

ST ANDREW'S JUNIOR COLLEGE  
PRELIMINARY EXAMINATIONS – 2011  
General Certificate of Education Advanced Level  
Higher 2

**Suggested Answers  
and Mark Schemes**

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**ECONOMICS**

**9732/02**

Paper 2: Essay Questions

**19 Sep 2011**

**2 hours 15 minutes**

Additional Materials: Answer Paper

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**READ THESE INSTRUCTIONS FIRST**

Write your name and class on all the work you hand in.

Write in dark blue or black pen on both sides of the paper.

You may use a soft pencil for any diagrams, graphs or rough working.

Do not use staples, paper clips, highlighters, glue or correction fluid.

Answer **three** questions in total, of which **one** must be from Section A, **one** from Section B and **one** from **either** Section A **or** Section B.

At the end of the examination, fasten all your work securely together.

The number of marks is given in brackets [ ] at the end of each question or part question.

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Question 4 – Pg 18

Question 5 – Pg 23

Question 6 – Pg 27



This document consists of **32** printed pages.

Answer **three** questions in total.

### Section A

**One or two** of your three chosen questions must be from this section.

- 1** China's economy grew at an average of 10% over the past decade. Under the terms of the EU-China WTO accession agreement, China has also agreed to substantial reductions on import tariffs for over 150 leading European exports, ranging from machinery to wines and spirits.

Assess the likely impact of the rising income in China and her reduction of import tariffs on the sales of various types of EU's exports to China and China's domestic sales. [25]

- 2** Proton, Malaysia's largest car producer, continues to struggle with high production costs that make local cars relatively more expensive than many foreign cars.

Source: *AsiaTimes* Aug 2003

(a) Explain how a firm like Proton can enjoy economies of scale. [10]

(b) Discuss the relevance of achieving cost savings in determining the welfare of consumers. [15]

- 3** The wonders of free market often disappear when the assumptions are relaxed.

(a) Explain how the free market could bring 'wonders' to the economy. [10]

(b) Discuss the view that the government would often fare better than the free market when the assumptions are relaxed. [15]

### Section B

**One or two** of your three chosen questions must be from this section.

- 4** The relative importance of aggregate expenditure components in influencing the outcome of the economy differ among economies, depending on their size, openness and the government policies.

(a) Explain the above statement. [10]

(b) Assess the policies which the Singapore government could adopt to achieve sustainable growth for its economy. [15]

- 5** Discuss whether maintaining low unemployment rate will lead to an improvement in the standard of living in an economy. [25]

- 6** Globalisation is a double-edged sword, as the increased interconnectedness not only creates opportunities but also presents risks.

Speech by Mrs. Lim Hwee Hua, Minister Of State For Finance And Transport At The CPA Forum, Aug 2007

(a) Explain how globalisation could bring opportunities and risks to an economy. [12]

(b) Discuss whether the Singapore government currently adopts appropriate policies to reduce the risks of globalisation. [13]

## SUGGESTED ANSWERS AND MARK SCHEMES

- 1 China's economy grew at an average of 10% over the past decade. Under the terms of the EU-China WTO accession agreement, China has also agreed to substantial reductions on import tariffs for over 150 leading European exports, ranging from machinery to wines and spirits.

Assess the likely impact of the rising income in China and her reduction of import tariffs on the sales of various types of EU's exports to China and China's domestic sales. [25]

### Q1

Students to discuss the question based on simple demand and supply framework; need to show how equilibrium price and quantity being determined for a good;

Students to define sales as price \* quantity, show the area in diagram;

Identify the demand factors: income, taste and preferences

- Analyse how changes in income will affect the various goods imported from EU;
- Compared to domestic good, imported goods like EU cars, wines and fashion wears etc, should have an  $YED > 1$  (luxury), thus dd will increase for imported goods as income increased;
- Taste and preferences should also shift towards imported goods as compared to domestic goods;
- Thus DD for import will shift to the right while DD for the domestic goods should shift to the left cp;

Identify the supply factors: reducing tariff (cost of import)

- Reducing tariff will lower the cost of imported goods => SS curve will shift to the right;
- Thus, PED is important in determining the impacts on import expenditure;
- For most imported consumers durables, PED should be  $> 1$  as imported goods are viewed as more luxurious and proportion of income spend is relatively higher;
- Given a fall in price, import expenditure should increase;
- On the other hand, demand for domestic goods will fall as imported goods are substitutes for the domestic goods, example imported cars and domestic produced cars; the extend of the fall in domestic demand depends on the degree of substitutability between the imports and domestic goods;

The students need to divide the goods into various categories for a detail analysis:

Case 1: Imported luxury goods

- $Y \uparrow \Rightarrow DD \uparrow$  ( $YED > 1$ ), also T&P will increase DD further
- $SS \uparrow$  as tariff  $\downarrow$
- $PED > 1$ ,  $PES > 1$  (manufacturing products)
- Sales (import expenditure) should  $\uparrow$

Case 2: imported necessity

- $Y \uparrow \Rightarrow DD \uparrow$  ( $YED < 1$ )
- $SS \uparrow$  as tariff  $\downarrow$
- $PED < 1$ ,  $PES < 1$  (manufacturing products)
- Sales depends on the relative shift of DD and SS

Case 3: imported FOP

- Derived demand, with increasing production, DD should  $\uparrow$
- $SS \uparrow$  as tariff  $\downarrow$
- $PED < 1$ ,  $PES > 1$  (manufacturing products)
- Sales should increase

Case 4: China's domestic products

- $Y \uparrow \Rightarrow DD \downarrow$  (view as inferior as compared to  $YED < 1$ )
- T&P shift towards imported luxury goods
- $SS \uparrow$  as tariff  $\downarrow$  ( $P_m \downarrow$ ) XED between local and imports
- $PED > 1$ ,  $PES > 1$  (manufacturing products)
- Sales should fall

Students must be able to use correctly drawn diagrams to illustrate changes in each market;

**Evaluations: other factors may affect the overall demand and supply, such as China's domestic goods may be luxury as well, depending on the range; also depends on the absolute price difference;**

- 2 Proton, Malaysia's largest car producer, continues to struggle with high production costs that make local cars relatively more expensive than many foreign cars.

Source: *AsiaTimes* Aug 2003

- (a) Explain how a firm like Proton can enjoy economies of scale. [10]
- (b) Discuss the relevance of achieving cost savings in determining the welfare of consumers. [15]

## Q2 (a)

### INTRODUCTION

Identify that Proton is a large producer in an oligopoly car market → it is able to enjoy internal and external economies of scale.

### BODY

Explain: When a firm wants to increase its size to produce more output or enlarges its scale of production, it can enjoy cost savings.

Define internal economies of scale: possible cost reductions that a firm enjoys when it increases in size. This is reflected by a fall in average costs illustrated by a movement along the LRAC curve as the size of firm increases.

### Sources of Internal Economies of Scale

#### Technical economies

Division of labour and specialisation

- When output is sufficiently large, it becomes more efficient to allow workers to specialise in their tasks as it saves time to repeat the same task rather than move from one task to another. Thus more output can be assembled by the firm's workers in a given time because of the increase in workers' productivity. Division of labour thus increases the productivity of labour, resulting in lower unit cost of production.

Indivisibility of plant

- Some inputs may be too large for a small firm to use efficiently. A large firm that requires the use of indivisible inputs will reduce its average costs when output increases.
- Eg. Protons are manufactured in a state-of-the-art manufacturing facility in Tanjung Malim. Capable of 150,000 units per annum on four multi-model production lines, it allows flexibility and rapid response to market demand situations. Thus it requires a large firm to use the indivisible inputs effectively to reduce average costs.

#### Commercial economies

- As the firm expands, marketing economies can be reaped when it buys inputs and sells its output. It can buy inputs such as raw materials in bulk, thereby enjoying lower prices. In addition, it may also receive discounts as suppliers are usually keen to maintain business relations with larger firms.

### Marketing economies

- A larger firm can spread its advertisement and promotion costs over a larger output, thereby reducing the unit cost of production. For Proton to be able to fully exploit EOS, it is necessary for Proton to expand overseas by engage in marketing activities such as new launches in emerging car markets e.g. China, South Africa, etc, to build brand awareness and see whether there is any significant increase in exports.

### Financial economies

- Financial economies arise as large firms can borrow money more cheaply than small firms. Banks are more likely to charge larger firms lower interest rates as they are usually deemed to be more credit-worthy i.e. they are seen as customers who are better able to repay loans.

### Managerial economies

- As a firm expands, it is also able to hire professionals to specialise in different areas of work. Different departments can be set up, each led by an expert in the field. This specialisation increases the productivity of the firm and thus lowers unit cost of production.

**External Economies of scale:** cost advantages that accrue to all firms in a particular industry due to the growth of the industry itself or improvement in the level of production technology.

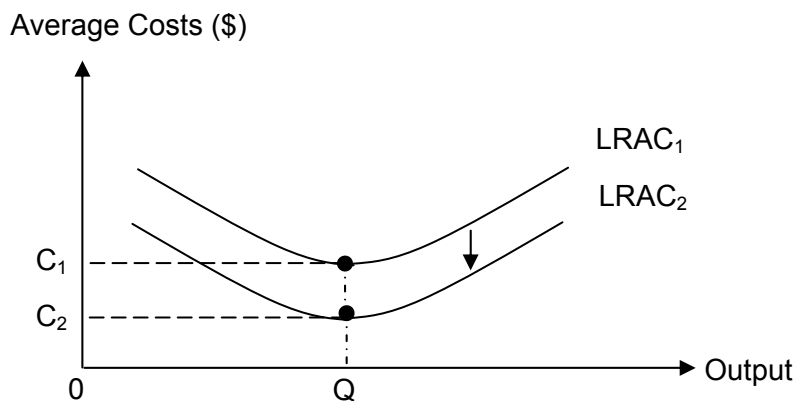


Fig. 1

As shown in Fig. 1, when the cost curve shifts downwards from  $LRAC_1$  to  $LRAC_2$ , the firm's unit cost of production falls for each and every given level of output.

This is more evident if car industry is supported by government to make it viable. Lowering of average cost can be reaped in the following types of external economies of scale:

### Sources of External Economies of Scale

#### Economies of Concentration

If firms in an industry cluster in the same area, they can reap the economies of concentration.

The individual firm benefits:

- if the industry's suppliers also re-locate their operations in the vicinity. Apart from ready access to inputs such as raw materials, the cost of these inputs also falls with lower transportation fees.

- E.g. Managing Director of Goodyear pointed out that it is important to make high quality of goods easily available for consumers to buy. Hence, Goodyear shifted its manufacturing base to Thailand in anticipation of growing demand.
- as labour with specific skills and talents are attracted to where the industry is concentrated. This translates to lower hiring costs for all firms as they do not have to advertise as widely or in as many newspapers as before.
- from the growth of supporting facilities, subsidiary industries and setting up of research and development centres. Technological improvements translate into lower unit costs of production. E.g. Goodyear had hosted engineers from Proton at their technical centre to improve on their quality of products to reduce cost of production.
- as the government becomes interested in developing the local infrastructure to provide better access to the airports and seaports, thereby reducing transportation and other costs.

### Economies of Information

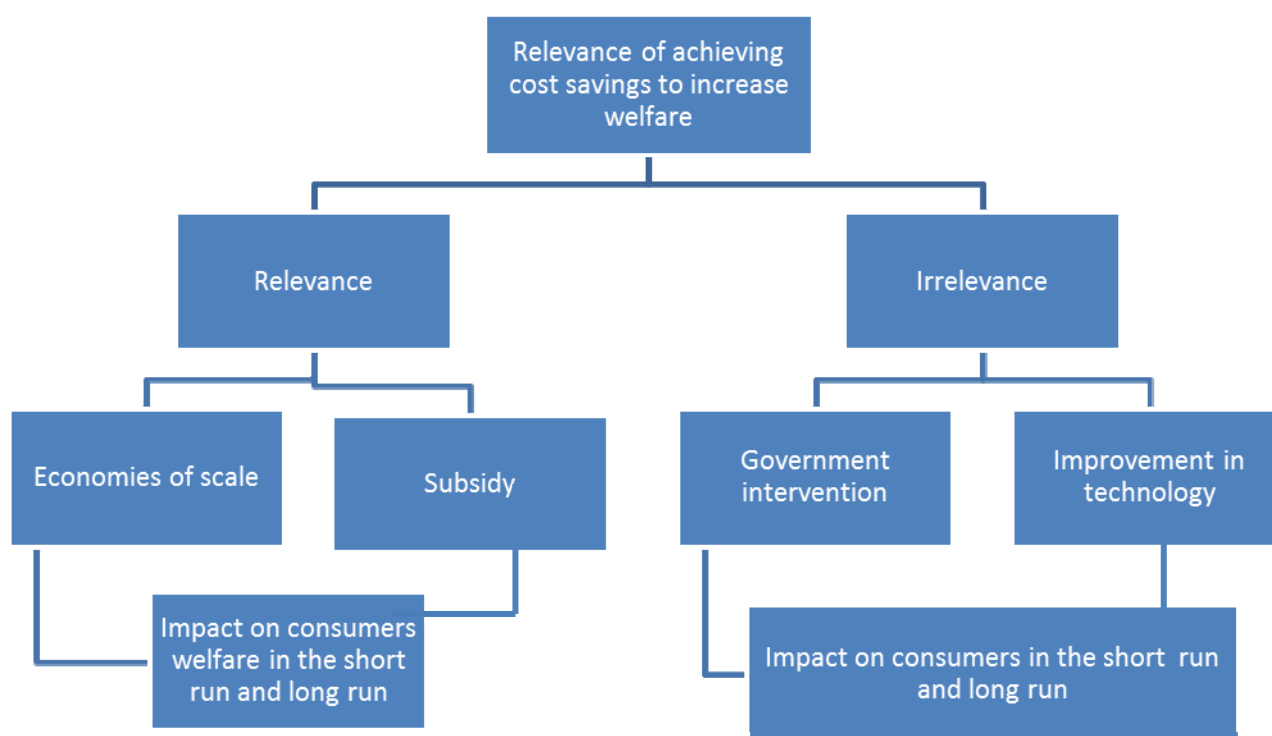
- As an industry grows there is generally an associated growth in the number of trade or specialist journals catering to the needs of the industry. Information about the industry becomes more widely available from which all firms in the industry can benefit. There may even be televised features about the industry which provide free publicity. This reduces the costs of generating information for the firm.

Level (Marks)	Knowledge, Application, Understanding and Analysis
L3 (7– 10)	<ul style="list-style-type: none"> <li>• Thorough explanation of internal and external economies of scale with respect to it being an important industry and therefore given govt help to lower cost of production.</li> <li>• Candidates must be able to give relevant examples relating to Proton industry.</li> <li>• Answer must contain at both internal and external economies of scale. ( 2 internal + external EOS or 2 external EOS + 1 internal EOS)</li> <li>• Explanation must show application to context.</li> </ul>
L2 (5 – 6)	<ul style="list-style-type: none"> <li>• Able to explain sources of economies of scale but worded in an incoherent manner.</li> <li>• There should be minimal mistakes.</li> <li>• Little application to context</li> </ul> <p>Max 6m: candidates only mention either internal or external economies of scale.</p>
L1 (1 – 4)	<ul style="list-style-type: none"> <li>• For an answer that shows conceptual errors and limited understanding of the question.</li> </ul>

## **Q2 (b)**

### **Question requirements:**

- Identify that consumers consist of domestic car consumers and imported car consumers.
- Students should not merely discuss the effect on consumer surplus, they have to show what happens to the welfare of consumers in the short and long run.
- Students must assess the **relevance** of achieving cost savings in determining welfare of consumers in terms of equilibrium price and quantity and then consumer surplus



### **INTRODUCTION**

- State that the welfare of consumers is the individual benefits derived from the consumption of goods and services and it is affected by price changes.
- Hence, changes in prices will be result a change in consumer surplus (measure of aggregate consumer welfare)
- Define consumers' surplus: excess of social valuation of product over price actually paid. It is measured by the area of a triangle below a demand curve and above the observed price.



**BODY****Thesis:**

Students need to identify the causes of cost savings and the underlying assumptions.

**Supply factors:**

**(i) Economies of scale** (no need to elaborate too much here as it has been explained in part (a))

- Economies of scale (Internal or external EOS) → ↓AC
- Assume that the producers pass on the costs to consumers, ↓Prices → ↑ Consumers surplus.

**(ii) Subsidies**

- Aim of subsidy (A form of protectionist measure to protect the infant industry): Lower prices of the domestic cars (Proton) to stimulate the consumption of Proton since it is the national car brand.

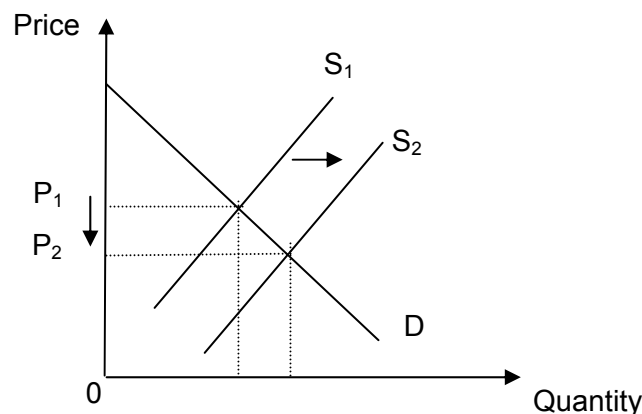
Students need to explain the increase in consumer surplus using DD and SS analysis. The effect of a subsidy on the supply of a good → ss shifts right → the equilibrium price and quantity →  $P \downarrow$ ,  $Q \uparrow$

- It will benefit the consumers (for those who buy Proton cars) if the producers are willing to pass on the cost savings to the consumers.

**Evaluation**

However, if the cost-savings lead to compromise of the product quality, there will be a general fall in consumer welfare.

Better answer will bring in the extent of shift of SS curve which will affect the extent of consumer surplus.

**Synthesis:**

- Identify the extent of relevance of cost savings to different groups of consumers.

**Anti-thesis:****1. Firms may not pass on the cost savings to consumers due to high BTE.**

Proton has a large market share (Oligopoly market) → price is rigid in the short run → even if there is a fall in cost of production → Proton is not able to reduce prices in fear of price war.

**2. Government intervention: Impose tariffs or quotas on imported cars**

Aim of a tariff/ quotas: increase the price paid for the imported cars by domestic customers, while leaving the prices paid to foreign producers the same.

Students need to consider the effects of a specific tariff and quotas on imported cars in Malaysia and explain how it results in a loss of consumer surplus and a fall in choices due to the higher-priced cars.

Analysis:

When Malaysia implements a tariff/quota → fall in SS of imported cars ⇒ ↑ in equilibrium price & ↓ in equilibrium quantity (diagram + explanation)

Evaluate:

By imposing tariffs/quotas: violate ASEAN Free Trade Agreement (the agreement effectively bar practices that discriminate against goods that are considered “Made in ASEAN” by the use of tariff and/or non-tariff barriers). Malaysia government has to pay penalties to ASEAN members for violating established free-trade regulations.

**Tariff/quota effects on the Malaysia's consumers**

Consumers of the imported cars in the Malaysia suffer a reduction in well-being as a result of the tariff/ quotas. The increase in the domestic price of imported cars reduces the amount of consumer surplus and thus variety of cars available to the consumers in the market.

Consumers of Proton in Malaysia enjoy an improvement in well-being as it seems that the price of Proton has become relative cheaper compared to imported cars.

Alternative answers

Assess the effect of the government measure to liberalise domestic car market

Aim of liberalising the domestic car market: to promote sustained economic growth and increase in standard of living for its people.

Analysis:

When Malaysia liberalise domestic car market by reducing tariff/quotas → increase in SS of imported cars ⇒ ↓ in equilibrium price & ↑ in equilibrium quantity (diagram + explanation)

E.g. Malaysia's car market set to accelerate after the government slashed import duties on imported cars made in ASEAN countries, in line with the regional trade development.

**Removal of tariff/ quotas effects on the Malaysia's consumers**

Consumers of the imported cars in the Malaysia enjoy an improvement in well-being as a result of a removal of tariff/ quotas. The decrease in the domestic prices and increase in the quantity of imported cars increases the amount of consumer surplus in the market.

Since Proton cars are substitutes of imported cars, competition can cause the demand for Proton cars to fall. This will lead to a fall in the price of Proton cars. Therefore, the overall impact would be a fall in the price of cars and increase in the quantity of cars demanded, consumer surplus will increase leading to an increase in the welfare of the consumers.

Evaluation:

Malaysia may reduce tariff/ quotas on ASEAN made cars. However, they may still retain high import duties on non-ASEAN made vehicles.

### **3. Improvement in technology**

Students need to note that R & D is critical for car industry.

High BTE → Car industry will be able to earn supernormal profits in the long run. → to strengthen BTE → Engage in R&D → improve in quality of cars → increase in consumer welfare

Evaluation:

Proton is already suffering from high cost of production. Hence, they may not have the excess supernormal profits to engage in R&D. For R&D to take place, the company has to invest in people, productivity and technology which may be difficult as it takes time and lots of resources. Within a 'cutthroat environment', it may be hard for Proton to move forward unless they have some technological tie-up with a foreign partner.

Overall evaluation

The effects on consumer surplus in long and short run

- SR: Consumer welfare will improve especially in Malaysia as majority of the car owners consume Protons rather than imported cars. However, consumers of imported car will suffer as they have to pay a higher price for the same specification.
- LR: The uncompetitiveness of Malaysian firms and the failure of Malaysian industry to move up the value chain in the face of increasing costs and competition from other countries in the region. Furthermore, the lack of R&D, still cloud the horizon Malaysia's long term prospects are therefore somewhat uncertain. This will affect the consumer welfare in the long run as they are consuming goods of a lower quality.
- The extent of relevance: It is not necessary true that cost savings will really affect the welfare of consumers in Malaysia. Given that Proton is protected by the government, cost savings may not be a big issue as government will find ways and means to reduce the price of Protons to encourage consumption.

Level (Marks)	Knowledge, Application, and Analysis
L3 (9 – 11)	<ul style="list-style-type: none"> <li>▪ Demonstrate clearly the ability to apply and analyse.</li> <li>▪ Thorough knowledge of the factors that will affect costs savings with an ability to describe and explain this in a precise, logical, reasoned manner as applied to the car market in Malaysia.</li> <li>▪ Discussion is appropriately illustrated with examples from the car market in Malaysia.</li> <li>▪ There is much critical comment (example – what happens when assumptions are relaxed) and the ability to recognise and comment on unstated assumptions.</li> <li>▪ Statements are consistently supported with theory and backed up with real world examples.</li> </ul> <p>High L3 Marks: Includes further segmentation of the consumer market e.g. consumers from domestic car market, consumers from imported car market.</p>
L2 (6 – 8)	<ul style="list-style-type: none"> <li>▪ Demonstrates the ability to explain and clarify rather than apply and analyse.</li> <li>▪ Able to explain and outline the causes of the cost savings and how it is applicable to the welfare of the consumers.</li> <li>▪ May relate to long run or short run only but not both.</li> <li>▪ Statements may not be consistently supported with theory and real world examples.</li> <li>▪ Weak attempt at specifying assumptions made in analysis.</li> </ul>
L1 (1 – 5)	<ul style="list-style-type: none"> <li>▪ Where the answer is mostly irreverent and contains only a few valid points made incidentally in an irrelevant context.</li> <li>▪ Managed only the basic analysis without specifying the assumptions</li> <li>▪ Demonstrates mainly the ability to identify and outline eg the causes of the cost savings but the link to consumer welfare is weak.</li> </ul>
E2 (3 – 4)	Judgement based on analysis, well-supported with theories and relevant examples. Two or more evaluation points given.
E1 (1 – 2)	Mainly unexplained judgements – one evaluation point inadequately, though correctly, reasoned.

3 The wonders of free market often disappear when the assumptions are relaxed.

(a) Explain how the free market could bring 'wonders' to the economy. [10]

(b) Discuss the view that the government would often fare better than the free market when the assumptions are relaxed. [15]

### Q3 (a)

#### Analysis of Question

- Explain: no evaluation required though high order analysis is expected.
- Free market: Market without govt intervention/regulation
- 'Wonders': to be interpreted as the benefits/advantages
- Answer should present a hypothetical case of how the unregulated market could perform its two functions well (achieving allocative efficiency), while explaining the conditions/assumptions within which the 'wonders' could be reaped.

#### INTRODUCTION

- The study of economics revolves around making the best of the limited resources we have. One of the methods in utilising the resources would be to leave it to the free, unregulated market system to allocate the resources to production of goods and then to allocate those produced goods to maximise social welfare. Though often touted as the ideal method, some assumptions need to be made in order for the wonders to be materialised.

#### BODY

- The free market performs two important roles – allocate scarce/limited resources to production of goods and services demanded by consumers; and to allocate such goods and services to consumers. The reason why it remains efficient is that it relies on the price mechanism to do so.
- Wonder 1 – Efficient allocation of resources  
Producers in the free market will find incentive (in the form of profits) to respond to consumers' demand for goods and services. Thus, consumer sovereignty will govern how scarce resources in an economy get allocated to the production of a myriad of goods and services. The increase in demand for a good will lead to upward bidding of prices for that good, signalling to producers to marshal more resources to produce that good. Eventually, the market will restore equilibrium, a situation with no shortage nor surplus – the wonderful outcome of resource allocation as there was no wastage of scarce resources and no one who is willing to pay for the good gets denied of the good.
- Wonder 2 – Efficient allocation of goods among consumers  
Once the goods get produced, the market again does its job of allocating them to the consumers. Only those consumers who are willing and able to pay for the good gets it. There is no other mechanism necessary for the market to work its wonders to perform such allocation. It also ensures that no one who is unwilling or unable to pay for the good gets it.

- Some assumptions/conditions

There are at least three assumptions which is required for the free market to achieve AE.

(i) Perfect Information

Both consumers and producers need to know the changes in the market signal (i.e. price) so as to respond to it. Suppose demand has fallen, but the producers were not aware of the change in taste and preference of their customers. The continued production of the good will thus represent wastage of resources in the production of goods. The amount of wastage will correspond to the amount of time taken for the information (fall in demand) to be transmitted to the producers, who will then cut down production, thereby using less resources. In reality, such time lag could be substantial.

(ii) Perfect Factor Mobility

Even when the producers know that there has been an increase in demand, producers may find it difficult to increase their output immediately due to resource constraint. For example, it is difficult to find more lawyers to handle increase in lawsuit cases, discover new pieces of rich farm land to boost agricultural production, and manufacture another specialised machinery to produce cars in face of increase in demand for a certain product in a short period of time. Hence, there will remain shortages in the market – allocative inefficiency occurs.

(iii) Absence of Market Failure

Based on self-interest, whereby individuals seek to maximise their own personal welfare, the market fails to take into consideration the welfare the society should garner. Externalities, under-consumption of merit and over-consumption of demerit goods as well as the absence of incentive to produce public good will mean that the allocation of resources was not ideally done by the free market itself. There might be over- and under-allocation of resources, leading to an outcome that was not entirely wonderful.

## CONCLUSION

Free market can indeed bring wonders to the economy in terms of resource and goods allocation. However, that would only be restricted to those products which do not face the constraints as described above. Otherwise, the free market may also fail to do its wonders for the economy.

Level (Marks)	Knowledge, Application, Understanding and Analysis
L3 (7 – 10)	<ul style="list-style-type: none"> <li>• A detailed explanation of how the free market bring wonders to the economy.</li> <li>• Assumptions given are relevant and well-explained.</li> <li>• An incomplete though almost-error free essay could still be awarded top marks.</li> </ul>
L2 (5 – 6)	<ul style="list-style-type: none"> <li>• Answer shows sufficient grasp of the concept though not well-expressed or illustrated. For example, attempt to explain the two roles as well as mentioning of the relevant assumptions for the market to do well.</li> </ul>
L1 (1 – 4)	<ul style="list-style-type: none"> <li>• Answer is mostly irrelevant and contains only a few valid points.</li> <li>• <b>Poorly explained points</b> which leave reader bewildered at the grasp of concepts attained by the student.</li> <li>• <b>Basic errors of concept</b>, for instance explaining PC market vs. imperfect market, should be given bottom marks.</li> </ul>

### Q3 (b)

#### Analysis of Question

- Discuss: Need to present both points of view – agree/disagree before coming to a judgement.
- A classic question on market failure vs. govt failure. Answer needs to present at least two cases of market failure and how the govt could 'fare' better than when left to the free market. Must prove that the DWL is lowered with govt intervention.

#### INTRODUCTION

- When the market fails to bring wonder to the economy, the government often has to step in to attempt to maximise society's welfare. However, it is not always the case that the government may fare better than the market all the time. The outcome would depend mostly on the capability of the government in recognising and resolving the problem left by the free market.

#### BODY

- Market Failure – Steel Production (-ve ext)  
In the event of a negative externalities suffered by a laundry shop next to a steel factory, the steel producing market has failed to achieve allocative efficiency as excessive production has caused society's welfare to be suboptimal. Should the social cost be taken into account by the steel producer, there will be less output produced, hence, reducing the net welfare cost incurred due to the excess production.

##### Government's response

The government could then impose a quota of the amount of steel the producer can churn out per period. This will move the production closer to the social optimal level. The ability to achieve such socially optimum level of output requires the government to be able to accurately project/predict that level of output. Data on cost and benefits to all parties (and not just the laundry shop boss) need to be collected. This is a difficult task considering the scale of operation of a steel factory and the impact pollution might have on people in the long run might lead to several factors instead of merely inhalation of excessive pollution from a particular steel factory! Hence, with inappropriate data or methodology employed, the government might not be able to fare any better than the free market (in the event that too few amount of steel was produced, leading to huge shortage in the construction sector?).

- Market Failure – Public Good

The economy cannot depend on the free market to provide public good. There is simply no incentive for any profit-motivated firm to do so, as he cannot possible collect any revenue from the 'sale' of public good. Hence, the government's role here is to provide the public good free. Such provision will therefore have to be funded by tax revenue collected.

##### Government's response

It is indeed true that the government is likely to fare better than the free market – at least some public goods get produced! Such desirable goods/services such as streetlamps, parks, defence would otherwise be left out of the free market's consideration. Indeed, the government has helped to improve the allocation of scarce resources to the production and provision of such goods to the economy, thereby improving the society's welfare.



**Evaluation:**

Not all governments can fare better than the free market all the time. For example, if the government does not have the technical know-how to improve the market performance, then, the outcome would unlikely be a better one. A government dealing with its first ever local crude oil exploration firm may not have had the experience to limit the amount of pollution it can generate.

Even if the government possesses the technical knowledge, the changing economic climate and advancement in technology employed by the firm may render the policy (e.g. quota) previously set by the government outdated. This is likely going to lead to an under-provision of the goods in the market, depriving the society the positive net welfare of consuming the good.

**CONCLUSION**

It is difficult for an economist to assess whether the government has done better or fared worse than the free market in allocation of resources. This is because there are often multiple viewpoints and beliefs placed by various stakeholders. The continued monitoring of the key market indicators would inform the government of the appropriate actions that need to be taken in order to sustain a high standard of living for everybody in Singapore and beyond.

<b>Level (Marks)</b>	<b>Knowledge, Application, Understanding and Analysis</b>
L3 (9 – 11)	<ul style="list-style-type: none"> <li>• A thorough comparison made between market and govt in resource allocation. Richly illustrated examples managed to convince reader that concepts are fully grasped. Almost error-free answer.</li> <li>• Sufficient analysis given to the question. For example, appreciate that the govt did not intervene due to inability (lack of funding) instead of know-how.</li> <li>• Structure of the essay is clear and sound, makes reading a pleasure.</li> </ul>
L2 (6 – 8)	<ul style="list-style-type: none"> <li>• Answer could make certain logical comparison between market and govt, quoting a couple of market failure as supporting cases. However, explanation is incomplete and unconvincing of complete grasp of the question.</li> <li>• Covers the main points though such revelation require the examiner's interpretation and giving of 'benefits of doubts'. Answer is fairly coherent but may be presented in a clumsy manner. For example, explaining govt intervention that attempts to solve all forms of market failure at once.</li> </ul>
L1 (1 – 5)	<ul style="list-style-type: none"> <li>• Answers are mostly irrelevant and contain only a few valid points.</li> <li>• Some answers might show some knowledge but does not indicate the intent of the question has been grasped.</li> <li>• Basic errors of theory are evident.</li> </ul>
E2 (3 – 4)	<ul style="list-style-type: none"> <li>• For an evaluative assessment of whether the govt fares better or worse than the free market. Such judgement/assessment could be based on real-life situations using sound economic analysis.</li> </ul>
E1 (1 – 2)	<ul style="list-style-type: none"> <li>• For an unexplained stand or one which is unconvincing. Demonstrates attempt to evaluate. For example, quoting scenarios in which the govt might also have failed without providing the reason behind it.</li> </ul>

- 4 The relative importance of aggregate expenditure components in influencing the outcome of the economy differ among economies, depending on their size, openness and the government policies.

(a) Explain the above statement. [10]

(b) Assess the policies which the Singapore government could adopt to achieve sustainable growth for its economy. [15]

## Q4 (a)

### Question Analysis

The focus of this part of the question is on how different components of aggregate expenditure (C, G, I and X-M) can be relatively more or less important depending on the kind of economy and its governance. The importance is here linked to the outcome of the economy which comprises its economic performance in terms of macroeconomic objectives such as low inflation rate, low unemployment rate, sustained and stable economic growth, favourable BOP position and strong and stable exchange rate.

### INTRODUCTION

- **Define and explain Aggregate Expenditure (AE)**

- A good knowledge and understanding of AE enable us to judge/analyse the outcome of the economy.

**Note:** the framework used is  $Y=AE$  approach to determining the level of income and employment (outcome of economy)

### BODY

**So what is meant by AE?**

AE is the sum of desired consumption, investment, government expenditure and net export expenditures. It has 2 components: an autonomous component and an induced component.

Consumption:  $C = a + bY$  where  $b$  is the  $mpc$  and  $a$  is the autonomous consumption.

Investment, Government expenditure and Export earnings assumed to be constant, exogenously determined, an autonomous component of aggregate expenditure. Imports assumed to be endogenously determined (i.e. income-induced)

- **Explain what is meant by the outcome of an economy**

All economies desire the attainment of goals such as low inflation rate, low unemployment rate, sustained and stable economic growth, favourable BOP position and strong and stable exchange rate. However it is not always possible to achieve all these macroeconomic objectives simultaneously. Inevitably there would usually be a trade-off among these goals often guided by what a government judges to be the most pressing problem at hand that needs immediate attention and cure.

- **Link the relative importance of AE components with size, openness of economy as well as government policies**

Changes in AE depending on which components change and their relative importance have differing effects on the outcome of the economy. Of course, no one economy is exactly the same as another, so each though dependent on AE changes to influence the economy, the components of AE which are more dominant therefore differ depending on the characteristics of the economy.

**Size of the economy** does exert a powerful influence on which component is likely to be relatively more dominant. For example, the U.S., a large economy, tend to depend more on domestic consumption expenditure than other components to alter AE be it to boost AE in times of recession or to reduce AE when inflation specifically demand-pull inflation gets out of hand. Although it is easy to conclude a large economy is likely to depend more on domestic consumption, this might turn out not accurate in certain cases.

Let's consider China. It is a large economy which with its rapidly increasing affluence as well as population which still relies more on exports earnings rather than domestic consumption despite strong economic growth in the past decade. This phenomenon is in part due to Chinese government policies such as undervaluation of Yuan which are aimed to increase export earnings and decrease import expenditure. Also a large part of production are aimed in capital goods rather than final consumer goods to spur future growth, which could also explain relatively less importance to domestic consumption in influencing AE.

**Openness of the economy** plays a part in determining which component/s of AE will be relatively more important. Very open economies such as Singapore are more dependent on external trade than less open economies such as US in influencing AE. Of course, size of Singapore in a way does force it to be very open since it is a small nation with limited natural resources, thus making it both export and import reliant for both survival and growth. So does government policies of Singapore which saw export-led and FDI driven growth by ensuring brand name for Singapore's products internationally and conducive pro-business environment in the island state.

- **Explain the relative importance of AE components to the outcome of the economy.**

As established so far, the size and openness of economy and government policies impact the relative importance of AE components and thus the effect on the outcome of the economy.

In 2008, the global financial crisis had a major impact albeit a negative one on most economies of the world. In US, the major contributor to falling AE was domestic consumption due to uncertainty and poor consumer sentiment. Falling AE due to falling C had widened the deflationary gap and possibly brought multiplied fall in equilibrium RNY assuming there was a fall in autonomous C as well. Since, US is less open and given its relatively low saving and tax rates, this fall in real output is likely to be large given its relatively larger multiplier size and huge impact of fall in C on AE. This does explain how US suffered from recession and high unemployment rate in 2008 and 2009.

In Singapore's case, the drastic fall in export earnings from other countries such as US and Europe rather than fall in domestic consumption that had a relatively stronger impact on AE as it led to a huge fall in AE, triggering a deflationary gap in Singapore. Given the relatively smaller multiplier due to its great openness in terms of great propensity to import as well as high savings rate, the fall in equilibrium RNY is likely to be at a smaller extent compared to a country like US but still Singapore did suffer from recession and rising unemployment in 2009 but bounced back as other economies recovered combined with timely and effective government policies such as Resilience Package.

## CONCLUSION

The outcome of an economy is affected as explained above by changes to AE. However not all changes in AE components have similar effects on outcome. In countries like the U.S., a relative change in C has stronger influence on its economy than a country like Singapore which is more dependent on external trade. The relative importance of AE components in turn depend on the characteristics of an economy such as its size, openness and government policies.

Level (Marks)	Knowledge, Understanding, Application, Analysis
L3 (7 – 10)	For a well-elaborated answer that clearly links how the characteristics of an economy affect the outcome of the economy via their influence on AE, making some components of AE relatively more important in influencing the outcome of the economy.
L2 (5 – 6)	For an under-developed answer that shows an understanding that characteristics of an economy do have an impact on the relative importance of AE components. May lack examples or examples are weakly explained.
L1 (1 – 4)	For an answer that shows a descriptive knowledge of components of AE and outcome of an economy in terms of whether the economy achieves its macroeconomic objectives.

## Q4 (b)

**Command word:** Assess

**Focus:** Consider alternative policies, both demand and supply-sides, to achieve the objective of sustainable growth for the economy. Students have to explain how the suggested policies can achieve the stated objectives and assess the ability to sustain its growth which can be both short and long term. The assessment has to be linked to the characteristics of Singapore economy and the constraints she faces in the world of globalisation. Analysis can be based on AD/AS or  $Y=AE$  framework.

### INTRODUCTION

- Introduce Singapore as a small, open and with few natural resources.
- Explain economic growth – actual and potential, measured by increase in real GDP
- AD/AS framework
  - With the help of a diagram, explain how the initial equilibrium National Income (where  $AD=AS$ ) can be increased given an increase in any of the components AD or AS.

### BODY

- Policies that can change AD or AS → FP (G), MP (I), exchange rate policy (X-M), supply-side (AS), trade (X-M).
- Students are to choose 3 to explain, elaborate (with specific examples) and assess: 1 demand, 1 supply and exchange rate/trade. Assess each of them in terms of their effectiveness/limitations, appropriateness. However, 'sustainability' is key in this answer.
- Thus sustainability would encourage increase in the components of AD in the SR (which component would be determined by the size, openness etc as discussed in part (a)), and increase in AS in the LR (increase in terms of increase in quantitative and qualitative capacity of FOP for potential growth)
- Analysis can follow the following points of discussion:
  - Given a rise in AD (as it approaches to Full N), sustainability has to be discussed in terms of increasing potential growth by increasing AS (i.e. supply side policy in the long run)
  - Being vulnerable to the external forces, in the case of stagnant growth (when brought about by increasing cost of production – in the case of stagflation), the policies that are appropriate have to affect the (X-M), I components of AD and the AS.

### Possible Overall Evaluation:

Among the 3 policies that were assessed, compare the appropriateness their and the challenges faced by a small and open economy like Singapore (with no natural resources) as compared other economies with different characteristics, e.g. USA, China and emerging economies.

### Conclusion:

Given the vulnerability of Singapore position and our reliance on international trade, policies that would help cushion negative external impact on the economy have to take priority.

<b>Level (Marks)</b>	<b>Knowledge, Understanding, Application, Analysis</b>
L3 (7 – 11)	For a well-elaborated answer that clearly links how the characteristics of an economy affect the outcome of the economy via their influence of AE, making some components of AE relatively more important in influencing the outcome of the economy.
L2 (5 – 6)	For an underdeveloped answer that shows an understanding of how characteristics of the Singapore Economy have on the policies that can achieve growth. May lack examples or examples weakly explained.
L1 (1 – 4)	For an answer that shows a descriptive knowledge of how different policies work to promote growth without focusing on sustainability.
E2 (3 – 4)	For an evaluative assessment of the appropriateness of policies to sustain growth in comparison to other type of economies and the challenges for future growth.
E1 (1 – 2)	For unexplained assessment or one not supported by economic analysis.

- 5 Discuss whether maintaining low unemployment rate will lead to an improvement in the standard of living in an economy. [25]

### Analysis of Question

- Discuss: Need to adopt Thesis, Anti-Thesis, Synthesis approach, ending with sufficient evaluative comments of the question given.
- Analysis should include the various types of unNt and the composition of SOL – material and non-material aspects of it.
- Use of good examples (real-life preferred though hypothetical ones are accepted) to illustrate the points raised will be duly awarded.
- Answer SHOULD NOT focus on the various policies to maintain low unNt rate in the economy.

- Outline:

SOL → ultimate goal of govt  
⇒ How to achieve improvement in SOL – mat/non-mat aspects

unNt → inverse relationship with SOL  
⇒ How to maintain low unNt

Thesis – low unNt rate could improve SOL

- ⇒ Continued maintaining of low unNt rate may allow for consistently high NY per capita to be earned. This would in turn allow for high amount of consumption and savings rate.
- ⇒ High savings rate allows high investment, leading to greater potential growth in future. Future SOL likely to increase, *ceteris paribus*.
- ⇒ Low unNt rate means less strain on govt budget → could spend on other sectors of the economy or reduce tax rates.

Anti-Thesis – low unNt rate may not improve SOL

- ⇒ High NY → high pollution level, stress → sustainability of such NY may be in question. SOL may not improve in future.
- ⇒ High NY does not mean equitably distributed → may worsen SOL
- ⇒ High NY → higher C → but on wrong types of goods (gambling? Fast food?)
- ⇒ Low unNt rate might mean high  $\pi$  → affects COL, inward FDI → not ideal for the long run.

Synthesis – what are the circumstances/conditions/assumptions?

- ⇒ What led to the low unNt? If it is govt who is propping up the economy, it will also be a drain on budget (opportunity cost)
- ⇒ Is low unNt occurring in all sectors? Or were there some sectors experiencing unduly high unNt rate and compensated by unduly low unNt rate in others? Uneven growth (structural unNt), if persistent, may not be good in the long term.

Conclusion

## INTRODUCTION

- There are macroeconomic objectives of a government and the attainment of all of them would likely bring improvement in the standard of living (SOL) of its people. Low unemployment is one of these aims. Though achieving low unemployment is likely to bring improvement in SOL, it may not always do so.

## BODY

- Low unemployment rate refers to a situation where a small percentage of the workforce is willing and able to work but could not get a job. Joblessness brings opportunity costs to the economy in terms of the income and output which could have been otherwise produced and consumed. The lower the rate, the lower the opportunity cost.
- Real GDP per capita could help indicate the material aspect of one's average quality of life in a country. The higher the figure, the more goods and services the average person can enjoy. Non-material aspect of SOL, however, would require another set of indicators such as level of pollution, accessibility of medical services, work stress level, income distribution, etc.
- There are a few ways in which the govt could achieve low unemployment rate in an economy. Depending on the source of the unemployment, there needs to be the appropriate strategies to resolve the various types of unemployment. One key strategy would be to adopt the expansionary fiscal/monetary policy to combat cyclical or demand-deficient unemployment. When faced with structural unemployment, the govt could adopt supply-side policies to ensure that workers are re-trained and re-equipped with the right knowledge and skills for the job available in the economy.
- Low unemployment rate would indicate that a large portion of the workforce will be able to earn an income. As a whole, the real GDP per capita will remain high (assuming constant population and price levels), indicating that the economy is currently producing near its full potential output. With the high income per capita, households can enjoy high material standard of living by being able to satisfy a broad range of wants and needs.
- Will maintaining low unNt rate improve the SOL?
  - o **Yes, it will.**  
Low unNt rate indicates that high amount of income earned. This also means that a high level of savings can be expected. Should such savings be channelled to fund investment projects, the economy can expect to reap potential economic growth in the future. Assuming such investments bear fruits, the actual growth brought forth by the potential growth will mean even higher NY earned. Hence, material aspect of SOL would increase, indicating an improvement in the SOL.

Low unNt rate also means that govt will need to spend less on subsidies or unemployment benefits. Such freeing up of precious budget funds could be channelled to other more productive uses such as to raise the productivity of the workforce to secure higher paying jobs for the average worker in the long run. Alternatively, the lower budget outlay required could lead to the govt lowering the tax rates (direct as well as indirect). Such a move is likely to bring forth even greater consumption and investment, both of which will boost the economy, generating higher income for all. Material aspect of SOL will tend to increase in tandem.



○ **No, it will not.**

The potential growth described above may not be accompanied by actual growth should the economy face a recession in the future. No increase in output was experienced and there will be as much income per capita as there had been before. Material aspect of SOL remains unchanged.

Even if there will be increase in actual output, such increase in output will usually be at the cost of the environment. More factories need to be powered and more resources required in the production line would mean that air/noise/water pollution will be generated. Quality of life could hardly be considered to have improved should workforce apply for more sick leave and had to don face mask whenever one ventures outdoor.

The increase in income generated may not be equitably distributed in the absence of a sound income tax regime. Any of such increase in national income could largely fall into the hands of the few influential firms/industries, leading to the rich gaining the most during such growth periods. In this case, the average worker may not experience any improvement in their SOL.

The increase in income may have led the average individual to experience an increase in ability to consume more goods and services. Depending his choice of consumption pattern, one may observe that his SOL may not have improved. Should he choose to gamble, drink or consume unhealthy food, it would be hard pressed to consider his SOL to have improved.

If the attainment of low unNt comes at the expense of high inflation, the economy will also suffer from lower purchasing power, possible loss in FDI as well as export revenue. Should this continue, the economic outlook will unlikely be favourable and improvement in SOL would be difficult to reap.

## **EVALUATION**

- How was the low unNt rate achieved?  
If it was the huge amount of G that propped up the economy through expansionary FP, the high tax burden in the future may negate any likely increase in gross income, leaving the same disposable income fairly unchanged.
- The types of unemployment?  
Overall low unNt rate in an economy could be achieved when the extremely low unNt rate in one sector is negated by a rather significant unNt rate in another sector. The prolonged unNt rate in the declining industry will require substantial re-training/re-skilling of workers before they become a huge drag on the economy.

## **CONCLUSION**

While low unNt is a valid economic objective to attain, it may not necessarily bring higher SOL in the future. The govt should keep a tab on the composition of unNt rate as well as other indicators so as to implement appropriate remedial actions to maximise the potential of such improvement in SOL in the future.

Level (Marks)	Knowledge, Application, Understanding and Analysis
<b>High L3 (18 – 21)</b>	<ul style="list-style-type: none"> <li>Thorough knowledge of concepts &amp; theory, with no or little errors throughout the answer. A full grasp of the question must be demonstrated.</li> <li>Precise, logical, reasoned explanation of relationship between low unNt and SOL. Ability to <u>analyse types of unNt and their relationships</u> with changes in SOL.</li> <li>Well-organised flow of ideas presents a convincing argument and makes reading a pleasure.</li> <li>Application to real world context is not a must but would be a huge bonus.</li> </ul>
<b>Low L3 (15 – 17)</b>	<ul style="list-style-type: none"> <li>Good knowledge of concepts &amp; theory. Answer may contain very few 'unintentional errors'. Answer demonstrates well the main requirements of the question though some lapses might exist.</li> <li>Clear evidence of ability to apply facts &amp; theory with accurate reference to question.</li> <li>Ability to <u>analyse the types of unNt and their relationships</u> with current and future SOL.</li> </ul>
<b>High L2 (12 – 14)</b>	<ul style="list-style-type: none"> <li>Answer is able to meet the main requirements of the question – presenting Thesis, Anti-thesis and Synthesis but is either incomplete or remains unconvincing in the argument. Insufficient points raised to be awarded L3 marks.</li> <li>Analysis is present but weak – mentioned various types of unNt and their relationships with SOL but not well-explained.</li> <li>Answer remains coherent and allows reader to follow line of thought.</li> <li>No fatal errors should be made.</li> </ul>
<b>Low L2 (10 – 11)</b>	<ul style="list-style-type: none"> <li>Answer hardly goes beyond the ability to explain the <u>basic</u> relationship between unNt and SOL. Explanation contains gaps and errors, which may border fatal zone.</li> <li>Answer does not demonstrate a full grasp of question requirement.</li> <li>Organisation of points may be clumsy. For example, certain paragraphs may be written as an after-thought, which require further processing by the marker.</li> </ul>
<b>High L1 (6 – 9)</b>	<ul style="list-style-type: none"> <li>Shows some conceptual knowledge and understanding of related concepts.</li> <li>Does not show that meaning of question has been grasped. E.g. heavy description on SOL without linking to unNt.</li> <li>Fatal errors made which leaves bad after taste.</li> <li>Random answers may be present. E.g. emphasise on multiplier or policies.</li> </ul>
<b>Low L1 (1 – 5)</b>	<ul style="list-style-type: none"> <li>Answer mostly irrelevant &amp; contains only a few valid points made incidentally in an irrelevant context.</li> <li>Fatal errors abound, which does not justify anything more than the lowest credit possible.</li> </ul>
<b>E2 (3 – 4)</b>	Judgment with justification. For example, after stating that maintaining low unNt is key to improving SOL, answer goes on to present various conditions within which SOL would improve – near but not yet suffering from high $\pi$ , sound utilisation of tax revenue by govt, etc.
<b>E1 (1 – 2)</b>	Judgment without justification. For example, able to suggest that maintaining low unNt may be able to improve SOL but without any substantiation.

**Note:** Answer which provides good evaluation should be rewarded with more than 4 marks of evaluation marks.

- 6 Globalisation is a double-edged sword, as the increased interconnectedness not only creates opportunities but also presents risks.

Speech by Mrs. Lim Hwee Hua, Minister Of State For Finance And Transport At The CPA Forum, Aug 2007

- (a) Explain how globalisation could bring opportunities and risks to an economy. [12]
- (b) Discuss whether the Singapore government currently adopts appropriate policies to reduce the risks of globalisation. [13]

## Q6 (a)

Students are expected to explain both the opportunities and risks on both the micro & macro goals of an economy (preferably Singapore).

### INTRODUCTION

- **Define globalisation**  
→ Globalisation refers to the integration of the world's economy into a single international market in term of trade in goods and services, technology, labour and capital flows.
- **Main forces driving globalisation:**  
→ Rapid advancement of technology, lowering of trade barriers, etc.
- With globalisation, it means freer flow of goods and services (free trade), capital across borders and labour.
- **Briefly mention some characteristics of Singapore**  
→ Limited natural resources and dependent on trade and investment for economic growth due to small domestic sector.

### BODY

#### Opportunities

- Increase consumer welfare as consumers can obtain lower priced goods because Singapore's trading partners could produce them more efficiently due to their comparative advantage (more cost efficient). Singapore, being a small nation with little natural resources, has the most to gain from free trade. Globalisation enables its citizens to have access to products that Singapore does not produce and thus enjoy greater varieties & choice of goods and services. Therefore, it will lead to an improvement in the material aspect of SOL of the citizens.
- Along with trade creations, more foreign investment (long term capital inflow) inflows (from US and China etc) can possibility creating an improvement or even surplus in BOP position together with the increased in export demand. In addition, as Singapore has already minimal tariffs before FTA, the increase in imports from tariff reduction would be small. With a potential BOP surplus, it is likely that exchange rates will appreciate which enable Singapore to achieve external stability.
- Increase in AD through increase in consumption, investment, net exports implies an increase in production through the multiplier process which will lead to an increase in NY, employment and SR economic growth (if economy is operating below full employment). Show AD-AS curve. Creation of jobs in X sector due to higher demand for domestically produced goods due to CA.

- Sustained economic growth can be achieved through technology transfer to Singapore from foreign investments as well as increase in capital accumulation which allows Singapore to increase productivity, increasing the productive capacity of the economy and hence achieving LR economic growth. Show rightward shift of AS curve.
- Increase domestic firms' efficiency in production and quality of products because of greater competition from foreign firms. Domestic firms will try to achieve productive efficiency (PE) and dynamic efficiency (DE) to remain competitive in the global market. Elaborate on PE and DE.
- Domestic producers will gain from an enlarged export market, particularly for small domestic market like Singapore as they are able to reap internal EOS due to larger scale of production. In addition, with greater opportunities to outsource in order to reduce costs due to cheaper labour costs overseas e.g. China and India, which also increases the profitability of firms.

### **Risks**

- Increase unemployment in Singapore
  - 1) Structural unemployment especially in industries such as manufacturing due to greater competition from lower-cost foreign producers or transition of economy from capital intensive to knowledge & technology based industries. Decline in production levels will imply hiring of lesser labour or even retrenchment of workers. As such, workers who are previously employed in the sunset industries (or industries without CA) cannot gain employment in sunrise industries because of the mismatch of skills of these workers with the jobs available.
  - 2) Cyclical unemployment can occur due to overreliance on exports which might make Singapore more vulnerable to external shocks. E.g. Fall in GDP due to SARS outbreak, global recession etc → fall in demand for labour → unemployment rises.
- Increasing trade and capital flows encourage advancement in technology and increasing productivity of factors of production. Thus, less workers may be required due to the increase in technology and productivity levels and the economy may be facing jobless growth.
- With an increase in AD due to increase in net X and I, it may lead to dd pull inflation if Singapore's operating close to  $Y_f$ . Goods and services in Singapore will become more expensive and consumers' ability to buy more goods and services will fall and hence leading to lower material SOL.
- On the other hand, slower economic growth may occur because of greater competition from emerging economies such as China & India → fall or slower increase in investment, fall or slower increase in AD → multiplied fall or slower increase in NY, output & increased cyclical UN → lowers material SOL of Singaporeans. Singapore would also be faced with the need to develop new areas of comparative advantage and move up the value-added industries.
- Increase in NY through improved X revenue could lead to more M expenditure and worsens CA balance if the increase in M expenditure is greater than increase in X revenue. Given that the MPM in Singapore is very high, it increases the likelihood of worsening CA as there is a need for Singapore to import more resources for the production of more exports. Higher reliance on M may also make us more vulnerable to the threat of imported inflation.

- Coupled with the possibility of outward FDI, i.e. FDI may relocate to cheaper destinations which may result in 'hollowing out' of domestic economy, thereby worsening Singapore's BOP position.
- Higher income disparities may be observed as workers in exporting industries are likely to see higher incomes while those that focus in producing for domestic sectors are likely to see their incomes falling. The influx of cheap unskilled labour from the neighbouring countries such as India and Thailand has driven down the wages of unskilled workers in Singapore. On the other hand, highly skilled labour is demanded by MNCs in other countries and thus these workers are able to earn high wages abroad.
- Lower SOL (non-material aspect) due to higher stress level and greater environmental problems. Workers may need to work longer hours at the expense of leisure time. Environmental problems such as air pollution, water pollution etc due to higher levels of industrial production, clearing of land for production facilities, discharge of toxic wastes into the environment may occur.
- Possible occurrence of brain drain – loss of scarce talent to other countries which is a major challenge confronting the small open economy. It is a serious concern as this will limit the growth of the economy. Fall in productive capacity of Singapore economy → AS falls → limit both actual & potential growth of the economy. Despite Singapore's development of a world class education system to produce a skilled workforce, brain drain implies that the benefits will not be experienced by the Singapore economy despite efforts by government in incurring huge costs to provide subsidised education to its citizens.

## CONCLUSION

- Governments, in this case, should strive to maximise benefits (opportunities) and minimise costs (risks) through attempts to foster greater economic integration and government policies are needed to address problems so as to fully benefit from globalisation.

<b>Level (Marks)</b>	<b>Knowledge, Application, Understanding and Analysis</b>
L3 (9 – 12)	Developed explanation of the impact (at least 2 opportunities and 2 risks) of globalisation on an economy.
L2 (5 – 8)	Underdeveloped explanation which shows limited understanding of globalisation and an attempt to apply to an economy. One-sided and well-explained answer (Max 6m).
L1 (1 – 4)	For an answer which shows some basic correct facts or an undeveloped explanation (merely listing with no elaboration) on the impacts on an economy.

## Q6 (b)

### Question Analysis

Students are expected to identify two most harmful risks of globalisation with reference to part (a) and provide a clear, detailed explanation and analysis of how the various current policies adopted by the Singapore government work to mitigate them, addressing the appropriateness of the policies by looking at their strengths and limitations.

### INTRODUCTION

As explained in part (a), globalisation brings about various opportunities and risks to the Singapore economy. However, due to the unique characteristics of the Singapore economy, it is impossible for Singapore to resist the trend towards globalisation. Thus, the Singapore government has embraced globalisation and undertook various measures to reduce the harmful risks on the economy.

### BODY

#### Two most harmful risks (not exhaustive):

- (i) Loss of comparative advantage (in the production of certain goods such as low value manufactured products) leading to outflow of investments and thus a rise in structural unemployment;
- (ii) Over-reliance on external demand and thus increased vulnerability to external shocks on the economy.

**Note:** If students select other risks, tutors are to award mark based on their explanation and analysis accordingly.

**In view of these harmful risks, the government has undertaken some measures to reduce the extent of their impact.**

#### For the 1<sup>st</sup> harmful risk:

Loss of comparative advantage → implies a loss of export competitiveness in the production of certain exports. For e.g., Singapore may become relatively more expensive for firms to invest in the production of low-value products which usually are more labour-intensive thus leading to outflow of FDI.

In view of the above, Singapore government attempted to develop new areas of comparative advantage by encouraging new clusters of growth i.e. moving up the value chain from production of low-value products to more knowledge intensive sectors such as environmental and water technology, biomedical sciences etc. For e.g. provide R&D incentives and grants to improve quality of exports and efforts to promote new capabilities in these areas.

In addition, besides providing quality infrastructure such as transport and communication networks, the government will also try to attract foreign investments through the attractive corporate tax regime by ensuring competitive corporate tax rate. In doing so, this will enable Singapore to attract new firms, especially those more knowledge and technology intensive. Moreover, the outflow of FDI due to the loss of comparative advantage could give rise to structural unemployment as low skilled workers find their jobs lost to countries like China and India where labour is relatively cheaper. These workers are unable to take on jobs in the new industries in the short run.

Thus, Singapore government has adopted supply side policies to improve the skills of such low-skilled workers through retraining and increasing the productivity level of its labour force. For e.g. WTS (Workfare Training Scheme) aims to equip workers with skills to stay employable in the new industries. In doing so, the productive capacity of the economy will also increase leading to long term potential growth.

### Evaluation

Training involves huge cost and results often are not guaranteed. Moreover, providing R&D grants are costly and there are opportunity costs incurred as these grants could be used to provide subsidies in other areas such as healthcare and education etc.

### For the 2<sup>nd</sup> harmful risk:

Over-reliance on external demand → increased vulnerability to external shocks. For e.g., recent financial crisis spread and led to a recession in Singapore due to a fall in demand for Singapore exports by our trading partners such as US. This translated into a rise in cyclical unemployment due to the fall in AD and thus national income.

In view of the above, Singapore government tried to mitigate the extent of the fall in AD and national income by adopting expansionary fiscal policy. This was done through increasing G by hiring more people in the public sector as well as increasing its expenditure on improving the infrastructure of the country by building more MRT lines such as the Circle and Downtown lines, etc. This will raise national income through increasing AD and thus mitigate the extent of cyclical unemployment.

### Evaluation

Small multiplier in Singapore implies that any attempt to pump money into the economy is likely to leak out as imports and this is unlikely to be substantial to increase the national income significantly. Moreover, with the poor economic outlook and small domestic market, it is unlikely that any increase in domestic consumption, investment and government expenditure would be sufficient to raise national income and employment as the growth of the economy is mainly export-driven.

### CONCLUSION

Conclude that on the whole, current policies are largely appropriate despite their limitations. These measures are adopted after taking into account the fact that Singapore cannot isolate herself from the rest of the world due to the characteristics of its economy and thus need to embrace globalisation by tap on the various opportunities while undertaking various measures to minimise the risks.

Level (Marks)	Knowledge, Understanding, Application & Analysis
L3 (7 – 9)	<b>Well-developed</b> discussion on <u>both</u> sides of arguments i.e. able to identify 2 relevant ‘harmful’ risks of globalisation on the Singapore economy with reference to (a) and a good attempt to provide a clear and detailed explanation and analysis of how the various policies work to tackle these risks.
L2 (4 – 6)	<p><b>Underdeveloped</b> discussion on <u>both</u> sides of arguments i.e. able to identify 2 relevant ‘harmful’ risks of globalisation on the Singapore economy but fail to make a clear link between these risks to the respective policies currently adopted to tackle them and superficial explanation on whether these policies are appropriate or not.</p> <p><u>One-sided</u> discussion. I.e. students only discuss <u>one</u> harmful risk of globalization but with a <u>well-developed</u> explanation and analysis of the appropriate relevant policies. (Max 4 marks)</p>
L1 (1 – 3)	For an answer that shows some knowledge but does not indicate that the meaning of the question has been properly grasped. Students are unlikely to have addressed the ‘harmful’ risks of globalisation and went on to cite some general policies. Basic errors of theory or an inadequate development of analysis may be evident.
E2 (3 – 4)	Limitations of policies are well explained and able to provide a clear stand with justification on whether the government is currently adopting the appropriate policies.
E1 (1 – 2)	Limitations of policies are superficially explained and no stand given.