Question 3

a. Explain how the price mechanism allocates scarce resources in an efficient manner. [10]

b. Discuss the difficulties of achieving this in practice. [15]

Explain scarcity and its implications

Scarcity is the situation that exists when there is insufficient amount of resources to produce all goods needed to satisfy unlimited wants. Most economies seek to address three basic economic questions – 'What to produce', 'How to produce' and 'For whom to produce'. In a market where the government does not intervene at all, the price mechanism seeks to address the above basic economic questions by determining the prices of goods and services and factors of production through the interaction of the forces of demand and supply.

Define demand and supply

Demand refers to the willingness and ability of consumers to purchase a particular good or service at various prices per period of time, ceteris paribus. The supply of a good is the amount of the good that producers are willing and able to offer for sale at various prices per period of time, ceteris paribus.

Price acting as a signal from consumers to producers

The basic principle underlying the price mechanism is that goods and services are provided through the market and that consumers and producers act in their self-interest. On the supply side are profit-maximising producers who will provide a certain good or service if the revenue they receive is equal to the cost of producing an additional unit of that good or service (i.e. MR = MC). On the demand side are consumers who will acquire a certain good or service to maximise their satisfaction if the price they have to pay is equal to the utility or benefit derived from consuming an additional unit of that good or service (i.e P = MU).

The price thus acts as a signal which consumers send to producers indicating their demand for a good and producers will allocate resources among competing needs to the production of these goods most desired by consumers, backed by their ability to pay. In this way, the price mechanism plays the allocative and rationing function.

Prices perform a signalling function. Market prices will adjust to reflect where resources are required and where they are not. In deciding on what to produce, consider crops such as corn which could be used to produce either biofuel or breakfast cereals. Biofuel and food are goods in competitive supply. Demand for biofuel has been growing in recent years due to greater acceptance of it as a viable source of fuel in place of oil. Referring to Figure 1(a), the increase in demand for biofuel causes the demand curve D1 to shift to D2. Without a change in supply, the increase in demand results in a shortage and the price of biofuel rises from P_1 to P_2.

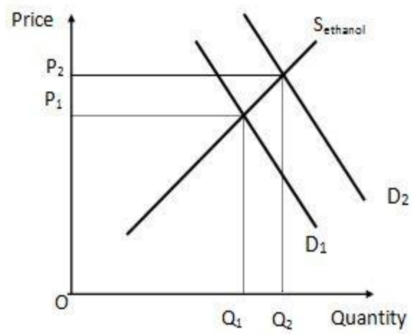

Fig 1a: Market for biofuel

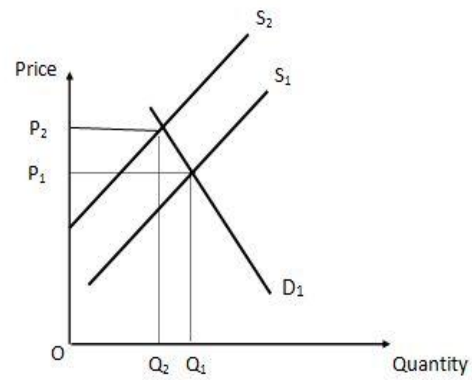

Fig 1b: Market for breakfast cereals

Use example to explain how the price mechanism performs the allocating function – 'What to produce' → Link to allocative efficiency

The rise in price of biofuel is a signal to the producers to expand their production to meet the higher demand. Producers begin to shift resources, in this case corn, away from the production of breakfast cereals to the production of biofuel. The quantity supplied of biofuel increases and more resources are used to produce biofuel and fewer resources are now available to produce food. As seen in Figure 1(b), the supply of breakfast food falls as shown by a leftward shift of the supply curve to S_2. This causes price of breakfast food to rise to a new price P_2.

Therefore through prices, consumers are able to signal to producers about their changing needs and wants. When demand is strong, higher market prices act as an incentive to raise production because the producer stands to make a higher profit and will be willing to supply more, causing quantity supplied to increase. In this way, the price mechanism performs the rationing function by rationing scarce resources to the production of goods which consumers are willing and able to pay for (effective demand).

Price mechanism performs the rationing function 'How to produce' → Link to productive efficiency

The price mechanism also answers the question of 'How to produce'. It does so based on the prices of factors of production which are determined by the demand and supply of these factors. Different combinations of factors of production will lead to different costs of production. In seeking to minimise costs, producers may choose the lowest-priced factors to produce a given product at the least-cost. For example farmers may choose to use the least-cost fertilizer for their crops. Thus, the price mechanism also ensures productive efficiency.

'For whom to produce' → Link to allocative efficiency

In allocating resources to the production of goods backed by consumers' willingness and ability to pay, the price mechanism answers the question of 'For whom to produce'. Those consumers who value a good more would be willing to pay a higher price for it. Therefore, more resources will be allocated to produce goods for these consumers than others.

Conclusion

In conclusion, prices place a value on a good or service, which helps to sieve out consumers' wants that are backed by the ability to pay.

Mark scheme

Knowledge, Application, Understanding and Analysis		
L3	For an answer that explains the workings of the price mechanism well and address the three basic economic questions with the use of examples.	7 – 10m
L2	For an answer that attempts to explains how the price mechanism addresses the three basic economic questions.	5 – 6m
L1	For an answer that contains conceptual errors and some irrelevant points.	1 – 4m

(b) Discuss the difficulties of achieving this in practice. [15]

Price mechanism helps to allocate resources efficiently. However, in real world, the assumptions of free markets, such as homogenous product, perfect information, perfect factor mobility and marketable products do not hold true. Due to the above, market failure arises. The price mechanism in free unregulated markets (i.e. markets that are not subject to government intervention) fails to achieve an efficient allocation of scarce resources so as to maximise welfare. Market failure can either be complete or partial.

Introduction
Assumptions do not hold in reality → market failure

Perspective 1: A difficulty of the price mechanism in allocating scarce resources efficiently is due to non-marketability of certain goods

Perspective 1
Difficulties of price mechanism in allocating scarce resources efficiently would arise due to non-marketability of certain goods (micro)

The reason why price mechanism cannot allocate resources efficiently is due to the characteristics of non-excludability and non-rivalry in consumption, hence leading to complete market failure. Complete market failure occurs when the price mechanism does not allocate any resources to the production of the good. Public goods exhibit the characteristics of non-excludability and non-rivalry in consumption. An example of a public good is street lighting.

Complete market failure

Non-excludability means that it is technically impossible or extremely costly to exclude any individual from the benefits of a good once it is provided, in this case street lighting. The provision of the street lighting to any one person automatically makes it available to others.

Characteristics of non-marketability of goods

Since no one can be excluded from the consumption of street lighting once it is provided, consumers will not voluntarily offer payments to the producers. This means that there is no effective demand for street lighting (i.e. consumers are “unwilling” to pay for the good). If the consumption of street lighting and the enjoyment of its benefits are not made contingent upon payment, each consumer will find it in his or her interest to free-ride on others who pay. The free-rider problem exists when individuals cannot be excluded from enjoying the benefits of a good, yet these free riders pay nothing (or pay a disproportionately small amount) to cover the costs of providing the good.

The non-excludability feature of public goods makes them non-marketable. As a result, the market fails to produce public goods. No consumer is willing to indicate his or her willingness to pay for the good. There is **no effective demand** for the good.

Non-rivalry in consumption means that the consumption of street lighting by any individual does not reduce the amount of the lighting available for consumption by any other individuals. Once street lighting is made available to a single consumer, there is no additional cost in providing lighting to others. This means that the total cost of providing street lighting does not vary as the number of users varies. The cost of providing street lighting remains the same whether one or 1000 persons benefit from the street lighting. This essentially means that the marginal cost (i.e. additional cost) of providing street lighting to an additional consumer is zero. Recall that the condition for allocative efficiency is price equal to marginal cost. Since marginal cost equals to zero in this case, price equals to zero. It would be inefficient to charge a price since extra users can benefit at no extra cost to society. Charging a price would deter potential users and reduce the total welfare that can be obtained from the unit of the good. Since no price should be charged for the good, no producer would produce the good since no revenue can be generated. There is **no effective supply**. As a result, the price mechanism fails to allocate resources to ensure the production of public goods.

How the difficulties can be addressed

However, this difficulty of the price mechanism in allocating resources efficiently due to non-marketability can be addressed via direct provision by the government.

Perspective 2
Difficulties of price mechanism in allocating scarce resources efficiently would arise due to existence of externality (Micro)

Perspective 2: Another difficulty of the price mechanism in allocating scarce resources efficiently is due to existence of externalities caused by imperfect information or ignorance.

Partial market failure occurs when the price mechanism allocates some resources to the production of the good, but not at the socially optimal level. Partial market failure could be caused by the presence of either positive externality (under-allocation of resources) or negative externality (over-allocation of resources). For this essay, negative externality is discussed.

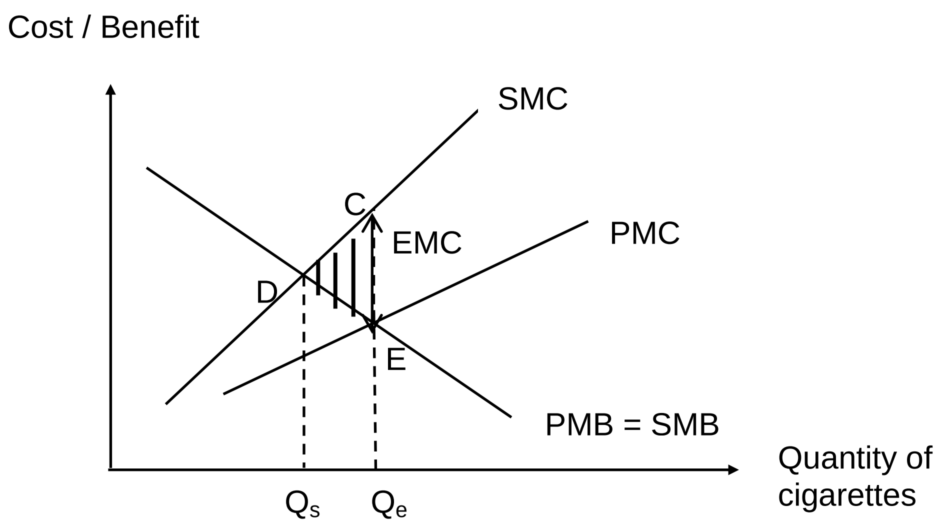

Figure 1

Partial market failure (Negative externality)

***OR** positive externality*

The consumption of cigarettes generates negative externalities.

In deciding how much to smoke, smokers weigh their private marginal benefit (PMB) against private marginal cost (PMC) of smoking. Smokers' private costs include the price of a packet of cigarettes and their smoking-related health problems. Their private benefit involves the valuation of the satisfaction they can derive from smoking.

However, smokers do not consider the negative externalities that would be generated as a result of them smoking. These negative externalities include health problems borne by passive smokers and costs incurred by society from having to provide healthcare services for smoking-related health problems. The social cost of undertaking the activity is the private cost faced by the smoker as well as external costs accruing to third parties. As a result of external cost, there is a divergence between private cost and social cost, thus resulting in market failure.

Third parties have to be clear

Based on the price mechanism, the market equilibrium level of cigarettes is at Q_e as shown in Figure 1 above (where PMB = PMC). At Q_e, the private marginal cost (PMC) is equal to the private marginal benefit (PMB). Individual smokers do not take into account the negative externalities arising from their consumption of cigarettes.

Due to the presence of negative externalities as explained above, the social marginal cost is greater than private marginal cost (SMC > PMC) at Q_e, as represented by the vertical distance CE. As SMC > SMB at the market equilibrium level of cigarettes, Q_e, society values an extra unit of cigarettes less than what it would cost society to produce it. The socially optimum level of cigarettes is at Q_s, where SMB = SMC. The price mechanism thus over-allocates resources to the market for cigarettes i.e. there is over-consumption of cigarettes where $Q_e > Q_s$.

This over-consumption of cigarettes results in a loss of welfare to society, otherwise known as deadweight loss, which is indicated by the shaded area CDE. Society as a whole could be made better off if the level of cigarettes consumed were to be reduced to the socially efficient level, Q_s.

However, this difficulty of the price mechanism in allocating resources efficiently can be managed by the government intervention through the market-oriented policies. For example, assuming that the government has perfect information, it could implement a tax that is equal to the external marginal cost at Q_s to effectively internalise the negative externality. Consumers will be induced to consume less cigarettes given the higher private marginal cost of consumption as a result of the tax imposed. The socially efficient level of cigarette consumption, Qs, will thus be achieved

How the difficulties can be addressed

Perspective 3: Another difficulty of the price mechanism in allocating scarce resources efficiently is due to government policy

<u>Perspective 3</u>
Difficulties of price mechanism in allocating scarce resources efficiently would arise due to government intervention itself (macro)

According to the Theory of Comparative Advantage, countries will be able to benefit from trade if they specialize in those areas they can produce at a relatively lower opportunity cost. However, some governments use protectionist measures to provide an advantage to domestic industries over foreign producers even though foreign producers are the ones having comparative advantage. This skews the allocation of resources from low-cost foreign producers to high-cost domestic producers. Hence this implies that there is allocative inefficiency.

However, this difficulty is unlikely to be a significant one since more and more countries are unwilling to adopt protectionism. With globalisation and greater interconnectedness among countries, free trade improves competitiveness and brings about greater world output, hence allowing the price mechanism to allocate resources efficiently.

How the difficulties can be addressed

(W) In conclusion, the price mechanism can, to a large extent, help to allocate resources for most types of goods. While most government intervention, in the case of public goods and goods that generate externalities, could generally help to address the difficulties and improve the allocation of scarce resources. Other government intervention could actually worsen the situation due to high administrative costs, information gaps and time lags resulting from red tapes and bureaucracy.

Evaluation

(S) Therefore, the difficulties of price mechanism in allocating scarce resources efficiently would depend on the level of development of the country which in turn affects its ability to collect information accurately. Developed countries are able to collect information more readily and accurately as compared to developing countries. With better information, economic agents would be aware of the true costs and benefits and hence may reduce the divergence/ extent of externality which would lead to more efficient allocation of resources. So, the difficulty can be better addressed.

Knowledge, Application, Understanding and Analysis		
L3	For a comprehensive and detailed answer that provides a balanced discussion on the difficulties of price mechanism achieving efficient allocation of resources	**9-11**
L2	For an answer that provides a balanced but undeveloped discussion on the difficulties of price mechanism achieving efficient allocation of resources	**6-8**
L1	For an answer that is mostly descriptive, with some inaccuracies and is not in context. One-sided answer.	**1-5**
Allow up to 4 additional marks for Evaluation		
E2	For a judgment based on economic analysis/ adequately substantiated	**3-4**
E1	For an unexplained judgment, or one that is not supported by economic analysis	**1-2**

Question 4

a. **Explain the likely benefits and costs of globalisation. [10]**

b. **Discuss the view that the best way for a government to maximise the gains of globalisation is to adopt discretionary fiscal policy. [15]**

Globalisation is the increasing integration of the international economy and is characterised by greater global interdependence. This increasing integration may take the form of signing more Free Trade Agreements (FTAs), having free trade areas, customs unions etc. It may be defined as an expansion in the volume and variety of cross-border transactions in goods and services and in international capital flows, labour flows and technology transfers. Globalisation brings abouts many benefits. However, globalisation may also lead to possible problems.

Definition of globalisation

Globalisation increases access to goods and services which were not available at home. It also increases the variety of goods and services thus catering to a wider range of taste and preferences. This allows for the increase in standard of living in the countries involved in trade, especially for countries that can now gain access to goods that they may be unable to produce (due to the lack of technical know-how and/or resources).

Benefits in terms of increase variety of g&s and SOL

Globalisation also encourages greater international specialisation based on comparative advantage, given the integration of markets for goods and services. This will enable countries to shift consumption away from higher-cost producers to lower-cost producers. Goods that countries do not have comparative advantage in can be obtained more cheaply from other member countries and imports rise. Goods that countries have comparative advantage in will see increased exports to other member countries. A more efficient resource allocation brings welfare gains to the member countries and avail them to a greater extent of the benefits from trade. This also enables countries to reap the gains of improved resource allocation and exploit economies of scale from larger markets and increase their productive efficiency. It also increases international competition between countries which helps to lower the price of goods, helping to ensure that the **level of inflation** (i.e. general price level) in the countries involved in trade are kept under control.

Benefits in terms of trade creation and specialisation & economies of scale & of price stability

Globalisation increases cross-border transfers of resources and technology which can help boost a country's production capabilities. With the large capital inflows into the country, it helps to facilitate economic expansion beyond the country's domestic resource constraints, allowing the country to speed up its pace of **economic growth.** This in turn raises the country's national income by several times higher due to the multiplier effect and allows the country to enjoy robust economic growth and development, greater employment and thus lower cyclical unemployment due to greater utilisation of existing resources.

Benefits in terms of technology transfer and economic growth

The greater ease of foreign direct investments resulting from globalisation benefits many countries too. These foreign investors not only bring their technology and capital equipment with them when they decide to set up

Benefits in terms of employment

production plants in certain developing countries (because of their relatively lower costs of production). They will eventually require labour to begin and sustain production, hence helping to increase the **level of employment** in the developing countries.

levels

With globalisation, there are many firms and MNCs in certain countries such as the US and UK that offshore their production to countries such as Singapore to take advantage of the lower cost of production and efficient infrastructure. The influx of FDI (foreign capital and technologies), coupled with the greater labour flows such as foreign talent and their ideas, skills and expertise, will increase both AD and the economy's productivity (thus aggregate supply) in the short and long run respectively. This not only accelerates but also sustains non-inflationary economic growth (due to lower cost-push inflation) of the country and creates more employment opportunities for the people. Moreover, such FDI and talent enhance the labour productivity, allowing the average worker to earn higher income, raising his material standard of living.

Benefits in terms of higher FDI

However, globalisation brings about many challenges for countries as well. Increased ability of firms to locate different stages of production around the world to take advantage of lower costs for a certain input or service will mean that production is now more fragmented. This would mean that a problem in one country will be transmitted to another country through these links. The result is that the economies are now **more vulnerable to external shocks**. In particular, certain countries may be better able to relocate different stages of production in other low-cost countries due to the availability of capital; however, this also implies that they are more likely to be affected by disruptions in production in these countries.

Costs in terms of greater vulnerability

With the rapid rate of technological change, there is an increased rate of structural changes in the economy. Domestic firms may find it difficult to survive with increased competition from the foreign firms and leave the industry. Retrenched workers from those firms may lack the necessary skills to find employment in expanding industries, leading to **structural unemployment**. In other cases, some workers lose their jobs which have been outsourced to lower-cost countries.

Costs in terms of structural unemployment

With relocation and offshoring in many developed countries, there is an increase in demand for skilled workers and fall in demand for lower skilled workers. The result is an increase in wages for those with relevant skills while low or even no income for those who are displaced. There is thus a **greater income inequality.**

Costs in terms of widening income inequality

At the same time, some countries may over-focus their resources in a few areas of comparative advantage, sinking in valuable resources in order to maintain the comparative advantage in these areas. Recognising that the comparative advantage of these countries tends to be in relatively lower-skilled, labour-intensive industries, these countries may therefore be **locked in lower value-added production**. Their ability to move up the value chain and develop other areas of comparative advantage is thus severely impacted.

Costs in terms of being locked in lower value added production

Globalisation may also threaten to pass some countries by altogether. Many of the world's poorest countries lack the human capital, infrastructure, institutions

Costs in terms

and policies necessary to seize the trade and investment opportunities of globalization. As such, some of these countries may resort to lowering environmental as well as production standards and hence business costs so as to be able to attract companies to locate their trading and/or production activities there. This results in the **concentration of highly pollutive production activities in these countries**.

of decrease in non-material SOL

Globalisation is likely to allow easier migration of highly educated and skilled people in search of better prospects to other member countries. These people are likely to come from developing economies which will suffer a loss of precious human resource and thus face limitations to potential economic growth.

Costs in terms of brain drain

As globalisation may bring about both positive as well as negative effects, governments can strive to maximise benefits and minimise costs through fostering greater economic integration. Also, government policies can be adopted to address the problems resulting from globalisation so as to fully benefit from it.

Conclusion

Mark scheme

Knowledge, Application, Understanding and Analysis		
L3	For a comprehensive and detailed analysis explaining clearly the benefits and costs of globalization, analysing the impact in terms of the 4 macroeconomic aims.	7 – 10m
L2	For an answer that distinguishes between the benefits and costs of globalisation. Answer is lacking in the link to macroeconomic aims.	5 – 6m
L1	For an answer that shows some knowledge of the benefits and costs of globalisation but not elaborated. Answer contains some conceptual errors.	1 – 4m

b) Discuss the view that the best way for a government to maximise the gains of globalisation is by adopting discretionary fiscal policy. [13]

<u>Suggested Answer</u>

Introduction

As explained in part (a), globalisation brings benefits such as higher employment and growth through production for export markets, and improvement of productive capacity through greater flows of foreign direct investment and foreign talent. Therefore, to maximise the gains from globalisation, policies should be geared towards boosting external demand and towards attracting capital and foreign talent. However, to fully maximise the gains from globalisation, it is also important to minimise the costs of globalisation. Fiscal policy is a policy that can be tapped on to maximise the gains from globalisation in some aspects. It will be analysed subsequently whether this is the best policy.

Perspective 1: Show how discretionary fiscal policy

Adopting discretionary fiscal policy may be a good way to maximise the gains from globalisation. The tools of discretionary fiscal policy are taxes and/or government spending. Lowering of taxes such as personal income tax helps to attract foreign talent to live and work in the country. This is because lower personal income taxes enable them to acquire higher disposable income.

Corporate taxes can also be lowered to attract more foreign direct investment. As the after-tax profits increases with the reduction of corporate taxes, foreign investors may choose to invest in the country. This helps to increase productive capacity, achieving potential growth. Government expenditure on the economy in stimulating actual growth could also create a positive economic outlook for investors, giving them confidence to invest in the country.

may be a good way to maximise the gains from globalisation.

However, there are limitations of fiscal policy in maximising the gains from globalisation. For example, if the government borrows to finance its spending, the increase in demand for loanable funds that subsequently increases interest rates, could crowd out private domestic investment, as it makes it more costly for private investors to carry out investment projects. If such a situation persists, there may be a relatively more significant proportion of foreign direct investment (FDI) than private domestic investment spending in the country (since FDIs are less reliant on the domestic country's interest rates in their investment spending). This makes the country more vulnerable to unemployment caused by footloose foreign investors who are constantly on the lookout for locations with attractive investment prospects. Hence, this policy may not shield the economy from the costs of globalisation, limiting the effectiveness of fiscal policy in maximising the gains from globalisation.

Perspective 2: Consider the limitations of fiscal policy in maximising the gains from globalisation.

Fiscal policy also may not be a viable option particularly for countries that are already accumulating national debt. Such lowering of taxes and government spending may put further strain on the government budget and hinder efforts to effectively service the debt. Hence for these countries, other policies may be better options to maximise the gains from globalisation.

A better alternative policy that can maximise the gains from globalisation is the pursuit of even more free trade agreements. By forging more trade agreements, it enables greater flows of FDIs into the domestic economy. Hence for countries that cannot rely on fiscal policy to achieve this outcome, forging of more trade agreements is a better option. In addition, such trade agreements enable all countries in general to further maximise the gains from globalisation in aspects that fiscal policy cannot. For example, forging of more trade agreements enables countries to continue to have greater access to the global market, boosting their export sales and enhancing their employment and growth levels. In addition, signing of more trade agreements with multiple and varied trading partners enables countries to have a diversified market which they can export to, so as to reduce vulnerability to adverse demand conditions in the countries of certain trading partner.

Perspective 3: Consider the aspects in which alternative policies may be better than fiscal policy in maximising the gains from globalisation.

Trade policies to boost FDI and X

Monetary policy such as depreciation of the exchange rates also has proven to be a more important and better policy for some countries in maximising the gains from globalisation. For instance, countries like China had enjoyed significant growth rates partly as a result of its under-valued currency. Clamping down on the high appreciation pressures on its exchange rates enabled China to continue to enjoy high price competitiveness of its exports over the years, enabling it to continue to export in high quantity to external markets, boosting its employment and output levels.

Depreciation to boost X

Discretionary fiscal policy alone may not be the best policy to maximise the gains from globalisation even for countries with strong budget balances. This is because in an increasingly competitive global market, low corporate taxes alone is just one of the many factors that influences investors' decision to invest in a particular country. There can be other more important factors that affect the decisions of foreign investors to invest in a particular country. For instance, for countries like India, despite having a corporate tax rate of 30%, still remains to be among the top FDI destinations. Hence fiscal policy alone may not be best in maximising the gains from globalisation. To fully attract FDI, various supply-side policies need to be adopted to improve the investment climate in the country. Supply-side policies geared towards improving the quality of infrastructure could attract investors more as connectivity and communications network improve. Reduction of red tape and bureaucracy could also better attract investors as ease of business workings are enhanced. The country should also craft supply-side policies that improve the quality of labour in the country such as embarking on measures to improve productivity as it would again make it attractive for investors to invest in the country. Hence supply-side policies may be viewed as more important in attracting FDIs rather than low corporate taxes alone, limiting the effectiveness of fiscal policy in maximising the gains from globalisation.

Inadequacy of fiscal policy in boosting FDI

Supply-side policies to boost FDI

Similarly, low personal income taxes alone is not sufficient in attracting foreign talent to the country. Quality of living in the country may matter more to foreign talent. Hence a better policy may again be supply-side policy. Improvement in the state of living such as supply-side measures to ensure strict environmental standards are adhered to in production activities may be more important in attracting foreign talent, other than the state of infrastructure in the country.

Supply-side policies to attract foreign talent

To enjoy as much gains from globalisation, a country should also actively pursue supply-side policies to improve the price and non-price competitiveness of their goods and services. Supply-side policies such as tax incentives to encourage R&D in process and product innovation help to improve and sustain the price and non-price competitiveness of a country's goods and services. With such improvements, the export demand of a country would be high and this would contribute to actual growth and employment in the country. Countries may also need supply-side policies to actively craft new areas of comparative advantage so as to remain relevant in the global market and continue to tap on the gains of globalisation.

Supply-side policies to boost X in the long term

To fully maximise the gains from globalisation, there is also a need to minimise the risks/downsides of globalisation through supply-side and exchange rate policies (as fiscal policies don't help to address these costs). For example, supply-side policies such as retraining of the workers may be necessary to address structural unemployment in the country. Exchange rate policies such as appreciation may be necessary at times to deal with imported inflation.

Supply-side and exchange rate policies to deal with the costs of globalisation

Appreciation of the currency helps to reduce domestic price of imported key inputs, reducing cost of production in the country, increasing aggregate supply and reducing general price level, curbing imported inflation. In addition, in an increasingly globalised world, where there's higher mobility of short-term capital, it is also imperative that countries put in place appropriate regulations in the financial sector to prevent too much instability from high capital flows. This is particularly so in view of the financial crisis experienced by countries like US and EU, which could result in high capital outflow from these countries to other countries.

Evaluation

(W) However, many of the supply-side policies mentioned above do not take effect immediately. It takes time to improve infrastructure, productivity etc that are necessary to attract FDI. Hence tools of discretionary fiscal policy such as lowering corporate taxes and income taxes may still be the best policy in the short run, particularly for developing countries that are still working on improving their state of infrastructure. For countries that are facing high budget constraints, where fiscal policy is not an option in the short run, alternative policies discussed earlier such as monetary policies and market-oriented supply-side policies may be the best policy for the time period. For developed countries, however, they may be in a better position to implement the interventionist supply-side policies and it may be more important for them to do so as they lose competitiveness in labour-intensive production to developing countries and in view of increasing globalisation, may lose competitiveness in other low value-add production and hence it is more important to implement supply-side policies to support high-value add production.

(S) The policy that is deemed to be best in maximising the gains from globalisation actually also depends on the current economic conditions facing the countries in general and expectations of investors on its future economic outlook. For example, if there are expectations of sustained economic boom enjoyed by a country, there may be less consideration of corporate taxes by investors, but greater consideration of the ease in which business operations can be conducted. This would then make supply-side policies such as improvement in infrastructure and improved workings of the market to be more important in influencing the investors' decisions to invest. Hence making supply-side policies more important in this context.

Mark scheme

Knowledge, Application, Understanding and Analysis		
L3	For a competent answer that thoroughly examines how the gains from globalisation can be maximised through the use of fiscal policy AND provides strong reasons for the use of alternative policies over fiscal policy.	**9-11m**
L2	For an undeveloped answer that attempts to examine how gains from globalisation can be maximised/enhanced through the use of fiscal policy. Answer also considers (implicitly or explicitly) how alternative policies are better.	**6-8m**

L1	For an answer that lacks clarity on how gains from globalisation can be enhanced through the use of the policies. Answer may be lacking even implicit consideration of how alternative policies can be better. For a one-sided answer as well.	**1-5m**
Allow up to 4 additional marks for Evaluation		
E2	For a judgment based on economic analysis/ adequately substantiated	**3-4m**
E1	For an unexplained judgment, or one that is not supported by economic analysis	**1-2m**