Question 1: Looming Threats to Globalisation

Questions & Suggested Answers **Marks**

(a) (i) State what happened to the British pound sterling effective exchange rate between the Q1 2014 and Q4 2016. **[2]**

- The British pound sterling effective exchange rate depreciated in value between Q1 2014 and Q4 2016. [1 mark].
- However, it was rising over the period Q1 2014 to Q3 2015 [1 mark] before decreasing thereafter.

(ii) Using a demand and supply diagram, explain the cause of the trend observed in the Sterling Effective Exchange Rate Index in 2016. **[4]**

- The main cause was a loss of investor confidence due to Britain's decision to exit from the EU (Brexit). [1 mark] This resulted in capital flight from the UK. This caused an increase in SS of sterling pound [1 mark] from S_0 to S_1 in the foreign exchange market.
- At the same time, as fewer foreign investors would want to invest in the UK. This means a decrease in the demand for UK sterling pounds from D_0 to D_1. [1 mark]

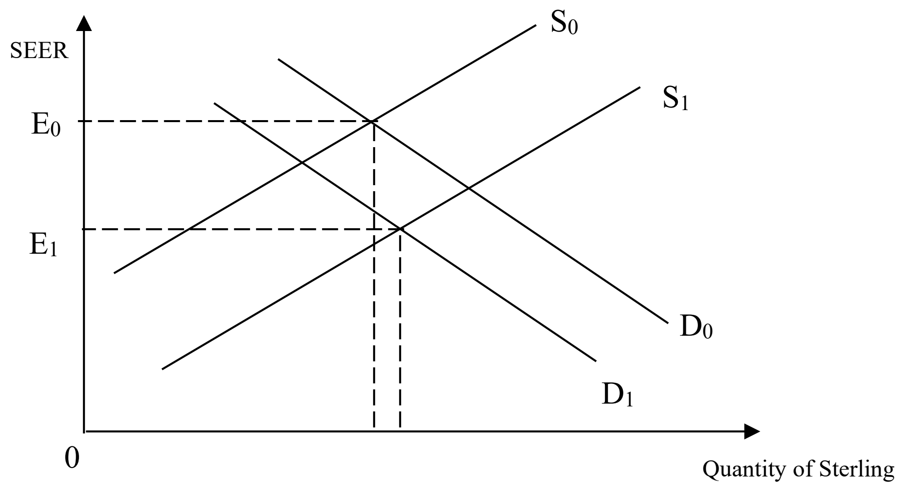

Figure 1: Market for Sterling Pound

(b) With reference to Table 3, calculate and compare the net income flow (including transfers) in the UK current account balance with that of the US. **[2]**

Note to students: current account comprises of both good and services balance (balance of trade) and income balance. Hence, to calculate the net income flow, we should subtract the current account balance from the balance of trade.

- UK's current account balance is -5.8% of GDP while its balance of trade is -2% of GDP. Hence, its net income flow should be -3.8% of GDP.
- US's current account balance is -2.4% of GDP while its balance of trade is -2.8% of GDP. Hence its net income flow should be +0.4% of GDP.
- This shows that UK experienced a net income outflow, while US had a net income inflow.

(c) Explain how a free trade agreement between the EU and Canada might affect a small dairy farmer in Belgium. [4]

Effects on revenue

- Since a free trade agreement would mean a removal or reduction of tariffs on imports, dairy farmers in Belgium will now have to compete with cheaper imports from Canada → likely fall in demand → lower prices and total revenue
  OR
- Demand for Belgium milk producers would also become price elastic due to rising competition from imports, which mean more substitutes. This would cause prices to fall to compete, affecting revenue. [2 mark]

Effects on costs

- Moreover, small dairy farmers tend to have higher costs compared to large multi-nationals, due to their lack of economies of scale. [2 mark]

(d) Given that membership in the EU means free movement of goods, labour and capital among member countries, assess the possible impact of Brexit on the UK economy. [8]

Command	Assess possible impact on economy • Negative impacts of Brexit on UK's macro goals • Positive impacts of Brexit on UK's macro goals
Concepts	AD/AS analysis 4 macro goals
Context	Brexit UK Economy

(shown in suggested answer below)
Requirement 1: Negative impact 1
Requirement 2: Negative impact 2
Evaluation: Possible positive impacts

OR

Requirement 1: Negative impact
Requirement 2: Positive impact
Evaluation: Factors that determine the extent of negative or positive impact

Introduction:

- The departure of UK from the EU (Brexit) would mean that firms in UK would no longer have free access to European markets and that labour and capital might not be allowed to move freely between UK and EU countries.

Requirement 1 - Negative Impact on UK economy

Loss of confidence and capital outflow – One of the major effects of Brexit is the loss of investor confidence, as mentioned in Extract 4. Brexit means that UK firms would no longer have free access to European markets and may thus face tariff barriers in exporting to EU countries. This could cause a fall in exports as UK's goods will be less price competitive. Assuming M remains the same, **UK's BOT will fall**. This also cause investors to have a pessimistic outlook of the UK economy. This would thus cause a **worsening of UK's Balance of Payments.**

- Fall in AD and economic growth –The fall in X and I leads to a fall in AD, which results in a fall in **real output and hence economic growth.** With the fall in real output, less labour will be needed as it is a derived demand of growth, causing an **increase in demand-deficient unemployment.** As shown in Fig 2 below, the fall in AD due to fall in X and I causes real output to decrease from Y0 to Y1, resulting in lower or even negative economic growth.

Evaluation: Greater autonomy to establish Free Trade Agreements with other countries as UK is free from the agreements due to their previous EU membership. This can allow UK to tap new opportunities in other foreign markets and expand its trade with the rest of the world. This can help to boost its exports, hence spurring economic growth and increasing employment opportunities.

Evaluation: While the movement of UK firms to Europe or other countries may worsen its balance of payments in the short run, it can generate higher profits which are repatriated back to UK in future, thus improvement in its Balance of Payments.

Requirement 2: Other negative impacts on UK economy

- Labour outflow – In addition, the loss of confidence and negative outlook could also cause people in UK to relocate to the EU. The fall in LRAS can lead to a rise in general price level in the long term, as productive capacity becomes a constraint. This would make UK more **susceptible to demand-pull inflation.**

Evaluation: Brexit also means that UK can now restrict the influx of immigrants into the country. This reduces the social problems caused by migrant workers, thus contributing to an improvement in non-material aspect of standard of living.

- With poorer investor confidence, there would be capital flight, causing the demand for pound to fall significantly. This would cause the currency to depreciate. This would cause the price of imports in pounds to be more expensive. If UK imports many raw materials from the EU member states, this will cause an increase in the unit COP for firms, causing SRAS to decrease. Firms will pass on the increase in costs to households through and increase in GPL. There is a higher cost-push inflation in UK.

Evaluation: Fall in exchange rate and improvement in BoT –This leads to an improvement in Balance of Trade and increase in AD, resulting in a more than proportionate increase in real national income via the multiplier effect, and hence an increase in economic growth rate.

Conclusion

- As discussed above, Brexit can have significant negative impacts on the UK economy. The impact is likely to be more negative in the short term as the loss of investor confidence as well as increase in barriers to trade with the EU could lead to a decline in UK's economic growth and worsen its balance of payments position.
- However, in the longer term, UK economy might emerge more resilient if they manage to establish other trade relationships with economies outside of the EU.

- The government policies that the UK government implements can also mitigate some of these challenges, such as supply side measures to build the competitiveness and uniqueness of its exports.

Mark Scheme

<table>
<tr><th>Level</th><th>Descriptors</th></tr>
<tr><td>Level 2
4-6</td><td>For an answer that demonstrates knowledge, understanding, application and analysis:

➢ EXCELLENT breadth that considers the following economic concepts in explaining multiple and balanced perspectives, viewpoints, relationships and factors. ALL points chosen should be of relevance and significance in answering the question.

➢ EXCELLENT depth in economic analysis that reflects the following in ALL explanations.
✓ Accurate use of economic concepts, clear elaboration, and precise use of economic terminologies, language and phrasing..
The answer should also be supported by:
➢ Well-labelled and well-referred to diagram(s) drawn with precision (where appropriate).
➢ Relevant examples and accurate use of facts.
➢ Logical structure.</td></tr>
<tr><td>Level 1
1-3</td><td>For an answer that demonstrates knowledge, understanding, application and analysis:

➢ GOOD breadth that considers the following economic concepts in explaining multiple and balanced perspectives, viewpoints, relationships and factors. ALL points chosen should be of relevance and significance in answering the question.

➢ GOOD depth in economic analysis that reflects the following in ALL explanations.

The answer should also be supported by:
➢ Diagram(s) that may not be well-labelled, may not be well-referred to and may not be drawn with precision (where appropriate).
➢ Example(s).
➢ Logical structure.</td></tr>
</table>

Evaluation

E2 **2** **marks**	For an evaluation that contains ➢ A synthesis of earlier economic arguments to arrive at **relevant** judgements/decisions (i.e. answer the question). ➢ Well-explained criteria-based evaluative comments supported by **accurate** and **clear** analysis to provide **fairness** in views. ➢ A good summative conclusion.
E1 **1** **mark**	For an evaluation that contains ➢ **Relevant** but unexplained evaluative judgement(s) / statement(s) i.e. evaluative judgement(s) / statement(s) not supported by analysis. **<u>OR</u>** ➢ A **relevant** conclusion.

(e) Discuss the factors that determine the extent to which globalisation is beneficial to different countries. [10]

Command	Discuss factors – answer should include at least 2 different factors that make globalisation beneficial to countries, with evaluation points that challenge the different assumptions made
Concepts	Benefits and costs of globalisation
Context	Different countries – students can use their own examples, but should provide a range of different countries

Introduction:

- Explain that globalisation refers to the increasing integration of national economies in terms of financial flows, trade, movement of factors of production, flow of information and technology.

Some possible benefits of globalisation include:

- Increase AD due to increase in net exports and FDI → economic growth and fall in unemployment
- Lower prices due to cheaper imports and increased variety of goods → increase in consumer welfare
- Outsourcing and offshoring increases profitability of firms → higher profits and higher wages in home country
- Technology and labour flows improve efficiency and reduce costs in recipient countries.

The extent of benefit to different countries depends on various factors [answer to give at least two factors as R1 and R2]

1. Nature of economy

- Globalisation allows countries to gain access to foreign markets → increase in exports → BoT improve and (X-M) increases → AD increases → more than proportionate increase in real output. Increase in real output → fall in unemployment.
- Being small in size and population, Singapore has a relatively small domestic market. This means there is limited scope for domestic firms in the country to expand if they were to focus only on the domestic market. With globalisation, Singapore is able to export its goods and services to the rest of the world. The increase in export revenue is a key driver of growth, as AD increases leading to an increase in real output and hence economic growth.

- Globalisation also benefits consumers as it allows a country to import goods at lower prices (compared to domestic goods) and increases the variety of goods available to consumers.

EV: However, there is the cost in terms of fluctuations in external demand and risk of imported inflation which small and open economies need to constantly deal with. For example, when there are external issues like the US-China trade war or the Russian-Ukraine war, there were spillover effects from affected economies to trade with Singapore.

2. Trading relations / Trade policies

- The extent to which countries benefit from globalisation also depends on its trade policies and trading relations with other countries
- Countries that embrace free trade will benefit more in terms of allowing more imports into the country, thus enabling consumers to enjoy wider variety of goods as well as possibly cheaper goods. As mentioned in Extract 6, "trade with China alone put $250 a year into the pocket of every American by 2008 due to cheaper goods."
- Conversely, if the country imposes tariff barriers on imports, it will result in higher prices of imports, thus reducing the welfare of consumers as well as increasing the cost of imported inputs for producers.

EV: Increasingly, weak economic conditions have pushed many countries to be more protective of their domestic markets. The use of export bans has also increased with countries using their advantage in some natural resources to build new industries or prevent other countries from exporting goods which use the natural resources. Export ban has also been used for domestic food security.

3. State of economy or state of development

- Globalisation also cause increase in FDI flows between countries. Developing countries like China and Vietnam experience FDI inflow → increase in AD → increase in real output. Increase in capital also leads to increase in productive capacity → increase in LRAS → potential growth
- Countries like Mexico operating in the Keynesian range where there is substantial spare capacity, will likely benefit more from globalisation, as the increase in AD due to the increase in X and I, will lead to an increase in real output.
- By contrast, developed countries which operate near full employment will gain less from globalisation, as the increase in AD could lead to demand-pull inflation if there are supply-side constraints.

EV: However, increasingly developed economies are using environment and labour issues as basis for their protectionist trade policies against developing countries. This may limit the benefits that developing countries experience as their exports are subject to protectionism policies overseas. For e.g., US has accused China of flouting labour laws and security regulations. As a result, the US government imposed tariffs on China's exports and vice versa.

<u>Conclusion / Overall Evaluation:</u>

- As discussed above, globalisation can be beneficial to some countries but can also cause challenges to other countries. The extent to which globalisation is beneficial to different countries depends on various factors such as the nature of the economy, the state of development, the terms of trade, the trade policies of countries concerned.
- Embracing globalisation demands countries to adopt economic policies which strengthen their domestic producers and labour, as well measures which build resilience of their domestic food supplies.

Mark Scheme

Level	Descriptors
L2 **5-7** **marks**	For an answer that demonstrates knowledge, understanding, application and analysis in two Requirements (factors). Answer recognises that the benefits of globalisation requires countries to be internationally competitive while at the same time strengthening their resilience for economic fluctuations and import shocks.
L1 **1-4** **marks**	For an answer that demonstrates knowledge, understanding, application and analysis for one Requirement or very superficial explanation of two Requirements.

Evaluation

E2 **2** **marks**	For an evaluation that recognises that the extent of net benefits depends on the set of economic places in place to address the challenges from globalisation. The evaluation suggests policy stance that involves countries forging free trade with trade partners while at the same time improving the resilience of their domestic economy (since globalisation exposes countries to greater economic fluctuations).
E1 **1** **mark**	Relevant but unexplained evaluative judgement(s) / statement(s) i.e. evaluative judgement(s) / statement(s) not supported by analysis in the answer.