

H1 EQ3

Suggested Answers

- 3 (a) Explain how the economic problem of scarcity could be overcome with the rise of globalisation. [10]
- (b) Discuss the view that globalisation is always beneficial to a small and open economy. [15]

Suggested answer for (a):

Introduction:

- **Define globalisation** → Globalisation is defined as the increasing integration of economies around the world especially through various forms like:
 - Free flow of goods and services (*free trade*)
 - Free flow of capital and investment (*financial flows*) → emergence of world financial markets & rapid movement of financial capital & rise and expansion of multinational corporations (MNCs) internationally
 - Free flow of people (*labour migration*)
 - Free flow of ideas and knowledge (*technology*)

Define economic problem of scarcity → Unlimited wants and limited resources → resulting in scarcity → thus required to make choices between competing uses → incur opportunity cost, which is the next best alternative forgone.

Body/Essay Development:

- ➔ **Free flow of goods and services**
 - With globalisation → Free flow of goods and services hence this allows consumers to gain access to goods and services internationally and even those that are not available in their home country → Resulting in an increase in quantity, quality and varieties → Thus increases consumers' utilities and reduces the economic problem of scarcity, i.e. there are unlimited wants but limited resources to produce where the domestic country might not have the resources to do so, such as lack of knowledge, skills and technology etc. Hence with the rise of globalisation, the country can now consume beyond the production possibility curve (PPC).
- ➔ **Free flow of capital and investment**
 - Globalisation opens up the country and results in an increase in the level of competition → In order to remain competitive in the international market, country would need to specialise in the production of goods that it has comparative advantage in i.e. lowest opportunity cost → Increasing both individual as well as world output → allowing countries to consume beyond their PPC → Thus, reduces the problem of scarcity.
 - At the same time, specialisation allows the countries to be more productive and efficient → Leading to better allocation of resources → Increasing quality and quantity of resources → Increases productive capacity → PPC shifts to the right/LRAS shifts to the right → Reducing the problem of scarcity.
- ➔ **Free flow of people/Free flow of ideas and knowledge**
 - Globalisation increases cross-border transfer of resources, in terms of labour, capital and technology & knowledge.
 - **Labour** → Increase quantity of labour in the countries, with highly skilled labour, it will also increase in quality of work force → Enhance productivity. Influx of low skilled foreign labour will also lead to an increase in quantity of FOPs → Increasing productive capacity → Shift PPC or

LRAS to the right → Hence reduce the resource constraints face by a country → Reduce problem of scarcity.

- **Capital and technology transfer** → Increase capital inflow and efficiency → FDI increases thus lead to increase quality and quantity of resources → Helping the country boost its productive capacity → Shift PPC or LRAS to the right → Hence reduce the resource constraints face by a country → Reduce problem of scarcity.
- With the rise of globalisation → More goods and services being produce, increase in labour, capital inflow and technology transfer → both AD and AS rises → increase real NY via the multiplier process → Country achieve both actual growth and potential growth → Achieving sustained economic growth → speed up economic growth → leading to more and greater utilisation of resources.

Conclusion:

Globalisation allows the economy to better utilise their resources due to the theory of comparative advantage. It also allows them to increase world output, thus reduces the 'limited resources' constraint. At the same time, with more goods and services available for consumption, it can also satisfy more wants, thus able to tackle the problem of 'unlimited wants'.

Marking Scheme for (a)

Knowledge, Application, Understanding and Analysis.		
Level	Descriptor	Mark Range
L3	<ul style="list-style-type: none"> Well-developed answer using real-life examples to explain and illustrate how globalisation is able to reduce the problem of scarcity. Minimum 3 aspects of globalisation covered, i.e. goods and services, labour, capital and technology linking clearing how it can reduce the problem of scarcity of BOTH unlimited wants and limited resources. Max. 7m for theoretical answer without using any example(s) for illustration purpose. 	7 – 10
L2	<ul style="list-style-type: none"> Sound explanation of only 2 aspects of globalisation with no clear link to the problem of scarcity. Or answer that only focus on unlimited wants or limited resources. Insufficient or inadequate examples given to support the analysis. Max 5m: only 1 aspect of globalisation but well-explained with clear link to the problem of scarcity. 	5 - 6
L1	<ul style="list-style-type: none"> Smattering of points. No link of globalisation to reduce the problem of scarcity. Superficial analysis with limited economic concepts and framework. Presence of major conceptual errors and inaccuracies. High L1: only 1 aspect of globalisation well-explained with clear link to only unlimited wants or limited resources 	1 - 4

Suggested answer for (b):

Introduction:

- **Define globalisation** → Define globalisation: the process through which an increasingly free flow of ideas (exchange of knowledge), people, goods and services (trade), and capital leads to the integration of economies and societies.
- **Define small and open economy** → Example: Singapore is a relatively small economy with domestic markets that are limited in size and is an open economy where trade to GDP ratio exceeds 300%, amongst the highest in the world. Other economies, such as the US and Indonesia, have large domestic markets and are less open as trade to GDP ratio is much lower, at about 28 and 53% respectively.
- Explain that globalisation benefits economies when they help the countries achieve their micro and macroeconomic goals (Economic growth, low inflation, full employment, healthy BOP position, efficiency and equity)

Body/ Essay Development

1. THESIS: Globalisation is always beneficial to a small & open economy

- Small economies such as Singapore and Hong Kong depend heavily on trade and FDI to drive economic growth → globalization which brings about increased trade and foreign investment will allow significant benefits to be reaped by small economies
- Explain the extent of increase in AD via trade is greater for smaller economies.

2. ANTI-THESIS 1: Globalisation is not always beneficial to a small and open economy → Possible dangers from globalisation to small and open economies which large and less open economy could be less susceptible to

- **Possibility of dd-pull inflation** when export industries do not have pdtn capacity (i.e. small economy faces labour shortages and infrastructural inadequacies) to cope with rising AD → could erode X competitiveness → Hurting EG

3. ANTI-THESIS 2: Large & less open economies may also benefit from globalisation → may be more able to withstand downsides of globalisation

- Domestic firms are larger and likely more productive efficient due to int. EOS. Free movement of gds & svs increase availability of export markets to them. Their firms more able to penetrate markets of small and open economies more effectively for greater profit, which when remitted improve BOP via the CA.

1. THESIS: Globalisation is always beneficial to a small & open economy (contd)

- Both large and small economies gain access to other economies.
→ But globalisation allows small and open economies to overcome the limited domestic market size to grow. For large economies, the gain to access markets in small economies may be insignificant. Also, Spore is able to benefit in terms of cheaper raw materials and intermediate products to be used for pdtn, exporting domestic goods to more countries and hence improving X comp.

For eg. Spore could capture the refined petroleum market in China of 1.3 billion population, dd for Singapore's refined petroleum will experience a huge increase and output can be increased to reap greater internal Economies of Scale (EOS) since the domestic market in Spore was previously too small to gain enough EOS to lower cost. Sporean firms enjoy greater profit margin since revenue will become higher and cost will be lowered. On the other hand, if China produced clothes and shoes for Spore, there will not be as much increase in dd and not much EOS to be reaped by Chinese firms given that Spore's market size for shoes and clothes is relatively small (5 million) compared to that of China. Therefore, not much profit can be gained by Chinese firms. That is why small countries will gain more when signing FTA with big countries, since AD will increase more and greater EOS can be reaped

2. ANTI-THESIS 1: Globalisation is not always beneficial to a small and open economy

→ Possible dangers from globalisation to small and open economies which large and less open economy could be less susceptible to (contd)

- **Greater possibility of imported inflation** (especially for small and open economies which lack natural resources) and depend heavily on imported goods and services.
- **Increase in vulnerability to external shocks & more volatile EG as compared to large and less open economies who can depend on domestic C and I**

3. ANTI-THESIS 2: Large & less open economies may also benefit from globalisation
→ may be more able to withstand downsides of globalisation (contd)

Many MNCs are from countries that are large and less open as the large domestic market enables their expansion

E.g. With the onset of globalisation and market liberalisation by China, this has led to FDI inflow into China to tap on their relative abundance in unskilled/semi-skilled workers → China gained CA in low end/labour intensive manufacturing → Singapore increasing imports from China such goods like food, textile, consumer electronics → China has become Singapore's 2nd largest trading partner in 2010.

- **Able to tap on small and open economies to invest in and export to neighbouring hinterlands like HK for China and Spore for Asia.**
- **Large and "less open" economies may benefit more since less subjected to vulnerability in external shocks** such as global downturn due to its large domestic demand. Less open economies can fall back on protectionism cushion global shocks though protectionism is likely to lead to contraction in world trade and making all countries worse off).

1. THESIS: Globalisation is always beneficial to a small & open economy (contd)

- Explain other benefits through freer movement of capital investment → LRAS (potential growth). Which may not be possible with a small domestic market -> local SMES may be inadequate to drive economic growth → Knowledge and transfers of technology via foreign MNCs based in Singapore.

FDI inflows help to increase domestic fixed capital formation and promotes capital widening and deepening

E.g. Singapore's push to attract FDI in the biomedical sciences industry since 2000 has attracted 11 of the world's leading pharmaceutical and biotechnology companies such as GlaxoSmithKline (GSK), Lonza, Merck & Co, Novartis and Sanofi-Aventis to produce medical equipment, vaccines, etc. Coupled with generous research grants to top scientific talents, have helped to grow her biomedical industry → Biomedical export is a top export of Singapore and this industry is the second-largest contributor to Singapore's GDP within the manufacturing sector.

- Explain benefits of improvement in CA and KA a/c (external impacts)

**2. ANTI-THESIS 1: Globalisation is not always beneficial to a small and open economy
→ Possible dangers from globalisation to small and open economies which large and less open economy could be less susceptible to (contd)**

- Remittances of wages by foreign workers and profits by foreign MNCs may worsen invisible balance of current a/c → worsening BOP

**3. ANTI-THESIS 2: Large & less open economies may also benefit from globalisation
→ may be more able to withstand downsides of globalisation (contd)**

- "Less open" economies may still benefit more if economy is relatively closed to flows of labour migrants → would be able to reduce the extent of competition at low skilled workers and highly skilled workers → reduce the degree of income inequality somewhat. Evaluation of extent of benefits: However if they are large and less open economies like China where there are wide disparity in the destination of FDI in China provinces, there could still be increasing inequality between local workers in the urban and rural areas.

Evaluation of extent of benefits:

- However globalization does not necc imply it will benefit the large and less economy especially if it has lost its CA in trade and investment arena. For instance, US who has lost CA in manufactured activity has seen rising trade deficit, falling AD and economic growth. Possibility of structural UN+.
- Environmental concerns in developing countries like China and India arise with the inflow of FDI.

1 THESIS: Globalisation is always beneficial to a small & open economy (contd)

- **Explain benefits via increased labour pool and reduction in local COP**

Openness of the economy allows for free movement of labour resulting from globalization, both highly skilled as well as lowly skilled. This augments the quantity and quality of labour, thus helping to overcome labour constraints of small economies. This compares to large countries where there is larger pool of talent which already ensures a larger productivity capacity.

For instance, as labour force increase through high and lowly skilled immigrants (i.e. 1 million foreign population in Spore), this increase the quantity and quality of labour → raising productive capacity → raises potential growth → thus achieving non-inflationary EG and falling unemployment.

2. ANTI-THESIS 1: Globalisation is not always beneficial to a small and open economy

→ Possible dangers from globalisation to small and open economies which large and less open economy could be less susceptible to (contd)

- **Increase in income inequality and rising competition for services like public housing, transport and education** → competition from locals and foreign workers for domestic jobs and services

Conclusion

- Globalisation has served as both a platform for greater opportunities as well as increased challenges for all countries, though it can be said that in some countries, the level of challenges faced as a result of globalisation to be greater than the opportunities presented.
- It is not true that globalisation is always beneficial to small and open economy, though small and open economy tend to gain more from the increase in export market and can circumvent the limitations imposed by their small domestic markets in achieving their macroeconomic objectives. This is because globalisation enables them to trade with the world, attract foreign workers and FDI. Such limitations are faced by large and less open economies to a smaller extent given their larger domestic demand.
- Given the problems brought about by globalisation, small and open economy need to be able to mitigate its costs in order to ensure that they benefit. Need to assert greater control over their external environment – through exchange rate policies. This requires them to build up sizeable reserves to manage their exchange rate for better stability. Signing FTAs with a larger number of countries to reduce the risk of external fluctuations.

Marking Scheme for (b)

Knowledge, Application, Understanding and Analysis.		
Level	Descriptor	Mark Range
L3	<ul style="list-style-type: none">Well-developed answer that explains and illustrates the benefits and costs of globalisation to small and open and large and compares them with less open economies using clear economic frameworks.Answer is thoroughly evaluated with constant use of real world examples applied to the context.	8 – 11
L2	<ul style="list-style-type: none">For an under-developed answer that explains and illustrates the benefits and costs of globalisation to small and open and largeAnswer has some attempt at evaluation and limited usage of real world examples to the context.Max 7m for a one-sided answer.	5 - 7
L1	<ul style="list-style-type: none">Mere listing of the benefits and costs of globalisationSome conceptual misunderstanding	1 - 4

Evaluation		
Level	Descriptor	Mark Range
E2	Economic judgement <u>with justification</u> using clear economic framework. Candidates need to present their own opinion backed up by economic theories.	3-4
E1	Economic judgement with justification but lacking in economic reasoning. A mere presentation of personal opinions <u>without</u> substantiation using economic theories.	1-2