Q6. “Nowadays, one country cannot go alone. This is a global village. Some problems may remain, but it can be solved amicably and bilaterally, through discussion.”

Source: Bangladesh’s Prime Minister Sheikh Hasina, World Economic Forum, 2019

(a) Explain how the imposition of tariffs might reduce one form of unemployment while increasing another. [10]

Introduction

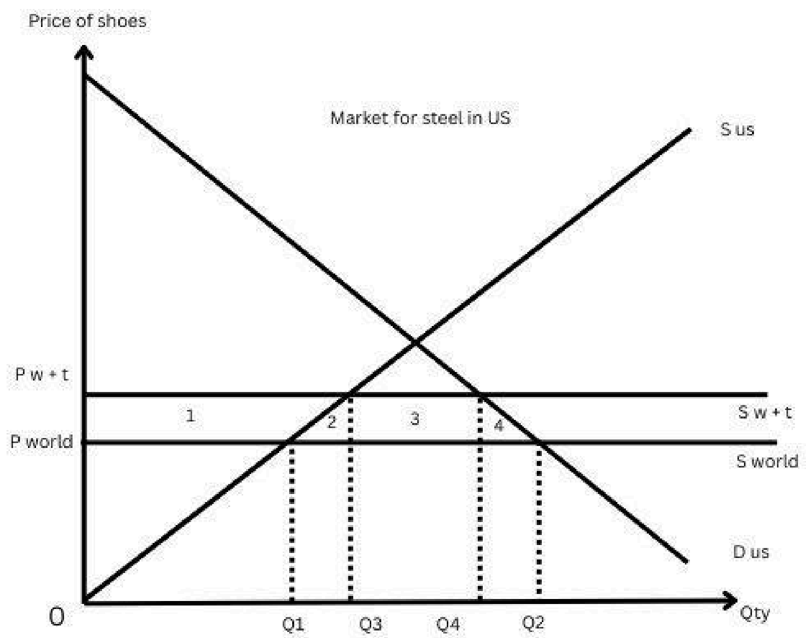
Tariffs is a type of trade protection measure, which is a tax on imported good or service to restrict imports.

The imposition of tariffs may affect unemployment rate – and unemployment refers to a situation where people of working age who are seeking for work but cannot find one (i.e., without a job)

R1: To explain how the imposition of tariffs might reduce structural unemployment

Consider the steel market in US, with free trade, the world supply, Sw determines the world price, Pw. At Pw, the domestic quantity supplied of steel was at Q1 while the domestic quantity demanded of steel was at Q2. The amount of steel imports was Q2 – Q1.

Diagram 1



In 2018, the US government accused some countries like China and Mexico for unfair trade practices which have hurt their domestic producers. The US government imposed tariffs on some goods like steel imports. With the tariffs, the world supply of steel decrease from Sw to Sw+t. This increases the domestic quantity supplied from Q1 to Q3, while the domestic quantity demanded decreases from Q2 to Q4. The amount of steel imports decreases from (Q2 – Q1) to (Q4 – Q3).

Since the domestic quantity supplied of steel increases, the steel producing firms in US increase demand for factors of production such as labour. This creates more jobs for the steel workers in US, hence reducing structural unemployment, as previously the influx of cheap imports may have reduced the domestic production of steel in US, which resulted in layoffs and the steel workers were not able to find jobs in other sectors due to a mismatch of skills.

Hence the imposition of tariffs on steel imports may help reduce structural unemployment.

R2: to explain how the imposition of tariffs may increase demand deficient unemployment due to beggar-thy-neighbour effect or retaliation by trading partners

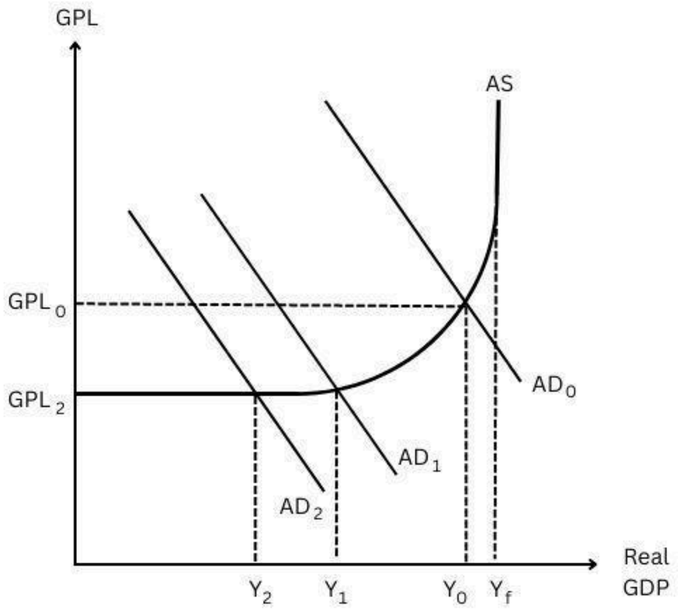
The imposition of tariffs may cause demand deficient unemployment as AD may fall in the long term. This might be due to beggar-thy-neighbour effect or retaliation by trading partners.

When US imposes tariffs on imported goods and alleviates its own economic problem, it worsens the economic problems of its trading partners. The trading partners of US will experience a decline in export sales and hence export revenue (X), and especially if US is a key export market. Assuming import expenditure (M) is constant, net exports (X-M) of US trading partners may decrease significantly, reducing AD. This may cause a slowdown or contraction of the economies of US' trading partners. With the falling incomes of foreign households, the demand for US exports fall, assuming US' exports are normal goods. X decreases.

Furthermore, should trading partners start to retaliate and impose retaliatory tariffs on US goods, US' X falls further

Assuming M constant, (X-M) decreases. US' AD decreases, as illustrated by a leftward shift of AD curve from AD0 to AD1.

Diagram 2:



The fall in AD will cause firms' inventories to rise, so firms reduce production of goods and services in the next production cycle. Real GDP decreases from Y0 to Y1. As firms demand for less factors of production such as labour, unemployment rate increases. The economy operates away from full employment level, Yf. Implying that demand-deficient unemployment has increased.The fall in autonomous spending will further cause multiple rounds of reduced induced spending, since one's man spending is another man's income. AD falls further, causing further contraction of the economy. As firms demand for less factors of production, unemployment increases further.

Hence the imposition of tariffs may lead to higher demand deficient unemployment.

Knowledge, Application, Understanding, Analysis		
L1	- Descriptive response without application of economic tools such as DD-SS, and AD-AS to analyse how imposition of tariffs may affect different types of unemployment. - Glaring conceptual errors	1-4
L2	- Underdeveloped explanation of both requirements of how imposition of tariffs affects structural and demand-deficient unemployment eg: response has missing link between falling AD and increasing unemployment, or did not explain in detail how the imposition of tariffs would affect the price and quantities - Developed but one-sided explanation on either of the requirements	5-7
L3	- An analytical response without gaps in explanation on both requirements – including the analysis of how tariffs works to reduce imports, and making explicit links to different types of unemployment	8-10

(b) Discuss whether globalization will have an overall positive or negative impact on a developing country like Bangladesh. [15]

Introduction

Globalisation is the growing economic inter-dependence (or interconnectedness) of countries, through increasing volume and variety of cross-border transactions, in goods and services (i.e., trade), in flows of capital (both short term capital and long-term capital), and in labour migration.

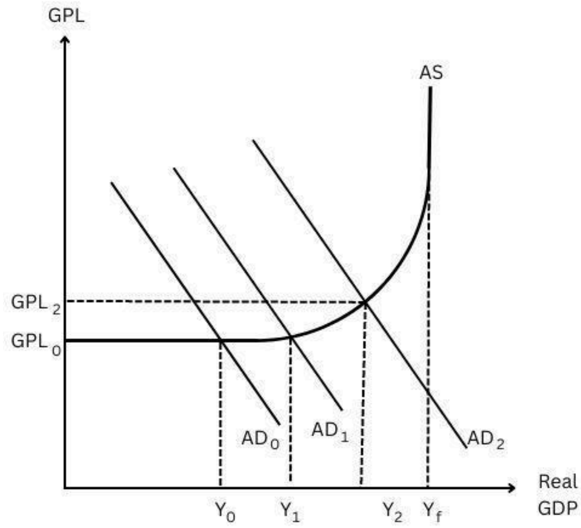
The increased inter-connectedness of countries will affect a developing country like Bangladesh in terms of its macroeconomic performance, as well as its stakeholders such as domestic producers (in terms of producer surplus), domestic consumers (in terms of choice, and consumer surplus)

R1: To explain the positive impacts of globalisation on a developing country

<u>Possible macro effects</u>

With the increased interconnectedness of countries in terms of trade flows, there will be greater access to larger and more affluent export markets such as US and EU since member countries in a free trade agreement would reduce or eliminate trade barriers such as tariffs on Bangladesh's exports. The demand for Bangladesh's exports increases, increasing export revenue (X), assuming import expenditure (M) constant, net exports (X-M) increases and AD increases.

In addition, with the increased interconnectedness of countries in terms of capital flows, possibly due to negotiation and rectification of new free trade agreements where barriers to investments are removed such as regulations and red-tape, hence greater inward foreign direct investments. Foreign firms (MNCs) build up their production facilities and acquire more capital goods such as machines and building, hence investment expenditure (I) increases, resulting in an increase in AD
Diagram 3:



The increase in AD is illustrated by a rightward shift of AD curve from AD0 to AD1. There will be an unplanned decrease in firms' inventories, so firms increase production of goods and services. Real GDP increases from Y0 to Y1, contributing to actual growth, assuming that there is spare capacity in the economy, where initial AD curve cuts AS curve at Keynesian range. As firms demand for more factors of production, demand-deficient unemployment decreases. The rise in autonomous spending (from Y0 to Y1) will stimulate multiple rounds of induced spending, because the rise in production due to the rise in autonomous spending will result in firms demanding for more factors of production, and with more incomes paid to households, purchasing power increases which includes induced spending, there will be multiple rounds of induced spending and this will end when sum of withdrawals = initial injections AD increases further from AD1 to AD2 contributing to greater growth (i.e., real GDP increases from Y1 to Y2) and employment.

Hence globalisation may help Bangladesh achieve internal stability.

EV: for developing countries like Bangladesh, where there are high poverty rates and income inequality, domestic demand is unlikely to be able to help drive growth and employment. So globalisation is likely to bring extensive benefits to these economies as exports will be an important driver for growth. Also, since these countries usually have a lack of infrastructures, the inward FDIs would likely help develop necessary infrastructures such as roads in the country, and they tend to bring with them technical and managerial expertise as well as new production technologies which are transferred to the local workforce, which helps contribute to a stronger macroeconomic performance.

Note: Examiners should be aware that candidates may take a different approach which, if appropriate, should be rewarded. Other possible macro benefits may include: improvement in BOT due to increase X, sustained growth due to inward FDI.

<u>Micro effect</u>

Globalisation may also lead to lower prices for consumers, and this may help improve consumer surplus and hence consumer welfare.

With globalisation where there is increased interconnectedness of countries in terms of trade flows, Singapore can import more goods and services from overseas as trade barriers will likely be removed or reduced

With reference to the diagram in part (a), assuming initially Bangladesh imposes tariffs on imports, with free trade i.e., the removal of tariffs, world supply increases from Sw+t to Sw , decreasing world price from Pw+t to Pw (i.e., consumers in Bangladesh will be able to enjoy products at lower prices, because Bangladesh will be able to import goods from countries with comparative advantage. The domestic quantity demanded increases from Q2 to Q4. Hence there is a gain in consumer surplus by Area 1+2+3+4

Note: Examiners should be aware that candidates may take a different approach which, if appropriate, should be rewarded. Other possible positive micro effects may include:

Consumers may also enjoy g/s at lower prices, because globalisation increases the level of competition due to increased presence of foreign firms and cheaper and higher quality imports which may incentivise firms to innovate to increase productivity OR higher revenues for domestic firms as they can export to other export markets, and/or enjoy lower average cost due to internal economies of scale.

R2: To explain the negative impacts of globalisation on a developing country

<u>Macro effects</u>

Due to the increased inter-connectedness of Bangladesh with the rest of the world in terms of trade flows, Bangladesh is likely to be very vulnerable to external shocks, both demand side and supply side.

The recent global recession caused by global health pandemic had resulted in falling incomes of economies of Bangladesh's trading partners. This reduces the demand for Bangladesh's exports decreases, assuming YED of Bangladesh's exports > 0 (i.e., normal good), export revenue (X) decreases. Assume import expenditure (M) constant, (X-M) decreases and AD decreases. There will be an unplanned rise in firms' inventories, resulting in lower production, so real GDP decreases (i.e., negative economic growth). As firms demand for less factors of production such as labour □ rise in demand-deficient unemployment □ as explained earlier, through the multiplier process, real GDP will decrease by a larger proportion than the initial fall in autonomous spending

Bangladesh may also be susceptible to imported inflation. The recent supply chain disruptions due to measures imposed by other governments to curb spread of Covid 19 virus has led to a prices of imported factor inputs due to shortages. Hence there is a rise in unit cost of production, reducing profitability for most firms decreases. When SRAS decreases □ shortages at prevailing prices in most markets, and firms pass on the cost increases □ GPL increases (i.e., cost push inflation) □ as GPL increases, due to the international trade effect, wealth effect and interest rate effect, AD decreases (i.e., movement along AD curve) □ real GDP decreases

EV: consider government policy responses to address negative impacts

However, the governments of developing countries may diversify its economy to mitigate the undesirable consequences of over-reliance on other countries. This can be done by increasing economic co-oporation with a diversified range of countries by having preferential trading arrangements to reduce or eliminate trade barriers between them. This reduces the risk of not being able to acquire essential imports if trade is disrupted.

Globalisation may also involve an increase in international migration of labour including human capital. Developing countries may suffer from brain drain which refers to a loss of human resources as high skilled workers search and migrate for better prospects in other countries.

EV: Significance of the costs

Especially for developing countries where there is already a limited supply of highly educated and skilled labour, brain drain will have severe negative impacts on the economy as LRAS decreases due to a decrease in quantity and quality of labour, resulting in a decrease in productive capacity. This may hinder the achievement of long term economic growth for developing countries.

Note: Examiners should be aware that candidates may take a different approach which, if appropriate, should be rewarded. Other possible negative micro effects may include: relocation of pollutive industries by MNCs to developing countries resulting in pollution and hence lower non-material SOL

Conclusion:

Globalisation is a double-edged sword. While it is a source of progress especially for developing countries, it has also caused many unintended consequences on its economy and stakeholders. If the government is able to adopt effective policies to increase the benefits and reduce the costs of globalisation, globalisation should have an overall positive impact on developing countries like Bangladesh.

Knowledge, Application, Understanding, Analysis		
L1	- Descriptive response without application of economic tools such as AD-AS to analyse the effects of globalisation - Glaring conceptual errors	1-4
L2	- Underdeveloped explanation of both requirements - Developed but one-sided explanation on either of the requirements - Developed and two-sided explanation on both of the requirements but response lacks scope. i.e., response did not consider the effects of more than one aspect of	5-7

	globalization (i.e., increased trade flow, labour flow and capital flow) and did not consider both micro and macro effects. - Developed and two-sided explanation on both of the requirements but did not apply the context of developing countries.	
L3	- An analytical response without gaps in explanation on both requirements ✔ With good scope – consideration of both micro and macro effects of globalization, and the consideration of effects of more than one aspect of globalisation ✔ Response considers the context of developing countries	8-10
	Evaluation	
E1	- A brief evaluation attempt is made in the form of simple evaluative statements that are not explained. Eg:	1-2
E2	- Some attempt to evaluate the significance of the benefits and costs of globalization in the context of developing countries, or recognizing that government policies may help mitigate the inevitable unintended consequences of globalization	3-4
E3	- Both requirements are evaluated, i.e., significance of benefits and costs of globalization in the context of developing countries is considered, and a summative conclusion/recommendation is provided.	5