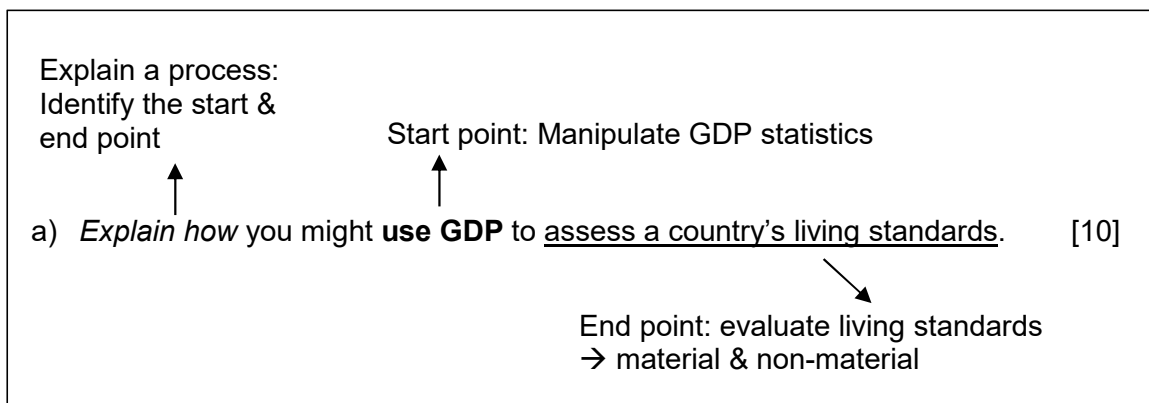


Suggested Answer for H1 Prelim EQ4

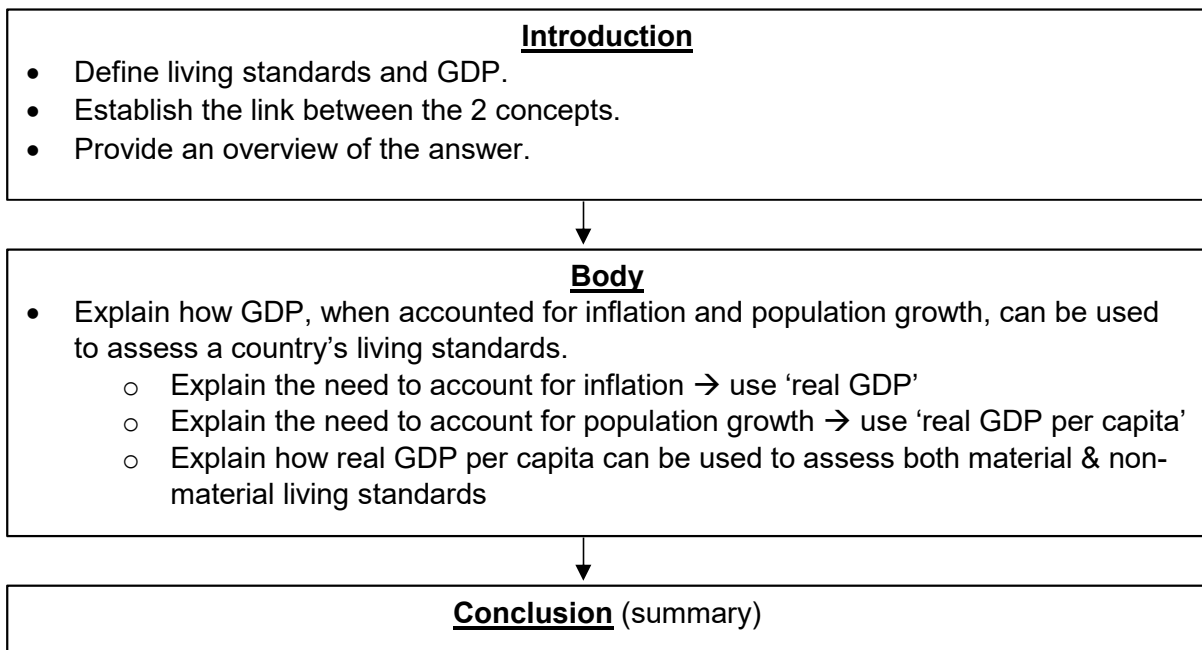
The creation of the ASEAN Economic Community (AEC) has potentially significant consequences for the Singapore economy. ASEAN leaders established the AEC, one of whose aims is to promote freer movement of trade and capital in the region. Mr. Guy Harvey-Samuel, chief executive of HSBC Singapore, said that if the AEC is well implemented, Singapore's gross domestic product (GDP) would be 9.5 per cent higher by 2030.

- a) Explain how you might use GDP to assess a country's living standards. [10]
b) Discuss whether the AEC would benefit Singapore's economy. [15]

Question Dissection



Schematic Plan



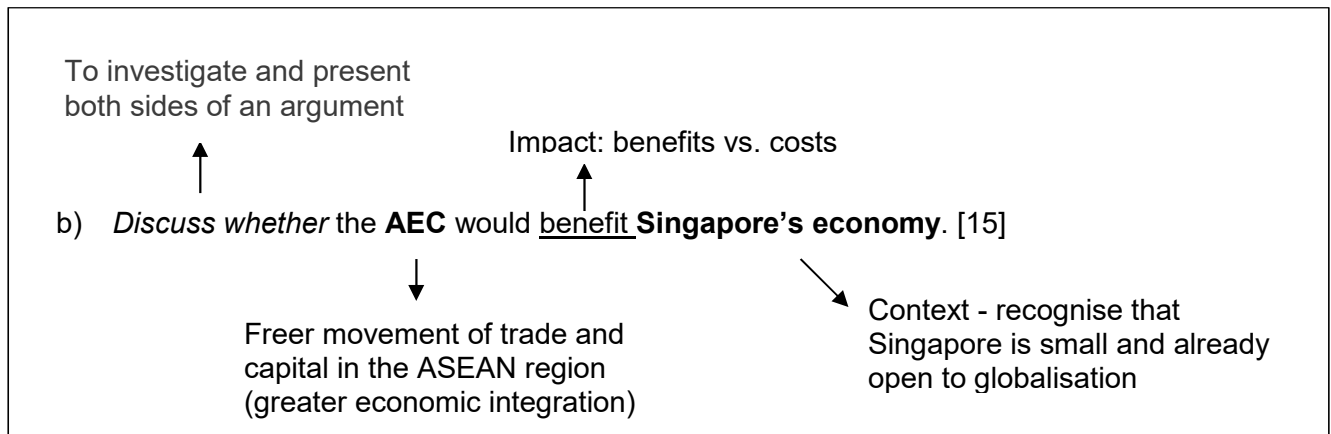
Suggested Answer for H1 Prelim EQ4

Suggested Answer	Comments
<p>Standard of living can be divided into two categories, material and non-material. Material standard of living refers to the bundle of goods and services available to the average citizen per year. Non-material living standard can be defined as the quality of life and measurements usually include stress levels, healthcare and education standards, and the state of environment. Although gross domestic product (GDP) is not a perfect indicator of standard of living, it is a measure that is commonly used.</p> <p>GDP is defined as the value of all output produced by factors located within the geographical boundary of the country, regardless of the ownership of factors of production, over a given time period. GDP is widely used as a measure of national income. After accounting for inflation and population growth, real GDP per capita can be used to assess a country's living standards.</p> <p>As GDP measures the total spending on goods and services in all markets in the economy, if total spending rises from one year to the next, the economy must producing a larger output of goods and services, and/or goods and services are being sold at higher prices. To measure the total quantity of goods and services available to citizens more accurately, price changes have to be accounted for. Real GDP is GDP measured in constant prices, i.e., in terms of the prices ruling in some base year. This would eliminate changes in prices and reflect how much real output has changed from one year to another.</p> <p>Furthermore, to measure the quantity and quality of goods and services available to the average citizen per year, population growth has to be accounted for. Real GDP per capita is measured by dividing real GDP over the size of the resident population. A rise in real GDP per capita indicates a rise in real income per capita, and hence a likely rise in the <u>material standard of living</u> because with a higher income, individuals can afford greater amount and better quality goods and services.</p> <p>In addition, higher income per capita may lead to higher tax revenue for the government, enabling it to spend more not only on basic necessities like health or education, but also sanitation, potable water supply, pollution reduction and arts/culture. Empirical evidence shows that countries with higher real GDP per capita, also score higher in indicators of quality of life such as life expectancy and infant mortality rates. Thus, higher real GDP per capita may also lead to higher <u>non-material standard of living</u>.</p> <p>In conclusion, if we take into account both inflation and the size of the population, though imperfect, GDP can be used to assess a country's living standards in both the material and non-material aspects.</p>	<p><i>Define standard of living – material & non-material.</i></p> <p><i>Establish link between standard of living & GDP.</i></p> <p><i>Define GDP.</i></p> <p><i>Provide an overview of the answer.</i></p> <p><i>Explain the need to account for inflation to derive real GDP.</i></p> <p><i>Explain the need to account for population growth.</i></p> <p><i>Explain how real GDP per capita can account for material standard of living.</i></p> <p><i>Explain how real GDP per capita can account for non-material standard of living.</i></p> <p><i>Summary of answer</i></p>

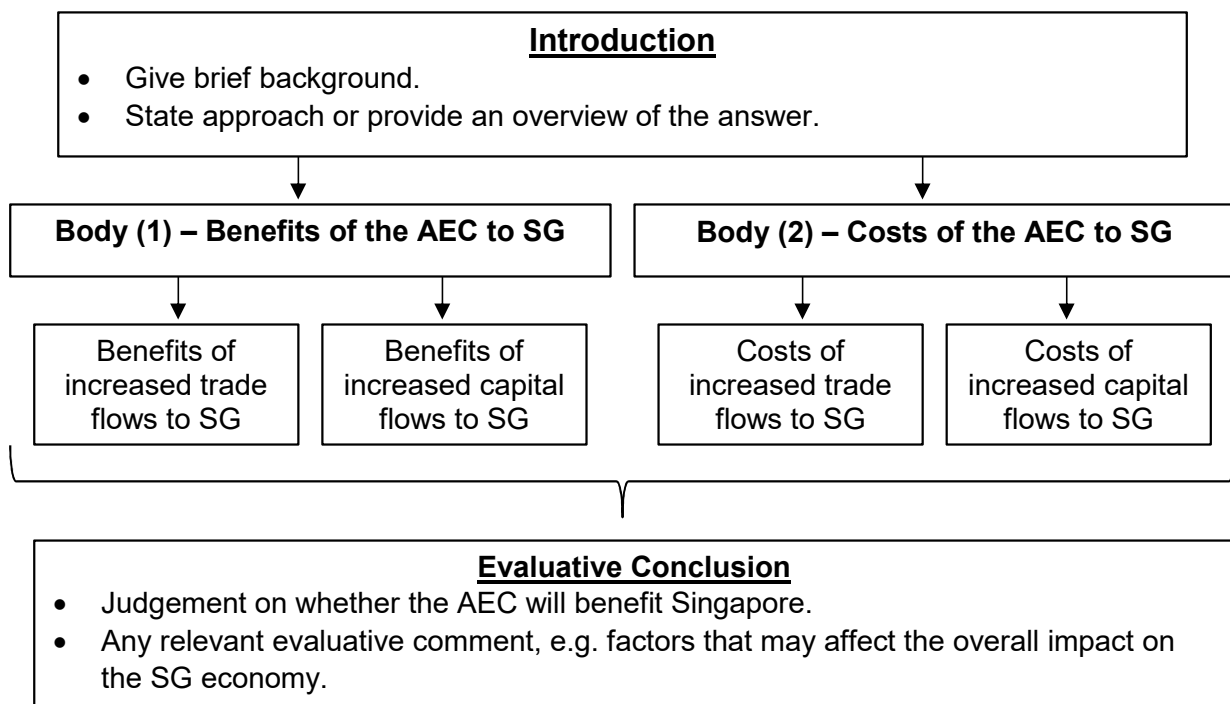
Mark Scheme

	Knowledge, Application / Understanding and Analysis	
L3	<p>Answers explain thoroughly why there is a need to account for inflation and population growth.</p> <p>Answers explain thoroughly how real GDP per capita might reflect a country's material and non-material living standards.</p> <p>Answers in this level are characterised by well-structured paragraphs AND a logical flow of arguments.</p> <p>Answers that fail to explain how real GDP per capita might reflect non-material living standards will be capped at 8 marks.</p>	7 – 10
L2	<p>Answers explain thoroughly how GDP might reflect a country's material (and non-material) living standards BUT fail to explain why there is a need to account for inflation and/or population growth.</p> <p>OR</p> <p>Answers explain how GDP, when accounted for inflation and population growth, might reflect a country's material (and non-material) living standards BUT lack rigour.</p>	4 – 6
L1	Answers may have some knowledge of the concept of standard of living and/or GDP, with significant conceptual errors or are very descriptive.	1 – 3

Question Dissection



Schematic Plan

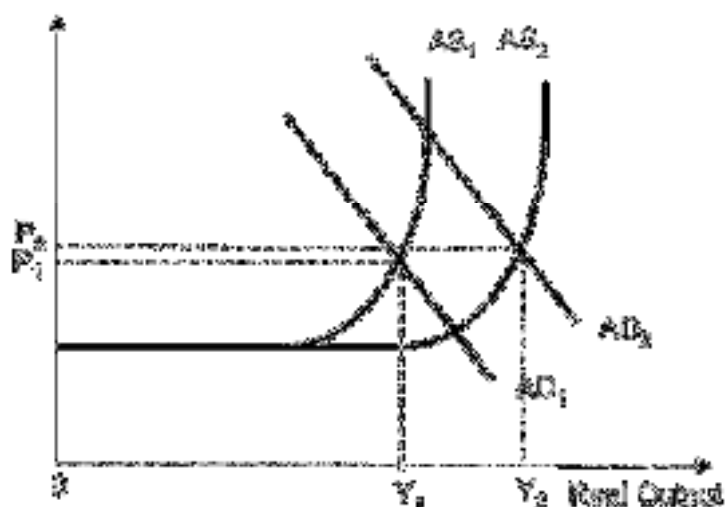


Suggested Answer for H1 Prelim EQ4

Suggested Answer	Comments
<p>One of the aims of the ASEAN Economic Community (AEC) is to promote freer movement of trade and capital in the region, which can have potentially significant consequences for the Singapore economy. This essay seeks to examine the potential benefits and costs of the AEC, before forming a judgement on whether the AEC would benefit Singapore's economy.</p> <p>The theory of comparative advantage states that provided the opportunity costs of producing various goods differ in two countries, a country is able to enjoy higher consumption levels if it were to specialise in goods in which it has comparative advantage in, and trade the good for other goods in which it has a comparative disadvantage. With lower trade barriers and freer trade in the AEC, a greater degree of specialisation based on comparative advantage is encouraged and Singapore is likely to benefit from higher consumption possibilities, increasing the material standard of living.</p> <p>In addition, with the reduction of trade barriers and the freer flow of goods that will ensue under the AEC, firms in Singapore can market and sell their goods and services more easily to the 630 million people that make up the population of all 10 ASEAN states. This prospect is extremely beneficial amidst the global economic slowdown, which hampers Singapore's growth in external demand. Furthermore, the growing middle-income class in ASEAN is likely to demand for more luxury consumer goods, creating opportunities for Singapore to export her consumer products and services. With increase in exports (X), aggregate demand (AD) and real output may increase, leading to faster economic growth. In fact, it is predicted that Singapore's GDP will be 9.5 per cent higher by 2030 if the AEC is well implemented. The economic growth is also likely to increase the derived demand for labour, lowering unemployment levels.</p> <p>Furthermore, the promotion of freer movement of capital may contribute to both actual and potential growth in Singapore. There may be increased capital flows from the other ASEAN countries into Singapore. At the same time, with the business-friendly environment in Singapore, export-oriented FDI from non-ASEAN countries may also increase, as firms outside of the AEC may seek to establish their production in Singapore to export to the region. As shown in Figure 1, the increase in capital flows increases investment levels in Singapore, increasing AD from AD₁ to AD₂. In the long run, the greater capital accumulation causes long-run aggregate supply to increase from AS₁ to AS₂. Overall the real output increases from Y₁ to Y₂ while general price level increase P₁ to P₂. The AEC can be said to act as an engine of growth as it enables Singapore to achieve sustained economic growth without significant upward pressure on the general price level.</p>	<p><i>Give brief background.</i></p> <p><i>State approach.</i></p> <p><i>Benefit of increased trade flows – higher consumption possibilities</i></p> <p><i>Benefit of increased trade flows – greater access to the ASEAN markets → ↑ X → higher economic growth and lower unemployment</i></p> <p><i>Benefit of increased capital flows – ↑ long-term capital inflow, especially export-oriented FDI from non-ASEAN countries → engine of growth</i></p>

Figure 1: Impact of increase in investment

General Price Level



However, with freer trade, as Singapore increases the degree of specialisation in the production of goods in which she has comparative advantage, workers in the declining industry in which Singapore does not have a comparative advantage may face a fall in derived demand for their labour. This may result in a rise in structural unemployment, which refers to unemployment due to mismatch between the skills of the unemployed and those required by producers seeking factors of production. Also, the increased specialisation may widen income inequality as demand for highly-skilled labour in the “sunrise” industries increases, causing wages to rise, while wages in the “sunset” industries fall due to the lower demand for labour.

Furthermore, Singapore may offshore her production processes to lower-wage ASEAN countries to lower cost of production and boost exports price competitiveness. However, this may lead to loss of job opportunities for domestic workers and worsen structural unemployment if they lack the skills to take on jobs in other industries.

In addition, the AEC may increase Singapore's reliance on Multinational Companies (MNCs), and this may make her more vulnerable to the footloose nature of MNCs. For example, MNCs might pull out of Singapore in the event of global recessions or when other countries offer better investment conditions. Without strong support of domestic companies and industries, Singapore may face greater difficulty in cushioning falls in national income when there is an outflow of FDI. In fact, Singapore's reliance on MNCs to fuel economic growth has been blamed for the absence of home-grown companies the likes of Korea's Samsung and Taiwan's Acer and there are calls to grow local SMEs, which stay in Singapore through highs and lows of our economy, unlike MNCs which choose their locations based on economic considerations.

Cost of increased trade flows – rise in structural unemployment and income inequality

Cost of increased capital flows – worsen structural unemployment

Cost of increased capital flows – vulnerable to long-term capital outflows

<p>Given that Singapore's economy is already highly liberalised, the extent to which the AEC may hasten changes in comparative advantage and hence result in greater structural unemployment and income inequality is likely to be less significant. Comparatively, amidst the global economic slowdown driven by the weakening in Europe and US as well as China, the benefits of an easier access to the ASEAN markets are likely to be heightened. While Singapore has been an active member within ASEAN, intra-ASEAN trade and investment is still minimal, contrary to the proximity of these nations. As such, AEC further provides Singapore with a greater diversification of its trade and investment portfolio, moving beyond the traditional partners in the West as well as China. While greater integration might increase vulnerability, the AEC may have been an attempt to hedge against the vulnerability of Singapore's traditional partners. <u>Overall the benefits of increased integration are likely to outweigh the challenges.</u></p>	<p><i>Evaluative conclusion – weigh the extent of costs against the extent of benefits</i></p>
<p>Whether AEC would benefit Singapore also depends on Singapore's ability to maximise the benefits and mitigate the costs. Firms may want to focus on consumer sectors that cater to the increasingly affluent middle class in ASEAN, and the Singapore government can continue to provide subsidies to local SMEs to help them lower their costs of production so that they can survive and compete with the MNCs, as well as to help them expand to the ASEAN markets and tap on the opportunities there. Instead of constantly looking at how FDIs might enter Singapore to aid in our economic development, the AEC is a great opportunity for local firms to consider entering the largely under utilised ASEAN markets, under the guidance and support of IE Singapore.</p>	<p><i>Evaluative comment – depends on firms' or governments' ability to maximise the benefits & mitigate the costs.</i></p>

Marks Scheme

	Knowledge, Application / Understanding and Analysis	
L3	<p>Answers that analyse thoroughly the benefits and costs of rising trade and capital flows under the AEC, applied to the context of Singapore.</p> <p>Answers recognise the nuance that Singapore is already open to globalisation, and therefore centre the analysis on the benefits and costs of having <u>a greater degree of integration</u> (instead of analysing the benefits and costs of moving away from autarky towards free trade and capital flows)</p> <p>Answers in this range are characterised by strong and well-structured paragraphs with relevant and complete diagrams.</p>	9 – 11
L2	<p>Insufficient rigour: Answers that inadequately analyse the benefits and costs of rising trade and capital flows under the AEC, applied to the context of Singapore.</p> <p>Lacks application: Answers lack application to the context of Singapore and AEC OR Answers fail to recognise the nuance that Singapore is already open to globalisation, and centre the analysis on the benefits and costs of moving away from autarky towards free trade and capital flows.</p> <p>Insufficient scope: Answers that analyse thoroughly the benefits or costs of rising trade and capital flows under the AEC, applied to the context of Singapore.</p>	5 – 8
L1	A very superficial description of the benefits or costs of increased trade and capital flows.	1 – 4
	Evaluation/Synthesis	
E2	<p>For an answer that synthesizes economic arguments to arrive at a well-reasoned conclusion.</p> <p>Insightful, and convincing evaluative comments are supported by economic or contextual analysis, demonstrating good awareness of real world context.</p>	3-4
E1	For an answer that gives an unsupported evaluative statement(s).	1-2