers-</p>

PRELIM SUGGESTED ANSWERS

	<p>> 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-> better able to engage the high skilled labours who can engage in product innovation and research-> improvement in quality of the products or increase in the variety of goods and services available-> higher satisfaction derived.</p>
Producers	<p><u>Desirable for producers in developed economies than developing economies.</u></p> <p>Increase in available labour supply-> lowered wages-> lowered cost of production for firms-> Reduction in AC-> 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.</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 increase in profits would be significant</p>

PRELIM SUGGESTED ANSWERS

Level	Descriptors	Marks
3	<p>L3: 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>L3: 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>	5- 20
2	<p>L2: 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>	1- 14

PRELIM SUGGESTED ANSWERS

	<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>	2- 8
3	<p>3: An 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>	1- 5
2	<p>2: An 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
1	<p>1: An answer that gives an unsupported evaluative statement(s).</p>	1

PRELIM SUGGESTED ANSWERS